NIGERIA

FINANCIAL SYSTEM STRATEGY 2020

HOUSING FINANCE

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MARK BOLÉAT

CONSULTANT
BOLÉAT CONSULTING

SIMON WALLEY

THE WORLD BANK
FINANCIAL AND PRIVATE SECTOR VICE PRESIDENCY

FIRST initiative

Strengthening Financial Sectors

Abbreviations and Acronyms

CBN	Central Bank of Nigeria
EDL	Estate Development Loan
FIRST	Financial Sector Reform and Strengthening Initiative
FMBN	Federal Mortgage Bank of Nigeria
MBAN	Mortgage Bankers Association of Nigeria
NDIC	National Deposit Insurance Corporation
NHTF	National Housing Trust Fund
PenCom	National Pensions Commission
PFA	Pension Fund Administrator
PMI	Primary Mortgage Institution
ROSC	Report on Standards and Codes
ROSCA	Rotating Savings & Credit Association
RSA	Retirement Savings Account

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Introduction

This report is a by-product of a World Bank FIRST project to support the implementation of the Financial Sector Strategy 2020 in order to enhance financial sector depth and diversity in Nigeria.

The authors were part of a wide ranging World Bank team that visited Nigeria in February 2008. Their views have been fed into an overall report. However, given the special nature of housing finance, merit was seen in producing a stand-alone report.

The authors have reviewed the abundant existing research and material on Nigeria's housing finance market, undertaken their own research, spoken to relevant people in Nigeria, and discussed the issues with colleagues in the World Bank team.

The report concentrates on four key issues identified in the terms of reference for the project:

- Funding issues
- Regulatory and legislative framework
- Institutional framework
- Property registration

The analysis in the report is in line with some other analyses, but differs from an apparent assumption in Nigeria that legislative reform is the key to the development of mortgage finance.

It is hoped that the report will contribute to an already lively debate on housing finance issues in Nigeria.

Mark Boléat

Consultant
Boléat Consulting

Simon Walley

Housing Finance Specialist
The World Bank
Financial and Private Sector Vice Presidency

March 2008

Note figures in Naira have been converted to US dollars at the rate of ₦117 = $1, the exchange rate in February 2008, and then rounded.

Executive summary

A. Current Situation

Housing

Nigeria has experienced rapid urbanization; nearly 50 per cent of the population lives in urban areas compared with just 10 per cent in 1952 and 38 per cent in 1993. There is a shortage of 12 – 16 million housing units. House and land prices are very high. There is very little construction of houses in the formal sector for lower and middle income groups.

The Financial System

The macroeconomic position has improved considerably in recent years. The rate of inflation is now around 7 per cent. Short-term interest rates are around 13 per cent. The financial system is dominated by retail deposit banks, which account for over 90 per cent of the assets of financial institutions. The minimum capital requirement for banks has recently been raised substantially, as a result of which there has been a restructuring of the banking industry. There are now 24 banks, the largest of which are also the largest quoted companies on the Nigeria Stock Exchange.

There are microfinance banks, microfinance institutions and primary mortgage institutions, all of which are very small. The other major holders of financial assets are Pension Fund Administrators.

The capital markets are not well developed.

Housing and Housing Finance – The Framework

The Land Use Act 1978 vested the ownership of all land in the Governor of each State. Governors allocate land for development. There is a network of Land Registries in each State but the administration is poor and computerization has made little progress in most states.

All transactions in property require the consent of Governors and registration with land registries. The process is time consuming and very costly, total fees being in the 20 per cent to 30 per cent range.

While there is a culture of repaying debts and mortgage arrears seem low, the foreclosure procedures are cumbersome and slow. Given the difficulties of the judicial process, lenders use a number of devices including a power of sale which provides limited rights to the borrower and is at times enforced with some degree of brutality.

The Informal Sector

Over 80 per cent of the population lives in informal settlements in the major urban areas or traditional villages. Housing in this sector is built by the owners, in some cases overnight in poorer slums, while more substantial dwellings can take ten or more years to complete. Remittances may well play a significant part in financing development in this sector.

The Mortgage Lending Market

The environment for mortgage lending is not good, primarily because of the absence of clear property rights, the requirement to obtain Governor's consent to each transaction, inefficient land management systems and high costs of property transactions.

There are also constraints on the development of land. Most transactions are in undeveloped plots rather than completed dwellings.

There is a reasonably efficient and rapidly growing mortgage market comprising loans made by banks at variable rates of interest. There is no ability to underwrite borrowers and accordingly lenders require the borrower to make mortgage payments through salary deduction. Total outstanding mortgage loans are probably around ₦100 billion ($850m). The vast majority of lending is done by banks, with Primary Mortgage Institutions taking a modest share of the market.

The open market mortgage rate is 17 -18 per cent, probably a reasonable spread over the cost of funds in the money markets, which is 13 - 14 per cent.

Various devices are used to circumvent the lengthy procedures for registering property and also to avoid the high costs.

The subsidized mortgage market

The Federal Mortgage Bank of Nigeria (FMBN) oversees a subsidized mortgage scheme. The Bank has a number of other responsibilities including re-financing existing mortgages. It has yet to engage in secondary market operations. It is being used as a channel for the 'monetization' program of government housing which was initiated in the Federal Capital Territory, but this is a one-off scheme which should not be confused with a market based funding role for FMBN. Its balance sheet suggests that it has substantial negative net worth.

The National Housing Trust Fund (NHTF) is a compulsory provident scheme, the proceeds of which can be used only for house purchase. 2.5 per cent of employees' wages are deducted and paid into the fund. After six months contributions, members are entitled to a ₦5 million ($43,000) loan at a rate of interest at 6 per cent for 30 years. The scheme is in effect a compulsory regressive tax and is also incapable of working in practice because of the mismatch between assets and liabilities. In practice, many people do not make contributions and so far only 3,000 loans have been disbursed.

Primary mortgage institutions are intended to be specialists in mortgage lending, like British building societies or Mexican Sofoles. Their primary role is to disperse loans funded through the National Housing Trust Fund. There are about 90 PMIs but most are financially weak and collectively they are small.

B. Reform Agenda

General Principles for Reform

An effective housing finance system will develop automatically if the necessary building blocks are in place. These are clear property rights, efficient land registration arrangements, the ability of lenders to realize their collateral and a functioning and well regulated banking system.

Financial Sector Strategy 2020

Nigeria has an ambitious Financial System Strategy with a 13-point reform agenda. Mortgage finance is seen as being a driver of the financial system. The action points tend to overemphasize institutional and legal changes rather than simpler administrative measures.

Property Rights and Registration

The major priority for Nigeria is to reduce the time taken to process property transactions and to reduce the charges. The action needed is administrative, and would be self-financing. New legislation is not required. This is in line with the conclusions of the report on the observance of standards and codes (ROSC) for insolvency and creditor rights in Nigeria.

Nigeria lacks a modern and effective land titling system. It can take advantage of modern technology and expertise from other countries to put suitable arrangements in place.

The poorest Nigerians can most easily be helped by giving them security of tenure in respect of the property they occupy.

Funding

Funding is not currently a problem in respect of the development of the mortgage market. The banks are liquid and will be able to continue to finance mortgage loans using the adjustable rate mortgage.

It is desirable that longer-term funds should be available. Pension Fund Administrators are most likely to be able to provide such funds. They can invest in mortgages by purchasing a pool of loans from a lender or coming to an arrangement with a lender whereby loans are originated straight onto their balance sheets. Longer-term there is scope for mortgage bonds and mortgage backed securities.

Regulatory and Legislative Framework

While a number of changes in legislation are desirable these are not essential in the short-term and should not deflect from the need for the more important process and administrative changes and reductions in fees.

FMBN, NHTF and PMIs

The major role for the Federal Mortgage Bank of Nigeria is to facilitate the development of mortgage finance. However, it needs to demonstrate that it has the capacity to undertake this work, and putting it on a stable financial footing is a priority in this respect.

The National Housing Trust Fund is seriously flawed. It is basically a regressive tax the proceeds of which are used to help better off people acquire subsidized housing. Either the scheme should be abolished or substantially reformed to redress the balance of interests between those who contribute and those who borrow money. Consideration should be given to a scheme whereby poorer Nigerians could access the fund to obtain a plot of land or even title to their land.

The capital requirement for PMIs should be substantially increased as is currently planned, and those that do not meet required standards should be closed down.

C. Priorities and Action Plan

Five recommendations are put forward for Phase 1 of a reform program. All can be implemented within two years without legislative changes:

1. Substantially improve the registration process by reducing the time taken to achieve the necessary consents and reducing the costs from 20-30 per cent of the value of the property to nearer 5 per cent.
2. Either abolish the NHTF or significantly reform it so as to redress the balance between contributors and borrowers.
3. Substantially increase the capital requirement for PMIs, and make loans through the NHTF only to those that meet this and other standards.
4. Put the FMBN on a stable financial footing and develop its facilitation role.
5. Implement a simple mortgage liquidity facility, potentially through FMBN.

The phase 2 measures are those that are not essential to stimulate the market and which would take longer to put in place, in some cases because of the need for new legislation. They are:

1. Put in place arrangements to allow covered bonds and mortgage backed securities to be issued.
2. Reform the arrangements for foreclosure.
3. Develop a mortgage insurance program.
4. Introduce some common standards for underwriting and for documentation.
5. Remove the need for Governor's consent for land transactions.
6. Introduce large scale land registration programs and facilitate the acquisition of title by existing occupiers of property.
7. Introduce a comprehensive suite of training programs.
8. Regulate the activities of real estate agents.
9. Introduce comprehensive building codes and provide protection for buyers of houses during the course of construction.

Implementing this program will require leadership at political, official and industry level.

Monitoring and evaluation

The key baseline data is –

- A mortgage market of about ₦100 billion ($850 million).
- An open market mortgage rate about four percentage points above money market rates.
- No significant open market for the resale of existing houses.
- Costs of house purchase in the 20 – 30 per cent of price range.
- The time taken to register transfers of property being at best 30 days but more typically 6 to 9 months.

Progress needs to be measured against these starting points, preferably on a state by state basis.

1. Housing

There has been rapid urbanization in Nigeria as in other emerging markets. The proportion of the population living in urban areas has increased from 10 per cent in 1952 to 20 per cent in 1970 and 38 per cent, 1993 and 48 per cent today. It is forecast to increase to around 60 per cent over the next few years.

Nigeria is one of the most urbanized countries in sub-Saharan Africa, with 48 per cent of its population inhabiting cities. The city of Lagos alone is estimated to hold around 10 million inhabitants, although estimates vary considerably. This makes it the most populous city in sub-Saharan Africa and one of seven cities in Nigeria with populations above 1 million. The United Nations has forecast that by 2010 the greater Lagos urban area will be one of the world's largest cities with a population exceeding 20 million.

Nigeria compares itself with the "BRIC" countries – Brazil, Russia, India and China. Comparative data on urbanization is shown below –

Table 1.1 - BRIC Countries Urbanization Rates

Country	Urbanization Rate
Nigeria	48%
Brazil	84%
Russia	73%
India	29%
China	40%

By any standards housing conditions in Nigeria are poor. Various studies have estimated that there is a shortage of 12 -16 million units.

Most people, probably over 80 per cent of the population, live in informal housing - structures of varying degrees of permanence on land on which they have no ownership rights. The property is often very poor quality and lacks basic facilities.

The Nigeria household survey 2004 showed that 61 per cent of the population had access to an improved water source. This average masks different positions in urban areas (83 per cent) and rural areas (42 per cent). Similarly, 60 per cent of the population had access to sanitation facilities; the average for urban areas was 72 per cent and rural areas 50 per cent.

In the more formal sector there is a shortage of properties, and accordingly rents and house prices are very high. The market is predominantly in plots rather than in completed housing units. The cheapest apartments for sale in the suburbs of Lagos cost ₦2 – 3 million ($17 – 25,000). The cheapest houses on the outskirts of Lagos are around ₦5 million ($43,000), while in Lagos itself the figure is nearer ₦10 million ($86,000). The high house prices have led many employers to provide housing directly for their staff.

New housing development is hindered by a number of factors. Two of them – inefficient mechanisms for transferring property and the absence of long term finance for home buyers - are covered subsequently in this report. The major factor is the ownership and management of land, which is in the hands of state governments. Although this is largely outside the scope of this report the issue is relevant to housing finance because of the impact on prices and mortgageability of property. Two others factors are a lack of basic infrastructure and an inadequate urban planning system, which fails to provide adequate land for housing, while at the same time allowing unauthorized development which has a detrimental effect on property values.

2. The Financial System

This section briefly describes key economic trends and the nature of the financial system in Nigeria, as they set the context in which housing finance operates.

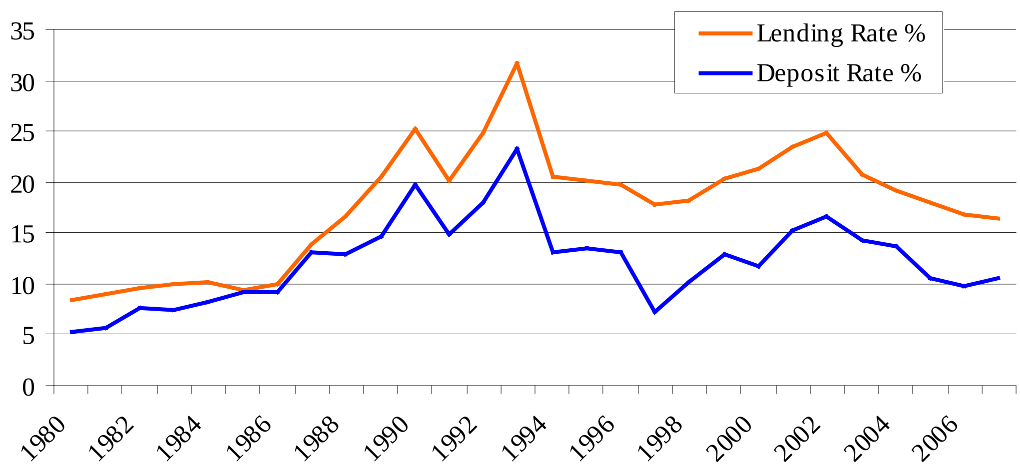
The Economy

Nigeria is currently enjoying rapid economic growth. Real GDP per capita rose by 8 per cent in 2007 and is forecast to increase by 9 per cent in 2008.

Two key related macroeconomic variables – the rate of inflation and the general level of interest rates – are relevant to housing finance. Loans to finance house purchase need to be for relatively long terms, and long term financing is difficult if not impossible in a high inflation/high interest rate environment.

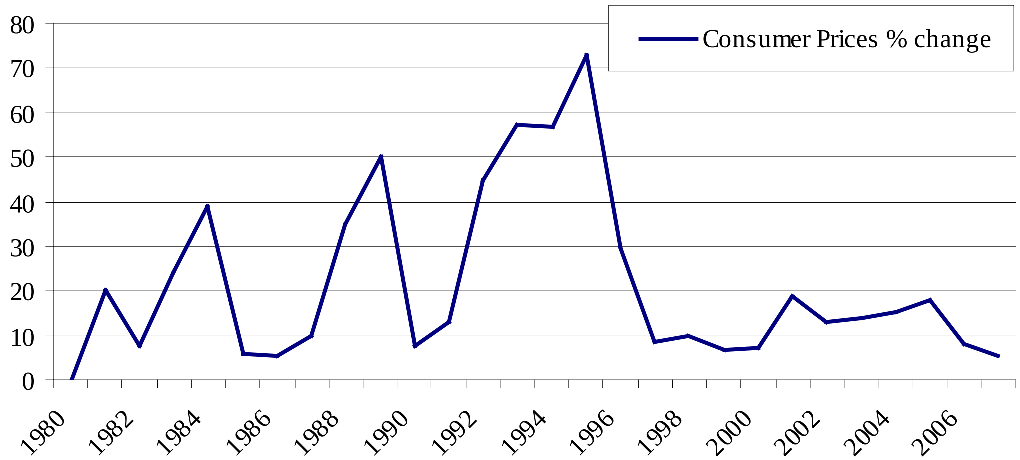
Nigeria has suffered from inflation and high interest rates. The situation has improved significantly in recent years. The prime lending rate has fallen from 25 per cent in 2002 to 16 – 18 per cent over the last few years. Inflation has fallen from double figures to around 6 per cent. Inflation is forecast to be in the 7 – 9 per cent range over the next few years.

Figure 2-1 - Lending and Deposit rates 1980-2007



Source: EIU Database

Figure 2-2 – Inflation rate 1980-2007



Source: EIU Database

Financial depth

The Nigerian financial system is not well developed given the state of the economy generally. Gross national savings as a percentage of GDP is significantly above the average for Sub Saharan Africa while money and quasi money as a percentage of GDP is perhaps a little below the average.

Only about 15 per cent of Nigerians have a bank account.

Even microfinance, an informal funding mechanism which substitutes for formal banking in most developing countries, is relatively undeveloped.

Interest Rates

The following table shows the wide spread between lending rates and savings rates. The Savings rate however is for short term deposits, compared to the long term nature of mortgage lending. Nevertheless, savers are offered a substantially negative real rate of interest. If funding is taken from wholesale markets at the interbank rate, and given that mortgage rates are around 18 per cent, this would suggest a mortgage spread in the range of 4-5 per cent.

Table 2.1 - Interest rates as at February 2008

Type	Period	Rate
Savings rate		3.0%
Prime lending rate		17.6%
Treasury Bill rate		9.9%
Wholesale deposits		10.0%
Interbank rate	7 Days	11.0%
	30 days to 1 year	13.0 - 13.4%
Govt bonds	2 to 4 years	7.7 - 8.0%

The World Bank *Developing Outcomes* report gives some relevant comparative data on interest rates. The interest rate spread (lending rate minus deposit rate) was 7.4 per cent in 2005, comparable with Kenya (7.8 per cent) but below the figures for Tanzania (10.4 per cent) and Uganda (10.9 per cent). However, caution is needed when making such comparisons because there is a wide range of deposit rates.

Financial institutions

The Nigerian financial system comprises a variety of banks and quasi banking institutions, government agencies, insurance companies and pension funds. Summary data on the major types of institution are shown in Table 2.2

Table 2.2 - Financial institutions, Nigeria, December 2006

Type	Number	Assets
Deposit money banks	25	$37,263m
Micro finance institutions	700	$470m
Micro finance banks	7	
Primary mortgage institutions	91	$970m
Insurance companies	71	
Pension Fund Administrators	25	$4,300m

Source: March 2008, International Monetary Fund: International Financial Statistics and Central Bank of Nigeria

Commercial Banks

Banks are the major financial institutions in Nigeria, accounting for over 90 per cent of assets. Banks and other deposit taking institutions are regulated by the Central Bank of Nigeria (CBN). In 2005 the CBN raised the minimum capital for a bank from ₦2 billion ($17.1 million) to ₦25 billion ($214 million). This bold move has led to substantial rationalization, the number of banks falling from 79 to 24. The rationalization was largely achieved by banks merging together rather than the weakest banks going out of business.

The National Deposit Insurance Corporation (NDIC) insures deposits up to ₦200,000 ($1,700) for deposit banks and ₦100,000 ($850) for others. However, there is concern that depositors in failed institutions have not been paid out. This has been the case for a number of banks which have been forced to close following the increase in capital requirements. Whilst the NDIC does protect small savers to some extent, its payout level remains very low and is probably not sufficient to provide any level of confidence if there was a run on a bank.

Notwithstanding the consolidation, the banking industry remains relatively fragmented and also at one end of the spectrum in terms of local ownership. Stanbic and Standard Chartered are the only wholly owned foreign banks to operate in Nigeria. Citibank has an 83 per cent share in the Nigeria International Bank, and Ecobank Transnational (based in Togo) has a 72 per cent share in Ecobank. There is one privately owned bank. The other 19 banks are wholly locally owned and publicly traded. The eight largest banks in approximate order of size are: Intercontinental, Union Bank of Nigeria, First Bank of Nigeria, Zenith Bank, United Bank for Africa, Guaranty Trust Bank, IBTC Chartered Bank and Oceanic Bank. They are the eight largest companies listed on the Nigeria Stock Exchange. The banks collectively have raised additional capital though share issues and other means, including investment by foreign banks and development agencies. Total capitalization of the banks has increased over the last few years from ₦293 billion ($2.5 billion) to over ₦1.1 trillion ($9.4 billion). All the banks have alliances with major foreign banks in respect of foreign exchange management. The largest banks are developing international operations and three now have branches in London.

The banks are very liquid. Retail lending is tiny, just 15 per cent of total loans. It is estimated that fewer than 1 per cent of the population have credit facilities with banks.

The state of the banking industry was usefully described in the IMF Report *Nigeria: Selected Issues* (February 2008):

> *"The banking sector is broadly stable. Banks are well capitalized, liquid and profitable. The distress in the banking system before consolidation, when a large number of banks were unsound or marginal performers, has eased; the systemic balance sheet has almost doubled since December 2005. Confidence has returned with growth in deposits nearly doubling since December 2005."*

A specific issue identified in this study is the close inter-relationship between the banks and the real estate market, to some extent predicated on an assumption that not only will property values always increase, but that they will increase rapidly. For example, the following quote is taken directly from the prospectus of the Skye Shelter fund (a Real Estate Investment Trust promoted by Skye Bank) in 2007:

> *"From the profit forecasts, the Fund Manager expects a return of 26 per cent in Year 1, 30 per cent in Year 2 and 33 per cent in Year 3, giving an average expected rate of return of 29.6 per cent. The value per share of the Fund is projected at 118.5 per cent in Year 1, 128 per cent in Year 2 and 138.9 per cent in Year 3 against a projected inflation rate of 9 per cent in Year 1, 7 per cent in Year 2 and 5 per cent in Year 3."*

The banks have directly invested in real estate and also have an exposure to real estate developments. Much of the new capital that they have raised has been used to expand branch networks. The number of branches increased from 3,000 at consolidation to 4,600 in June 2006, and a cursory glance at construction activity around Lagos suggests a further substantial increase since then.

Micro finance

There are seven micro finance banks which, between them, are tiny.

Until 2007 there were 757 community banks – small local institutions the core business of which is micro savings and micro lending. The CBN required them to increase their capital to ₦20 million ($170,000) to operate at state level and to ₦1 billion ($8.5 million) to operate nationally, and to convert to micro finance institutions. 600 duly met the requirements. The remainder are in the process of being closed down.

Like the retail deposit banks the micro finance institutions are very liquid. At present they do not play any role in the mortgage market, but may have a role to play in terms of lending for incremental construction.

Primary Mortgage Institutions

Primary Mortgage Institutions (PMIs) or savings and loans companies take savings and originate and hold mortgage loans. In practice, their main role is to distribute subsidized loans financed through the National Housing Trust Fund (NHTF).

They have weak capitalization and only a limited ability to collect deposits. There are currently 91 PMIs but many of these have no mortgage loans on their balance sheets. The CBN is shortly expected to raise the minimum capital requirement which would lead to a sharp reduction in the numbers. Most of the largest PMIs are either directly subsidiaries of banks or have a connection with a bank. The role of PMIs is considered in more detail in section 6.

Insurance companies

Following what was done in respect of the banks, the capital requirements for insurance companies were substantially increased in 2007. 71 companies complied with the new capital requirements of which 26 were life companies, 43 were non-life companies and two were reinsurers. ₦90 billion ($770 million) of new capital was raised in the process. However, the industry remains fragmented with very little involvement from major international insurers. The legal framework is both poor and not enforced.

Total premium income was about $700 million in 2006. Premium income per head is much lower than in comparable countries - $4 compared with $24 in India.

Pension Fund Administrators (PFAs)

There was a major reform to pension arrangements in 2004, centered on a change from defined benefit to defined contribution arrangements. Live defined benefit schemes now have to be administered by a new type of institution, a Pension Fund Administrator (PFA). The 2004 reform created defined contribution schemes, known as Retirement Savings Accounts (RSAs). Employers and employees in the formal economy are each required to make contributions of 7.5 per cent of salary.

The PFAs are regulated by a specialist regulator PenCom. There are currently 25 PFAs. The largest five have 80 per cent of the market, and the expectation is that in the longer term the number will fall to 5 - 10.

PFAs have around ₦500 billion ($4.3 billion) under management, about 4 per cent of the total assets of financial institutions, making them the second largest sector after the banks. About ₦300 billion ($2.5 billion) is held in legacy defined benefit schemes and ₦200 billion ($1.7 billion) in RSAs. Annual contributions are ₦100 -120 billion ($850 million - $1 billion).

Capital markets

The capital markets can best be described as being in an embryonic stage. Partly because of high issuing costs, including compulsory underwriting which carries a fee of 3 to 9 per cent of the proceeds of the issue, there are no corporate bonds. Other than government securities, the market has mainly been in capital raising issues by the retail deposit banks.

The Federal Mortgage Bank of Nigeria has issued what is called a “mortgage bond”. However, this was actually a government backed security issued as part of the monetization program. Nigerian legislation permits securitization and it is understood that there have been some private securitization transactions, although not of mortgages.

Remittances

As in other emerging banks remittances play a significant role in the Nigerian economy - although not in the financial markets. Recorded remittances are about $4.2 billion annually; unofficial transfers are probably of a similar amount. Only banks can distribute remittances that are made through the formal channel. Western Union has exclusive arrangements with 15 banks and Moneygram with six. It is understood that when remittances are accessed they are transformed into cash rather than going into the banking system.

3. Housing and Housing Finance – The Framework

Introduction

There are three sub-sectors of the Nigerian housing finance market:

- The informal sector – by far the largest.
- The formal open market sector, which is largely confined to the upper income groups in the major urban centers.
- The subsidized sector, a subset of the open market sector, which benefits from cheap loans from the National Housing Trust Fund.

This section sets out the framework; the next three sections examine the sub-sectors in turn.

Legal system

Generally, the Nigerian legal system in respect of mortgages and property follows the English common law system. However, there is a significant exception in respect of land ownership.

Nigeria's Federal system of government means that different laws already apply to land transactions in different parts of the country. There is a separate land registry in each state.

The Property and Conveyancing Law 1959 (similar to the English Law of Property Act 1925) applies in the former Western Region. The Conveyancing and Law of Property Act 1881 applies in the former Northern and Eastern Regions and parts of Lagos. The Registration of Titles Act applies in the other parts of Lagos.

Land ownership

The Land Use Act 1978 vested the ownership of all land in the governor of each state. This is enshrined in the Constitution. The governor can allocate specific pieces of land to individuals or corporate bodies for development. This would usually be on a 99 year lease. An individual's ownership of land, a "right of occupancy", is recognized through a "certificate of occupancy" for the period of the lease less one day. This "right of occupancy" is transferable, with the consent of the Governor.

However, over the last few years the original owners of the land have increasingly challenged the terms under which the state acquired their land under the 1978 Act, and have been successful in some court actions. This creates uncertainty.

Where land is allocated for development then it is a condition that development takes place within two or three years. If development does not take place then the state can take back the land. However, whether or not this is done is fairly arbitrary, which creates further uncertainty.

Notwithstanding the 1978 Act it is understood that in practice some 70 per cent of land is held on a customary basis. It is assumed that that such land cannot be transformed into individual ownership or used as security without being subject to the 1978 Act.

One major missing element in the legal system provisions for land is the absence of any means for shared ownership or land apportionment in multi-family dwellings. The land on which a multi-family dwelling is constructed would not be able to be split up between the different property owners. In other countries this is typically resolved by creating a management company or residents' association in which the property owners would have an equal share. This is not currently possible under Nigerian law. Land registries currently use work around systems, but are operating without any legal basis.

Title registration

Nigeria has a network of land registries in each state. The basic structure is sound. However, the administration is not. Work has begun to computerize the land registries. Where they are computerized then someone searching can be reasonably confident that the register is correct. Where they are not computerized there is no guarantee that the file will be correct.

The Federal Capital Territory is in the process of implementing a new computerized title registration system which includes cadastral mapping using GIS. This was a valuable by-product of the work done to plan and build the City. All title documents are being scanned in, and Certified True Copies of titles can be printed out on secure, numbered paper instantly. Likewise, title searches, which used to take several weeks, can now be carried out instantly. The Land Registry office has also made great strides to eliminate any opportunities for corruption or bribery by implementing a series of security features into the system and by eliminating any cash payments.

Significant progress has also been made in Lagos State, assisted by support from the British Council and the Land Registry in England and Wales.

Governor's consent and registration charges

All transactions in property, including sales, leases, mortgages and other charges, are subject to complex requirements in respect of Governor's consents and registration, and to charges which cumulatively are the highest in the world.

Understanding the charges is far from easy, and indeed there seems to be an equally complex system of waivers, derogations and special deals so that the full impact of the charges may be mitigated, albeit at the expense of some other facilitation payments being made.

The following description is largely drawn from the World Bank publication *Doing Business in Nigeria* and relate specifically to a $32,000 property in Lagos.

The charge for obtaining Governor's Consent varies from state to state. In Lagos state the basic fee is 8 per cent of the value of the property, but this is increased to 15 per cent where the property is resold within ten years.

The Land Registration fee is typically 3 per cent of the value of the property.

Stamp duty is also 3 per cent of the value of the property.

There are various fixed fees which typically will be between ₦15,000 ($130) and ₦25,000 ($210).

Legal fees are on a sliding scale and average 7.5 per cent of the value of the property. If an estate agent is used then each party employing the agent pays 5 per cent.

The fees can easily be cumulative. For example, if a developer buys a plot of land then fees are payable at that stage; when the property is sold further fees are payable; and when the property is mortgaged yet more fees are payable.

Total fees are likely to be in the 20 per cent - 30 per cent range. However, the point has been made that developers and others can negotiate waivers for particular developments, or defer payments. This has the effect of reducing the total fees charged at the expense of transparency and opening up opportunities for corruption.

The procedures generally have to be run consecutively rather than concurrently and require specific forms to be completed, payments to be made in specific ways at specific times and significant documentation requirements.

The 2007 World Bank Doing Business report put 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 property value. These figures are a considerable improvement on the 2006 figures of 16 procedures, 274 days and 27.1 per cent, reflecting a concerted effort by the State of Lagos to reduce costs and simplify procedures. Nigeria's performance in respect of registering property is by far its worst. Nigeria was in 108th place in respect of doing business generally.

Nigeria rightly compares itself with the "BRIC" countries (Brazil, Russia, India and China). Each scores much better than Nigeria. The following table shows the position.

Table 3.1 - Time and cost to register property, BRIC countries

	Nigeria	Brazil	Russia	India	China
Number of steps	14	14	6	6	4
Time (days)	82	45	52	62	29
Cost (per cent of value)	22.2%	2.8%	0.3%	7.7%	2.6%
Ranking (out of 178)	173	110	45	112	29

Source: *Doing Business*, World Bank, 2007.

Enforcing collateral

The ability of a mortgage lender to realize its security is rightly regarded as important in the development of an effective mortgage market. It is the security of the property that allows a lower rate of interest to be charged than for unsecured loans.

The arrangements in Nigeria are not straightforward. It is understood that arrears are very low on the mortgage lending that has taken place. More generally there is a culture that accepts that debts have to be paid and that default on a mortgage loan results in losing the mortgaged property.

The power of sale is governed by the Property and Conveyancing Law of 1959 (applicable in the West) and the Conveyancing Act of 1881 (applicable in the East and the North as a statute of general application). This works relatively well and is reflected in a soon to be published World

Bank survey where Nigeria ranks well in terms of the cost and time taken to enforce real estate collateral. This is a non-judicial process which does not require the bank to go to a judge to formal get authorization to initiate proceedings against a defaulting creditor. Under this regime the rights of borrowers can be quite limited. There are reports of property auctions being organized on the same day as the notice appears in the newspaper. There are also reports of brutal means being used to evict defaulting borrowers.

A new bill has been under discussion that would set a stricter framework and ensure more rights for the borrower. The bill offers a series of options for the sale of the property ranging from auction to an agreed sale process. Whilst the stronger consumer rights should be welcomed it is not clear that the proposed bill achieves a balance between a quick and efficient resolution of enforcement with the rights of the borrower. It also lacks considerable detail, with no definitions of basic terminology such as what constitutes a default.

In Lagos State there are special non judicial proceedings in use.

The foreclosure process is the judicial alternative to the Power of Sale provisions. Ideally, it should be the main way of enforcing collateral and is best able to preserve the rights of both parties. However at present the system is cumbersome and slow. Numerous opportunities exist for defaulting borrowers to prevaricate and seek frivolous injunctions. As is common in emerging markets, the judiciary is also pre-disposed towards leniency for the borrower. Courts insist on a pre-trial mediation process which can take several weeks and often ends inconclusively with the whole legal process then having to be re-initiated. In practice the foreclosure option is seldom used in Nigeria.

Lastly as is common in emerging markets where a strong sense of community often exists, particularly in the poorer areas or in the slums, repossession can be very difficult to achieve. The property would be unsellable or eviction would be impossible to achieve.

4. The Informal Sector

Most of this report is about mortgage finance, and therefore is about the formal sector of the economy. However, it is important not to lose sight of the informal sector which constitutes the vast majority of the population and housing in Nigeria.

Most people live either in traditional villages in the rural areas or in informal settlements in the major urban areas. These settlements are very visible in Lagos and the other major cities, and are similar to those found in other parts of Africa. In urban areas the housing is invariably poor quality, lacking the basic amenities, and overcrowded. The people living in this housing work in the informal economy and probably have no connections with any formal financial institution.

Housing in this sector of the economy is usually built by the owners. A very primitive construction can be built quickly, overnight if necessary. More substantial homes are constructed over a period of years as the owner can afford to pay for materials or occasionally for some professional help. Building a substantial dwelling is likely to take ten or more years on this basis. Rotating savings and credit associations (ROSCAs) play a role by providing short term loans to their members.

It is estimated that about 60 per cent of remittances are used for housing development, at all levels of the market. Although there is no evidence on this it is very likely that some of the poorest people are able to secure better housing conditions because of remittances from their relatives.

5. The Mortgage Lending Market

The environment for mortgage lending

House purchase on the open market is difficult. The legal complications were outlined in section 3. The problems were well summarized in the Financial Sector Strategy 2020 report on the mortgage market. The relevant section is reproduced in Appendix 1. In summary:

- Absence of clear property and security rights.
- Mandatory Governor's Consent to property transactions.
- Inefficient land management systems.
- High costs of property transactions.
- Inadequate sources of cheap long term funding.
- Inadequate structure of housing delivery.

While these factors are all a problem it is necessary to assess their relative importance and the extent to which they can be influenced in seeking to prioritize policy initiatives.

The supply of housing and house prices

The supply of housing is largely outside the scope of this paper. However, it is necessary to analyze this issue briefly as it is very relevant to housing finance.

The land ownership system acts as a deterrent to new house building. Land for development is allocated by state governors through an opaque administrative mechanism, which is not responsive to demand. When a developer acquires a plot of land he is liable to pay high fees up front. While spatial planning exists in theory, in practice there is a free for all, which means that land for housing has to compete with land for commercial use.

The position is accentuated in Lagos, the major urban centre, by a number of special factors. The most popular parts of Lagos are on an island where space is already constrained. Lagos has been booming which has led to a huge influx of population. There is no mass transport system so people either have to live close to their work or face a lengthy drive in traffic conditions that can best be described as chaotic. More recently, the unrest in the Niger Delta region has led multinationals to pull their staff back to Lagos.

The market in Lagos and the other major urban centers consists almost entirely of plots, rather than completed new houses or of second-hand houses. A plot or plots are offered for sale with either no services of with some services up to a gated community with full security. The buyer buys the plot and then builds the property himself or engages a builder to do it. The process is necessarily lengthy and in many ways unsatisfactory. In a large estate there will be properties at varying stages of development for many years.

There is a limited amount of sales of newly completed houses. Developers are not easily able to finance the construction process. This is partly due to inefficiencies in the building industry and shortages of materials and skilled labor. These combine with high interest rates to make the construction process expensive. What "speculative" building there is tends to be at the top end of the market.

There seems to be almost no market in second-hand houses, perhaps reflecting the cultural tendency for homes to be kept within families.

Mortgage lenders and products

Despite the unfavorable environment there is a reasonably efficient and rapidly growing mortgage market in Nigeria. Loans are provided by the retail deposit banks, and to a much lesser extent by the primary mortgage institutions. Loans are financed by retail deposits. The maturity mismatch is largely mitigated by use of the adjustable rate mortgage, loans rates typically being tied to banks' prime lending rates.

In most countries a key element of the underwriting process is examining the financial history of the borrower, particularly in respect of his record in repaying other loans. Bankers regard this as the single most important piece of information that they need in order to underwrite loans effectively. In Nigeria there is no means of doing this. For the future a credit bureau has been established by the major banks and the consulting firm, Accenture, but it will be some years before this has sufficient data to enable it to be fully effective.

Lenders require the borrower to have clear title for that property and will normally take a legal mortgage, although it some cases they may use an equitable mortgage.

To further protect themselves lenders will normally deal with borrowers only from certain specified employers – typically the public sector and large corporations. Mortgage repayments are made by deduction from wages, and there may also be some informal support from the employer.

There is no reliable figure for the size of the mortgage market. A best guess is around ₦100 billion ($850 million) and 40,000 loans. United Bank for Africa is probably the market leader. Skye, Diamond, Access and PHBI are other banks that promote themselves as having a significant role in the market.

Interest rates

The rate on mortgage loans had long been capped at the Central Bank Minimum Rediscount Rate + 4 per cent. This led to banks increasing the level of charges and fees imposed on loans to maintain their margins, and more generally the cap falling into disuse. In February 2008 the cap was abolished with immediate effect. This should lead to greater transparency in the rates charged to consumers.

Currently the open market mortgage rate is 17 – 18 per cent, roughly the same as prime lending rate, and a spread of 3 – 4 percentage points over money market rates. The spread is not unreasonable given the problems of mortgage security and the early stage of development of the market. However, the high mortgage rate acts as a deterrent to some potential borrowers and puts a heavy repayment burden on those who do borrow. As the market expands units costs are lowered and the extent of the potential risk becomes clear, and hopefully favorable. These should lead a narrowing of the spread although the scope for this is limited. However, mortgage rates will be more affected by the general level of interest rates. The effect of lower mortgage rates on monthly repayments is usefully illustrated by comparing the annual payments on repayment mortgages for varying terms at rates of 7.5 per cent, 10.0 per cent, 12.5 per cent and 15 per cent.

Table 5.1 - The impact of high mortgage rates on repayments

	7.5 %	*10.0 %*	*12.5 %*	*15.0 %*
Repayments on $30,000 loan				
Interest only	$2,250	$3,000	$3,755	$4,500
25 year repayment	$2,690	$3,310	$3,960	$4,640
10 year repayment	$4,370	$4,880	$5,420	$5,980
5 year repayment	$7,320	$7,900	$8,430	$8,950

A borrower with an income of $10,000 would be committing 25 per cent of income to repayments on a 25 year loan at 7 per cent, but a prohibitive 46 per cent with an interest rate of 15 per cent. If a 10 year loan is the maximum term available then repayments increase to 60 per cent of income. World Bank reports on housing finance in Africa argue that merely lengthening the mortgage term to 25 years is sufficient to make formal mortgage finance loans a viable option for middle income groups in most African countries.

Avoiding the costs and delays

Section 2 explained the complicated, time consuming and costly processes that apply to property transactions. In any country where these circumstances apply, there are two predictable outcomes:

- The volume of transactions is lower than it otherwise would be.
- Various devices are used to circumvent the procedures and minimize the fees.

These apply in Nigeria. It is impossible to estimate the extent to which activity is suppressed but there certainly must be some effect.

In respect of “workarounds”, in the massive informal sector no fees are paid at all as people have no ownership rights and transactions in property are not registered or reported. There are sales and purchases of existing homes in the informal sector but it is impossible to make a realistic estimate of the volume.

In the formal sector a variety of devices are used, all with their risks:

- Deliberately reporting a lower value of the property than the true value of the transaction. The authorities try to deal with this by valuing properties themselves and also by having a minimum value for particular areas.
- The lender having an equitable mortgage (i.e. he holds the deeds and does not register a charge against the property) rather than a legal mortgage. The risk for the lender is that taking possession is more difficult.
- Properties being owned by corporate bodies with changes in ownership being effected by sale of shares in the company.
- The buyer giving the mortgage lender a power of attorney.
- The lender taking security over assets other than land, and only taking security over land when the time arises to realize that security – prevalent in the commercial sector but much less applicable to residential property.
- The unofficial sale of the right to “own” or occupy a house, with the legal title remaining with the previous owner.

- Including compulsory arbitration clauses in mortgage contracts.

It also seems to be the case that developers are able to negotiate waivers or deferment from certain taxes or charges.

The overall result is very unsatisfactory. It seems that most pieces of land are not registered – it is understood that in Lagos just 80,000 titles are registered whereas the number should be 4 – 5 million. The main effect of the plethora of controls and taxes is that transactions either do not happen or happen in the informal sector, and where transactions are in the formal sector they are costly and time consuming, partly because of the efforts that are made to mitigate their effects.

The report on the observance of standards and codes (ROSC) for insolvency and creditor rights (ICR) in Nigeria (2007) provides a useful analysis of some of these issues. It comments that despite the requirement to register charges on land:

> *"there are widespread practices of both non-registration and under-registration of charges. This avoids the costs of registration and avoids the delays inherent in a system which requires the Governor's Consent to be obtained for any transaction in land. Non-registration leaves the banks with an "equitable charge" based on physical possession of the title deeds of the property and written evidence of the mortgagor to the effect that it was the intention of the mortgagor to create a security interest over the property. Under-stamping is the practice of a secured creditor registering security but at a fraction of the true value of the charge. The secured creditor then relies on its ability to "up-stamp" the security, that is to increase the value for which the charge is registered, paying the appropriate additional filing charge at a time when it seems likely that the bank will have to rely on the security."*

There is an adverse effect on valuations, which are essential for the smooth operation of the housing market. The volume of formal valuations is very small as transactions are not formally recorded, and in those that are recorded it is possible that devices will have been used such that the real valuation is not recorded.

6. The Subsidized Mortgage Market

Alongside the mortgage market described in the previous sector is a subsidized mortgage circuit involving a government agency, a provident scheme and a network of primary mortgage lenders:

- The Federal Mortgage Bank of Nigeria (FMBN) administers the provident scheme and also has other functions, although at present it is not a mortgage bank.
- The National Housing Trust Fund is a compulsory provident scheme the proceeds of which can be used only for house purchase.
- Primary mortgage institutions (PMIs) disburse subsidized loans financed by the NHTF, often combined with open market loans funded by retail deposits.

FMBN – structure and role

The FMBN has a long and chequered history and has been charged with implementing various government policies, historically with little success.

Its name is something of a misnomer, as it is not a mortgage bank in the normally accepted sense of the expression but rather the body that manages the NHTF and loans made under the scheme, and has a number of related responsibilities.

Technically, the bank is 50 per cent owned by the Federal Government, 30 per cent owned by the Central Bank of Nigeria and 20 per cent owned by the National Social Insurance Trust Fund. However, only the Federal Government has contributed any capital. It is the intention that the capital base of the Bank should be increased to ₦100 billion ($850 million) million but it does not seem that this has been done. As a financial institution the bank is supervised by the CBN.

It now describes its role as being to:

- Enhance the NHTF and encourage PMIs.
- Facilitate of land transactions by helping to secure improvements to the titling process.
- Facilitate quick foreclosure where this is necessary.
- Facilitate access to the capital markets by mortgage institutions.

The Bank has been involved in the various initiatives to improve the functioning of the mortgage market, and can be seen as the “champion” for mortgage finance within government.

FMBN and the “monetization” policy

As part of the drive against corruption and towards more openness and transparency the government decided to cease providing housing in the Federal Capital Territory to ministers and senior officials. This was implemented by giving a further benefit to ministers and officials who were offered 30,000 houses for sale at a discount and with the benefit of mortgage loans at 7.75 per cent. The Government does not need to raise money to finance the sale of an asset that it owns. However, the FMBN was permitted to issue a ₦100 billion ($850 million) “mortgage bond” at a rate of 9.95 per cent as part of the program. So far ₦26 billion ($222 million) of securities have been issued. Ostensibly this was to finance the purchase of the houses but in practice the bond has simply raised money for the government.

The government is in effect providing a subsidy of around four percentage points, given an allowance for administrative costs of two percentage points. The loans are being disbursed through a group of banks and PMIs. Aso Savings accounted for 70 per cent of the first tranche of loans.

The bond was fully backed by the government of Nigeria, therefore in fact it is a government bond the proceeds of which are used to invest in mortgages rather than a mortgage bond. The bond also benefited from a number of concessions in respect of fees and listing requirements.

The FMBN has a remit to develop a secondary mortgage market and talks enthusiastically about mortgage backed securities. So far it has completed one refinancing operation with a PMI, Aso Savings, but this seems like a straightforward liquidity facility; certainly no mortgage related bonds have been issued.

The FMBN has indicated that it intends to provide mortgage insurance.

Financial position of FMBN

The financial position of the FMBN is difficult to assess, but it is certainly not healthy. It seems to have an accumulated operating deficit of $67 million and in the last two years for which figures are available (2005 and 2006) the decrease in "other net assets", which may well be a proxy for losses, has been more than double gross earnings. This suggests a high cost base. There are 600 staff, one head office, eight zonal offices and 38 state/district offices. Conversely, its income is limited.

The following table reproduces statistics from a table included in the *Report of the Presidential Technical Board on FMBN Restructuring.*

Table 6.1 - Federal Mortgage Bank of Nigeria, Financial Summary, End-2006

	₦ million	*$ million*	*per cent*
Capital employed			
Capital fund	(636)	(5)	(9)
Long term deposits	220	2	3
Long term loans	6,676	57	95
Capital loans	750	6	9
Total	7,010	60	100
Assets			
Mortgage assets	12,068	103	172
Fixed assets	2,530	21	36
Long term investments	17	-	-
Working capital	17,411	149	148
Other net assets	(25,015)	(214)	(356)
Total	7,010	60	100
Gross earnings	2,730	23	

The table would seem to suggest that the Bank has negative net worth.

National Housing Trust Fund (NHTF)

The Housing Fund was established under decree No 3 of 1992. The employers of all employed Nigerians, and self-employed workers, earning more then the minimum wage are required to deduct 2.5 per cent of wages and pay the amount into the NHTF. The accounts are held in the names of the individuals who should receive annual statements. Contributions receive a rate of interest of 2 per cent. By law, the Government and financial institutions are required to contribute to the scheme. The contributions plus interest are repayable at age 60 or on death. After contributing to the scheme for six months workers are entitled to a mortgage loan of up to ₦5 million ($43,000) at a rate of 6 per cent for 30 years. The loan is for a maximum of 90 per cent of value, so the borrower needs to have a ₦500,000 ($4,300) deposit. The loan must be used for house purchase, house expansion or building on a plot which is owned.

Applications for loans are made through the PMIs. The PMI checks that the application is in order and forwards all the documentation to the FMBN which duly checks it. The processing time is between four and nine months. If the application is accepted then the necessary funds are paid by the FMBN to the PMI at a rate of 4 per cent, giving the PMI a spread of 2 per cent. The PMI may make an additional loan at a market rate of interest if the borrower requires more than ₦5 million ($43,000).

Money from the NHTF is also used by FMBN to make estate development loans (EDLs) to private developers and state housing corporations at a rate of 10 per cent over 24 months. Usually these loans are made to finance construction of properties which are then sold to buyers with 6 per cent loans. The land is often provided free. The properties must be sold for no more than ₦5 million ($43,000).

At first sight this is an attractive scheme to potential home buyers. After saving just 2.5 per cent of their income for six months they can borrow ₦5 million ($43,000) at an interest rate of 6 per cent, which compares with an open market rate of 17 per cent, to buy a house at significantly below market value. In addition, the house purchase is exempted from some taxes.

However, the scheme has never, and can never, work in the way outlined above. The amount raised through contributions is not sufficient to fund loans for more than a tiny proportion of those eligible for loans.

The scheme is in effect a compulsory regressive tax in that the majority of workers could never earn sufficient to be able to afford to buy a house. They are being forced to contribute part of their income to a scheme, receiving a return well below the rate of inflation, to finance cheap loans for the better off, most of whom are probably civil servants. The regressive nature of the scheme has recently been worsened as the loan terms have been considerably improved – the rate of interest has been cut from 9 per cent to 6 per cent, the loan ceiling increased from ₦1.5 million ($13,000) to ₦5 million ($43,000), the maximum term increased from 25 to 30 years and minimum borrower contribution reduced from 20 per cent to 10 per cent.

The scheme has also faced practical difficulties. A loan can be obtained only if the borrower can produce clear title to the property he is buying. This is impossible in the majority of states and accordingly no loans have been made in those states. Loans can be made only through PMIs and there are no PMIs in at least 10 states. In such cases a potential borrower can apply to a PMI in another state, but it seems unlikely that this happens to any significant extent. Many PMIs do not qualify to distribute loans. The FMBN will not disburse more through a PMI more than 25 per cent of the PMI's capital, and it requires a bank guarantee for the loans it does disburse.

The trades unions have long objected to the scheme and asked workers to stop contributing. This duly happened in all but three states, although the situation has now changed and contributions are being made in 27 states. The government and financial institutions also have never made the contributions that they were required by law to make.

Volume of NHTF loans

The result has been that the scheme has raised little money and disbursed no more than 3,000 loans. The key data up to the end of 2006 is –

3,600,000 contributors in 25 states

Total amount collected ₦26,430 million ($230m)
Total amount refunded ₦569 million ($5 million) to 38,613 people.

Loans approved
Through PMIs ₦18,908 million ($160 million) to 8,810 borrowers.
Through EDLs ₦35,238 million ($300 million) for 16,284 units.

Loans disbursed
Through 42 PMIs ₦9,593 million ($80 million) to about 3,000 borrowers
Through EDLs ₦17, 230 million ($150m).

These figures are cumulative. It is assumed that many of the EDLs have been repaid. No net figures are available. The number of contributors may also be a significant exaggeration because of double counting.

Loans have been made through PMIs in only six states. Lagos State and the Federal Capital Territory have accounted for about ₦14.2 billion ($120 million) of the total loans approved of ₦18.9 billion ($160 million) through PMIs.

PMIs

Primary mortgage institutions, which were established through Decree No 53 of 1989, as their name suggests, were intended to be specialists in mortgage lending, like savings and loan associations in the USA and building societies in Britain. Their role is to collect retail deposits and to make mortgage loans, both on the open market and as the only institutions through which loans from the NHTF are distributed. However, they have low capitalization and poor governance. They are distrusted by the public, which has meant that they have been unable to raise deposits.

Until 1999 PMIs were regulated by the FMBN. In that year regulation was moved to the Central Bank of Nigeria, recognizing that they were banking institutions.

Most PMIs are very small, have made no loans at all and engage in various real estate activities to keep themselves going. Some are owned by the states. Most of the larger PMIs are either subsidiaries of banks or are connected with banks. One of the largest – Union Homes, is listed on the Nigeria Stock Exchange, and another, Spring Mortgages, in which Spring Bank has a 51 per cent shareholding, will be listing shortly.

When the CBN took over regulation there were 199 PMIs, of which 115 were described as "terminally distressed". 97 of these were closed down. In December 2005 only 43 had the prescribed capital of ₦100 million ($850,000) and of the 70 that made returns in 2005 only 15 complied with the minimum ratio of mortgage loans to assets of 30 per cent.

The poor quality of PMIs is usefully illustrated by the fact that FMBN checks individually each application for a loan, introducing further delay and cost into the system. It does not feel able to rely on the procedures of the PMIs through a service level agreement.

The PMIs currently serve little useful purpose. Their position was usefully summarized in a speech in 2007 by Dr Obadiah Mailafia, the Deputy Governor of the CBN-

> *"PMIs globally do not fulfill their mission and their contribution to housing finance supply is limited. Ratios of mortgages to assets and mortgages to loanable funds (defined as deposits collected) are well below the 30 per cent and 60 per cent thresholds set by the regulators and document that the PMIs failed to perform their function as mortgage originators.*
>
> *With commercial banks putting increasing resources into developing their mortgage market, PMIs are bound to lose further market share, with the exception of those that are operating as mortgage finance subsidiaries of the commercial banks. Weak capacity has been an additional cause of the lack of success of PMIs in the mortgage market and the outright failure of several."*

Table 6.2 - PMIs, Consolidated Balance Sheet, End 2006

	₦ million	*$ million*	*per cent*
Assets			
Cash	1,302	11	1.1
Bank balances	64,576	550	56.5
Loans and advances	30,012	250	26.2
Other assets	11,654	100	10.2
Fixed assets	6,848	60	6.0
Total	**114,393**	**980**	**100.0**
Paid up capital	12,566	107	11.0
Reserves	2,941	25	2.6
Current year profit	45		-
Deposits	74,215	630	64.9
Placements from banks	3,096	25	2.7
Long terms loans NHTF	7,462	65	6.6
Other liabilities	13,968	120	12.2
Total	**114,393**	**980**	**100.0**

The table shows the very small size of PMIs, the fact that their assets are largely held with banks, negligible profitability and also a high proportion of fixed assets.

Issues to be addressed

There are a number of issues that need to be addressed:

- FMBN has a wide range of functions but no clear direction or strategy.
- FMBN is in a financially weak position which makes it difficult for it to be effective.
- The NHTF is not viable or sustainable in its present structure.
- The PMIs have a privileged position but make no significant contribution towards the development of mortgage finance.

The issues are considered in the second part of this report.

7. General Principles for Reform

An effective housing finance system will develop automatically if the necessary building blocks are in place. Unlike in other areas there is no need for government to take specific actions to pass laws and create institutions to provide housing finance; rather it needs to ensure that existing laws do not prevent the banks from making mortgage loans on reasonable terms.

There are a number of key building blocks. Two of these, political stability and economic stability, are objectives in their own right and are not sought simply to make the housing market work. The essential building blocks specific to housing are:

- Well established property rights.
- Efficient land registration arrangements.
- The ability of lenders to realize their collateral if the borrower defaults.
- A functioning and well regulated banking system.

There are some subsidiary building blocks that are less essential but which help facilitate the development of the mortgage market:

- Regulation of real estate agents.
- Reliable data on market activity.
- Mortgage insurance.
- Insurance or guaranty arrangements to protect buyers of newly built homes.
- Capital markets able to provide long term funding.
- Reliable and trained valuation professionals.
- Credit bureau.
- Consumer protection regulations.

If these building blocks are in place then investment in housing and the provision of mortgage finance will automatically follow. This is turn can have a beneficial effect on economic development by contributing to a deepening and broadening of financial markets.

Countries do not have to get everything right for housing finance to develop. Dubai has experienced a boom in housing and housing finance even though property rights are not well established – as other factors, including trust in the promises made by the government, have compensated for this. In countries such as India mortgage lenders have been able to develop workarounds to counteract difficulties in realizing their security. However, each workaround leads to inefficiencies in the system and prevents the full beneficial effects from being felt.

In respect of the four points listed at the beginning of this section, Nigeria scores very badly on property rights and land registration arrangements; these must be the priorities for reform.

8. Financial Sector Strategy 2020

Nigeria understands the issues that have to be addressed so that housing finance can develop. It is seeking to address these as part of its ambitious Financial System Strategy 2020 program. A 13 point reform agenda designed to "engineer" the transformation of the financial system of Nigeria has been adopted. The strategy includes strengthening the domestic financial markets, for which the key importance of regulation is recognized, enhancing the integration of domestic and external markets and physically building an international financial centre. The program includes wholesale modernizing of laws and the creation of a number of new organizations. Features relevant to housing finance include integrating the informal financial sector into the formal sector and revolutionizing access to finance.

Mortgage finance is seen as one of the "drivers whose immediate development would enable the financial sector to catalyze growth in other parts of the economy". The key recommendations for mortgage finance are:

- Establish a safe and profitable mortgage market by setting up appropriate infrastructure/institutions and remodeling existing ones.
- Introduce a new framework to strengthen property and security rights.
- Provide affordable and long term mortgages to all classes of Nigerians.
- Enhance the use of the market mechanism to improve the housing delivery system.

Under each of these headings is a set of specific action points. These are reproduced in full in the appendix. The analysis of the issues that need to be addressed, summarized above and reproduced in the appendix, and the vision as outlined above seem eminently reasonable. However, the action points overemphasize institutional changes and do not emphasize sufficiently the major priority which is to reduce the complexity and cost of the process of house purchase.

The remainder of this report considers the various areas where reform is needed or is being considered. The final section brings the analysis together by suggesting priorities and an action plan.

9. Property Rights and Registration

Reducing the time scale and costs

Section 3 showed that Nigeria comes near the bottom of the international league table in respect of the costs of house purchase, the number of procedures involved and the time to complete these procedures. Total costs can be as high as 30 per cent of price and the procedures take months if not longer. These two factors need to be tackled as the single area where action is essential to ensure a healthy mortgage market.

There are a number of possible ways to reduce the time taken to process applications and to reduce the scale of charges. Any reforms should:

- Remove any scope for special deals, waivers and deferments. There should be a transparent scale of charges with no scope for variation. If variations are needed for particular types of transactions these should be built into the scale, not done on an individual basis.
- The number of stages in the process must be reduced, which points to the taking out of some processes and taxes completely.

FSS2020 and other official studies have all emphasized the need to take out of the Constitution the requirement for Governor's consent and then the removal of this consent. This is seeking a legislative solution to what is actually an administrative problem. If Governor's consent could be given in two days and cost nothing it would not be a problem. While changing the legal position is desirable in the long term, in the short term state Governors should be encouraged to put in place arrangements that make consent as automatic a process as possible. To the extent that title has to be checked then this should be combined with the procedure for registering transactions with the Land Registry.

There is little point in having three separate charges (land registry fee, Governor's consent fee and Stamp Duty) all as a percentage of the transaction value. At least two and preferably all three should be merged, which would help to take out some of the procedures. The number of fixed fees could also sensibly be reduced.

It would be inappropriate for this report to be prescriptive. The Nigerian authorities are far better able to work out the best way to reduce the administrative and cost burden on house buyers. The aim should be for all the transactions to be completed in 30 days immediately, with a medium term target of seven days. The total costs need to be brought down substantially; 8 per cent should be an absolute maximum and under 5 per cent would be preferable. The number of stages in the process needs to be reduced from the present 14 to no more than five. These reforms would put Nigeria alongside comparator economies, such as the "BRIC" countries of Brazil, Russia, India and China.

States that implement such a package, all of which can be done without any legislative changes, will be successful in attracting new investment in housing and in helping their citizens improve their housing conditions. Lagos State and the Federal Capital Territory have already demonstrated that delays and costs can be reduced by taking the appropriate administrative action. In Lagos the consent fee was reduced from 30 per cent to 15 per cent and the time to obtain consent reduced from six months to 30 days. The Governor delegated the power to give consent to the Land

Registry Commissioner. It is understood that the halving in the consent fee led to a quadrupling of revenue.

Land reform and registration

Nigeria lacks a modern and effective land titling system. This combines with the effect of the Land Use Act to mean that most real estate in Nigeria is effectively frozen. It cannot be used as security and there are significant obstacles to the development of land. Land ownership is beyond the scope of this report, but even within the confines of the law there is scope to allow people to have 99 year leases on the land that they occupy. Nigeria can take advantage of modern technology and expertise from other countries to put in place efficient arrangements which will be highly desirable in their own right as well as facilitating the growth of the mortgage market. Again, Lagos State and the Federal Capital Territory demonstrate what can be done.

Extending lease periods

Where land is acquired then it is on a long leasehold basis, the lease generally running for 99 years. Certificates of occupancy are given for the lease period less one day. Currently this is not a problem as the value of a 99 year lease is similar to the value of a freehold. However, as the remaining term of the lease falls below 70 years so its value will begin to diminish. The owner of the land will be less willing to invest and lenders will be less willing to take the land as security.

For this reason in countries where the leasehold system exists there are provisions either for the freehold to be acquired or for lease periods to be extended. This is not currently an issue in Nigeria but it will begin to be so within ten years. It would be sensible for consideration to be given in the next few years about how to deal with this issue.

Helping the poorest Nigerians

This report is about mortgage finance, which in practice means the richest 5 - 10 per cent of the population. It is important not to ignore the other 90 - 95 per cent of the population, who are more deserving of what assistance is available than the rich. It is now generally accepted that the best way to help the poor in respect of housing is to give them security of tenure of land they occupy. This point was well illustrated in an article "A flourishing slum" in *The Economist* on 19 December 2007. The article was about Dharavi, a huge area of informal housing in Mumbai. It noted that:

> *[Dharavi] "has become safer for two main reasons. One is that in 1976 the state government gave the slum-dwellers limited rights over their hutments. They were recognised as "identified encroachers", a status guaranteeing compensation in the event that the government bulldozed their shanties. In return, the government began collecting peppercorn rents—currently around 100 rupees [about £1.50] a month for each hutment—on the encroached land. It also started supplying Dharavi with mains water and power, which the gangsters hitherto had stolen from the city and sold in the slum. This step put the slumlords out of business, and started a modest property boom. Today, tiny hutments in Dharavi are sold, without title, for 500,000 rupees [about £6,500].*

In Nigeria, there is scope to go well beyond an "identified encroacher" concept and seek to implement a large scale program of registering all land and making available small scale loans where necessary to enable people either to pay for title registration or to buy the land.

10. Funding

Some analyses have suggested that the inability to raise long term funds is a significant constraint on the development of the mortgage market. This is based on the argument that mortgage loans are long term and therefore need to be financed by long term investments. In fact many countries, notably Britain, have largely funded mortgage loans through short term deposits, the adjustable rate mortgage being used to mitigate the effects of the maturity mismatch.

While long term funding would be desirable, in the short term the availability of funds is not a constraint on the development of mortgage lending in Nigeria. This section examines both the immediate prospects and how long terms funds can be accessed in due course.

Banks

This report has already noted that banks are very liquid, and also that they are seeking to expand their mortgage lending, using the adjustable rate mortgage. It is probable that over the next few years the volume of bank mortgage lending will grow rapidly and that bank lending will account for well over 90 per cent of total mortgage lending. This will usefully serve to diversify the balance sheet of the banks. Normally, one would expect such an expansion of mortgage lending to lead to a decline in margins. However, in Nigeria bank margins are already low by sub Saharan Africa standards and even low by world standards, and there is probably not much scope for margins to fall further, at least in the short term.

The adjustable rate mortgage largely, but not wholly, transfers interest risk from lender to borrower. If the general level of interest rates falls then mortgage rates can be expected to fall similarly. However, inflation looks set to remain at around the 8 per cent level and it may be that there is little scope for a fall in market rates. A significant increase cannot be ruled out, and this is where the use of the adjustable rate mortgage would be tested. Borrowers need to be aware of the nature of their mortgage product, that is that the interest rate can go up.

Securing longer term funding

It is desirable that longer term funds are available to help finance mortgage loans. This would have a number of advantages including diversifying the sources of funding, facilitating the matching of assets and liabilities and enabling borrowers to have a choice between fixed rate and adjustable rate loans.

The bank themselves can raise long term funds through bond issues or simply by seeking long term deposits. However, there has to be a supply of funds as well as a demand. At least in the short term the institutions best placed to supply longer terms funds are the Pension Fund Administrators, both because they hold significant funds – ₦500 billion ($4.3 billion) and because they have long term and predictable liabilities. It is understood that the PFAs are interested in holding mortgages in their portfolios, although obviously these would need to be at a higher return that equivalent government securities. They may well also be interested in making long term loans to banks which in turn might be lent on mortgage.

However, under their current regulations PFAs are not permitted to make or hold mortgage loans but can hold mortgage-backed securities, corporate bonds and other tradable instruments up to a total of 30 per cent of their assets. The rationale for including mortgage backed securities but not mortgages, is that PFAs should hold instruments that are tradable. Mortgage backed securities will not be issued for some years in Nigeria, and, if they were available, the logic of allowing them to be included in the assets that PFAs can hold, but not mortgages, is open to question. Tradability should not be the only criterion. In any event while mortgage backed securities may in theory be tradable, in practice the market can be illiquid as indeed has proved to be the case in America and Europe over the last six months. Mortgage backed securities can also be high risk; indeed the current problems in financial markets are caused almost entirely by institutions holding mortgage backed securities not by institutions holding mortgage loans.

Consideration should be given to allow PFAs to hold up to, say, 10 per cent of their assets in mortgage loans that met defined standards of quality, a measure that in itself might help such generally accepted standards to be developed. There are two ways in which PFAs could acquire mortgage loans:

- Purchase a pool of mortgages from a lender. The pool would need to meet defined standards of quality, and the lender would continue to service the mortgages. The lender could guaranty the mortgages, in which case they would be considered to be on the lender's books for supervisory purposes. If risk was transferred to the PFA then this would be reflected in the price paid.
- Come to an arrangement with a bank or PMI whereby they originate mortgage loans that go straight on to the balance sheet of the PFA.

Longer term, mortgage bonds need to be considered. These are securities issued by a lender which are secured both by a guaranty from the lender and by the underlying mortgages themselves. These are more costly to put together and to administer and a reasonable volume of business is required to make them worthwhile.

There has been much discussion in Nigeria about the issue of mortgage backed securities. For Nigeria this type of funding is not practicable in the foreseeable future, and can safely be "parked" for the time being. The definitive study on this subject is *Mortgage Securities in Emerging Markets* (World Bank Policy Research Working Paper 3370, August 2004) by Loic Chiquier, Olivier Hassler and Michael Lea. The paper lists three prerequisites before investors will be interested in mortgage related securities:

- They must offer attractive risk adjusted returns. Mortgage securities will be seen as an alternative to government bonds which provide a benchmark yield.
- Investors must have a capacity for mortgage related securities.
- Investors must be able to invest in mortgage related securities, that is they must have the necessary legislative and regulatory authority and the regulatory treatment must be appropriate.

The paper also details the legal requirements:

- An adequate legal, tax and accounting framework for both investors and borrowers.
- Facilities for lien registration.
- Ability to enforce liens.
- Ability to transfer or assign security interest.
- Protection of investors against the bankruptcy of the originator or the servicer.

In addition there are three primary market prerequisites:

- Standardization of documents and underwriting practices.
- High quality servicing and collection.
- Professional standards of property appraisal.

Nigeria is a long way from meeting these tests. The three primary market pre-requisites are not met. In addition the primary market has not yet developed sufficiently in volume or maturity to provide the base to begin issuing mortgage backed securities. As it does so, so mortgage backed securities can come back on the agenda, but for the time being resources should not be devoted to the subject.

Liquidity facility

A liquidity facility could provide an interim step for Nigeria between having a fully functioning secondary market and the need to extend the maturity of the liabilities base from deposit funding.

Ideally, a liquidity facility would be a stand-alone institution with its long term future in the private sector. Preferably, such facilities are owned by the banks or institutions which use it for refinancing. There is always a danger when creating a new institution that it is seen as a subsidy vehicle or as a lender with a role in the primary market. Either of these would be counter-productive for the development of the private mortgage lending market and could result in large levels of government expenditure.

Given that the FMBN is already in existence and has a remit for developing a secondary mortgage market, this would seem to be the natural home for creating a liquidity facility. In many ways, the Nigerian experience is not dissimilar to Mexico which also had to contend with how to best use provident funds, how to make best use of state mortgage institutions and how to make specialized mortgage lenders work effectively. The experiences of Sociedad Hipotecario Federal could provide a useful template for the development of the Nigerian mortgage market institutions.

Firstly, mortgage Liquidity Facilities can fulfill a dual role. Firstly they can provide direct funding, by purchasing mortgages (often with recourse) or lending on the basis of mortgages being assigned. The second role is to provide a liquidity back stop to lenders. This facilitates a much greater level of maturity transformation and enables banks to better leverage their deposit base for on-lending as mortgage loans. This would be a particularly useful function for many Nigerian banks that are not capital constrained and are also relatively liquid, but just lack long term funds.

Ideally, the liquidity facility would fund itself by issuing standard bonds with tenors of 5 years or longer depending on market conditions. These would be guaranteed by the Liquidity Facility and if it is in public hands therefore benefit from a quasi-state guarantee. Ideally the facility should be well capitalized and the bonds rated so as to provide the basis for non-distortive market pricing.

Remittances

This report has emphasized the importance of remittances, which are probably running at around $7 billion a year. Much of this amount is probably used to finance investment in housing but virtually none of it goes through the banking system. As the banks offer increasingly attractive savings and mortgage products so it can be expected that they should be able to “monetize” the remittances, particularly as already they are the only formal institutions that can pay out the proceeds of remittances.

10. Institutional and Legislative Framework

Legislation

FSS2020 has numerous proposals for new legislation. Much of the internal analysis on mortgage finance argues the case for major reform of nine existing laws as well as the need for new laws on securitization and non-judicial foreclosure procedures. For example, the Report of the Presidential Technical Board on FMBN Restructuring referred to amendments to nine "critical housing finance laws" and two new laws, on non-judicial foreclosure and securitization, and stated that "When these new laws have come into operation they will boost investment in the housing sector and make Nigeria more mortgage friendly".

While a perfect legal framework would be ideal, no country has yet achieved this and many have highly effective housing finance systems with a less than satisfactory legal framework. The existing legal framework is quite capable of supporting a massive expansion of mortgage lending; the necessary reforms to the transaction process should not be held up while discussions take place on possible legislation. Rather, the legislation should be a separate work stream which can run at a different pace from the short term issues.

The FMBN

The only logical role for the FMBN is as a facilitator for the development of the mortgage market, a role that it is already adopting and which it is keen to expand. This role would have several different components.

Clearly, if the NHTF continues FMBN should continue to oversee its operations. However, if the suggestion in the following section is adopted it would be able to stop duplicating the work of the PMIs in checking loan applications and concentrate on overseeing the operation of the scheme and improving its effectiveness.

The FMBN already has a remit to operate as a secondary financing institution, linking the capital markets to the mortgage market. There are a number of ways in which this can be done. The simplest is to provide a mortgage liquidity facility by raising funds on the open market, using its access to a government guarantee to do so a cheap rate. The funds can be on-lent to PMIs and banks or can be used to purchase seasoned loans. Either way, the Bank would have additional assets which would need to be backed by the appropriate capital. This route requires no legislation. Longer term, the FMBN could play a significant role in helping to develop the market for covered bonds and mortgage backed securities.

There is a series of subsidiary roles that the FMBN could play in its capacity as
Facilitator:

- Developing a mortgage insurance scheme, preferably in conjunction with an international insurer. In addition to providing lenders with additional security this would help drive better and more consistent standards.
- It would be helpful if standard underwriting criteria were developed. These could be relevant to the risk weighting given to mortgage loans by the CBN, eligibility for any mortgage insurance arrangements that might emerge and eligibility for refinancing,

whether through a mortgage liquidity facility, a covered bond program or in due course securitization. Such standard underwriting criteria would cover variables such as loan to value ratio, loan to income multiple and insurance arrangements.

- Becoming the central point for the collection, analysis and dissemination of data on all aspects of the housing market. There is an almost total absence of reliable data on mortgage lending, housing transactions and house prices. Efficient markets need accurate data. This can help lenders, borrowers and investors to validate their decisions and help the regulatory authorities monitor market activity and the activities of particular institutions in the market.
- Regulating real estate agents.

However, FMBN needs to demonstrate that it has the capacity to undertake all this work. At present its website, the showpiece for any organization, is very poor. More importantly, section 6 illustrated the weak state of its finances. This needs to be resolved before it is capable of taking on a wider role.

The NHTF

That the NHTF and PMIs need substantial reform is not in doubt. This is accepted by the Government, the FMBN and the PMIs themselves. However, the reform proposals concentrate on enrolling more workers into the scheme and attracting matching funding from government and employers.

There is a legitimate debate as to whether these reforms would make a bad scheme worse – by drawing more workers into a scheme from which they can never benefit and imposing a payroll tax on employers – which they are likely to resist. If a worker contribution of 2.5 per cent was matched by similar contributions from employers and government then the scheme would be less bad for those workers who could afford to take out a loan under the scheme. However, the fact remains that the scheme can never benefit the vast majority of those that contribute.

If the scheme did not exist there would be no case for introducing it. The preferred option is for the scheme to be wound up and the contributions repaid to the contributors.

If the scheme is to continue then it is necessary to change substantially the balance between contributors and borrowers. There are several ways in which this could be done:

- Lengthening the contribution period before a loan can be obtained. Such schemes in other countries typically have a saving period of 3 – 5 years before a loan can be obtained.
- Ensuring that borrowers continue to contribute to the fund after they have received their loans.
- Reducing the loan term to 20 years.
- Increasing the rate of interest on deposits and loans.
- Reducing the maximum loan size to make the funds reach more people – recognizing that this would require many borrowers to raise a commercial loan as well, something that is already the case.
- Preventing resale for a given number of years or levying a significant charge where there is early resale.

There is also a need for better asset-liability management to measure and forecast to measure the cash-flows over time.

A more daring reform would be to use the scheme to help poor Nigerians and at the same time encourage states to speed the process of obtaining and registering title. For the foreseeable future the majority of Nigerians, even in the formal sector of the economy, will not be able to buy a completed house. For them the best hope is to acquire a plot of land, possibly the one on which they are living, with clear title. That would encourage them to invest in their home and give them the necessary security should they wish to raise a small loan to finance that investment. The NHTF could offer small loans, from, say, ₦300,000 ($2,600) in states where this could buy a clear title to the land. This would allow many more people to access the fund, although it would exacerbate the funding problems.

PMIs

Substantial reform is also needed to the framework under which PMIs operate. A package along the following lines merits consideration:

- Increase the minimum capital requirement to at least ₦1billion ($8.5m), in the knowledge that this would sharply reduce the number of PMIs.
- Close down those PMIs that do not comply with the minimum capital and other regulatory requirements.

If the NHTF is abolished then the stronger PMIs would survive as independent retail banks or become part of banks while the weaker ones would close down. If the Fund remains then three other reforms would be sensible:

- Announce that with effect from a certain date only those PMIs that can satisfy the FMBN that they have adequate procedures to process loans without the paperwork being passed to the FMBN will be permitted to disburse loans funded by the NHTF.
- When these steps have been taken remove the restrictions on the amount that can be lent to PMIs in relation to their capital, remove the need for the PMIs to obtain a bank guarantee and delegate to the PMIs responsibility for ensuring that loan applications are in order.
- Allow banks that meet the same standards to disburse loans funded by the NHTF.

11. Priorities and Action Plan

It is always tempting for such an analysis to conclude with recommendations for new legislation and institutional reform. The analysis of the current market suggests that this is not the immediate priority in Nigeria in order to stimulate housing finance. Rather, the legal and institutional framework is not the main problem; what is needed is a concerted effort to make the present arrangements work efficiently.

This section suggests a two stage approach to reform. It concludes by listing areas where some technical help may be desirable.

Phase 1 Priorities

Phase 1 should be implemented within two years. It deals with the priorities that are capable of being "quick wins" – essential to put momentum into the reform process.

Five recommendations are put forward for Phase 1, all of which can be implemented without legislative changes:

1. Substantially improve the transaction process by reducing the time taken to achieve the necessary consents and reducing the costs from the current level of 20-30 per cent of the value of the transaction to nearer 5 per cent. This is by far the most important single measure; if action is not taken on this the other measures will not succeed.
2. Either abolish the NHTF or significantly reform it so as to redress the balance between contributors and borrowers.
3. Substantially increase the capital requirement for PMIs, and make loans through the NHTF, if it is to continue, only to those that meet this and other standards.
4. Put the FMBN on a stable financial footing and develop its role as the source of knowledge, statistics and expertise on the mortgage market, and facilitator of market improvements.
5. Implement through the FMBN a simple mortgage liquidity facility which would help pave the way for the use of covered bonds and mortgage backed securities in the longer term.

Phase 2 Measures

The phase 2 measures are those that are not essential to stimulate the market and which will take longer to put in place, in some cases because of the need for new legislation. They should be implemented over a five year period. They are:

1. Put in place arrangements through the FMBN which would allow covered bonds and mortgage backed securities to be issued. This may require some legislative changes.
2. Reform the arrangements for foreclosure by one or both of improving current processes within the current legal framework and by providing for extra-judicial procedures.
3. Develop a mortgage insurance program in conjunction with a commercial insurance company.
4. Linked with 1 and 3, facilitate some common standards for underwriting and for documentation.

5. Remove the need for Governor’s consent for land transactions, which will entail changing the Constitution.
6. Introduce large scale land registration programs and facilitate the acquisition of title by existing occupiers of property.
7. Introduce a comprehensive suite of training programs.
8. Regulate the activities of real estate agents.
9. Introduce comprehensive building codes and provide protection for buyers of houses during the course of construction.

Responsibility for Implementation

The implementation of this ambitious program requires outstanding leadership - at the political level, the official level and the industry level.

At the political level, a minister has to “champion” the program. The major task is to persuade State governors voluntarily to take administrative steps to speed up consent and to reduce some fees and charges, in the expectation that this would contribute to greater activity. This may need to be combined with some changes in federal taxation. A political decision also has to be taken on the structure of the NHTF and putting the FMBN on a sound footing. Which minister should have this role is a matter for the Nigerian government, but it has to be somebody with sufficient authority to carry the program through.

At official level there is the need to provide policy support to the Minister, to implement the changes to the NHTF, the PMIs and FMBN and to develop the facilitation role and the mortgage liquidity facility. The FMBN, suitably restructured, is the obvious body to take this on. However, this would require a significant re-orientation of the Bank away from detailed management of NHTF loans and towards a more policy orientated and facilitation role.

Changes of such orders of magnitude must be done in conjunction with the industry. Only those directly involved in providing housing services and housing finance have the necessary practical knowledge to help ensure that policy measures can be structured so as to be effective rather than disruptive. There therefore needs to be a network of well-resourced and effective trade associations. The Mortgage Bankers Association of Nigeria (MBAN) is the key body. It needs to be an effective channel of communication between government and mortgage lenders and most importantly to ensure that the interests and experience of mortgage lenders are fully taken into account in the policy making process.

The banks are major financial institutions in Nigeria and in addition to working through MBAN should be able to exert collective influence on the government to help secure a reasonable operating environment for mortgage lenders in Nigeria.

Trade associations representing the house builders, the building material suppliers and the real estate agents also have a role to play in ensuring that their particular interests are properly represented and their practical experience appropriately drawn on.

Technical Assistance

The reform process may be facilitated by the provision of technical assistance by international agencies. Possible areas where such assistance might be helpful are:

1. In order to help “sell the case” for lowering fees and charges in property transactions, a study of current income from such fees and charges together with an analysis of the impact on reducing fees and charges taking into account the resulting increase in transactions and reduction in avoidance.
2. Transforming the FMBN will be a major organizational task which may benefit from appropriate professional assistance.
3. There is a wealth of available experience from other countries on the implementation of large scale land titling and acquisition schemes. That experience can usefully be drawn on.
4. MBAN has the capability to play a major role in driving change; assisting it to draw on the experience of trade associations in other countries may facilitate its development as an “exemplar” trade association in its field.
5. The development of a mortgage insurance program requires consultancy support able to draw on the successes, and more importantly the failures, from mortgage insurance schemes in other countries.

Monitoring and Evaluation

The development of a mortgage finance market needs to be monitored and evaluated. This is not easy, as reliable baseline information is not available. The best estimates for baseline data are:

- A mortgage market of about ₦100 billion ($850 million).
- An open market mortgage rate about four percentage points above money market rates.
- No significant open market for the resale of existing houses.
- Costs of house purchase in the 20 – 30 per cent of price range
- Estate agency fees of 5 per cent payable by whichever party commissions the agent and legal fees of 7 per cent.
- The time taken to register transfers of property being at best 30 days but more typically 6 - 9 months.

Progress needs to be measured against these starting points, preferably on a state by state basis. A system needs to be put in place to record the hard data and make qualitative assessments of market developments generally. Ideally a quarterly analysis is needed covering:

- Volume and number of mortgage loans made on a state by state basis.
- Total volume of mortgage loans outstanding.
- Spread between open market mortgage rate and an index of the cost of funds.
- A measure of activity in the market for second-hand homes, based on data from estate agents or mortgage lending data.
- The transaction costs imposed by Federal and state governments on a state by state basis.
- The cost of legal and estate agency fees.
- Time taken to register property transactions on a state by state basis.

Appendix

FSS2020 and Mortgage Finance

The FSS2020 program listed the obstacles to the development of mortgage finance in Nigeria -

> **Absence of clear property and security rights:** The Land Use Act governs all land transactions in Nigeria. Property rights depend on fulfilling usage and other conditions set by state governments and local authorities. In addition, the state governor may revoke title to a piece of land for any number of reasons. While this power of revocation is not absolute, it creates legal uncertainty about property security when lending.
>
> **Mandatory Governor's Consent:** The Land Use Act also requires the prior consent of the State Governor for any land transaction in that state to be considered valid. As it takes anywhere from 6 months to 2 years to secure this consent, this requirement has impeded mortgage lending and the development of the mortgage market.
>
> **Inefficient Land Management System:** The land registry system in most states is paper-based and manually maintained. Processing transactions for existing or potential landowners is hampered by bureaucracy and several bottlenecks. In addition, because cases where there are multiple *original* certificates of occupancy are not uncommon, it is often difficult to ascertain the true ownership of land, and this has also stunted the growth of the mortgage sector.
>
> **Lengthy, rigid and ineffective foreclosure procedures:** In the event of default, it is often difficult and costly to foreclose on the pledged property. There is currently no legal framework for foreclosure procedures thereby resulting in willful default as people take advantage of the slow and costly judicial process to stall the exercise of mortgage security rights.
>
> **High costs of property transactions:** State governments are legally empowered to charge fees/taxes for granting consent for property transactions. Over the years these fees/taxes, which are typically a percentage of the value of the property being exchanged, have increased significantly. In addition to increasing overall costs, this has also provided a disincentive to perfect property titles.
>
> **Sources of Cheap Long Term Funding:** Funding to support mortgages have been largely unavailable because of the short-term maturity structure of deposits in the banking system and the relatively underdeveloped state of the capital market. There was a paucity of financially strong long-term institutional investors like pension funds and insurance companies who traditionally provide long term funds. Coupled with the high cost of houses in Nigeria, the current mortgage interest rates of 17 per cent – 18 per cent put mortgages beyond the reach of all but the wealthy. However, with the recent reforms in the financial sector, long-term funds are becoming increasingly available and mortgage rates are expected to start falling soon.
>
> **Structure of Housing Delivery:** Over 80 per cent of urban housing in Nigeria is built by individuals from their savings. However, majority of home builders hardly use professionals to design and build their homes. Coupled with the weak and ineffective statutory verification and certification processes, the resulting structures are of poor quality and also violate building codes. The current structure of housing delivery therefore does not permit for a co-ordinated process to deliver a guarantee of quality and value of collateral on the scale required to drive the mortgage market."

The report then set out strategic objectives and initiatives which are reproduced below.

Establish a safe and profitable mortgage market in Nigeria by setting up appropriate infrastructure/institutions and re-modeling existing ones.

- Convert State Housing Corporations into land companies with a mandate to develop new geographic areas in each state.
- Develop and introduce new certification processes and building codes for the delivery of private housing to make them 'mortgage ready'.
- Introduce registration for real estate developers/Trade Associations by the governments (Federal & State) to manage distribution of incentive and support programs.
- Restructure and empower Federal Housing Authority (FHA) to commence management of Federal government guarantees, insurance, incentives and subsidies to facilitate development of mortgages.
- Amend regulations to permit Pension Funds to lend wholesale to PMI's and banks for onward retail lending to buyers of specific large scale housing development projects.

Introduce a new framework to strengthen property and security rights

- Amend or revoke the Land Use Act.
- Remove the requirement for governor's consent on land transactions in the Land Use Act.
- Remove arrangements for foreclosure proceedings on real estate from general common law provisions.
- Establish specialized courts/tribunals that will fix the grounds and timing of challenges/contestations of foreclosure.
- Commence the automation and eventual integration of all records and processes of Local, State and Federal Government land.
- Reduce statutory cost structure of all land transactions.

Provide affordable and long-term mortgages to all classes of Nigerians

- Convert existing NHF to a Second Tier Institution (STI) focused on providing liquidity to primary lenders and also promoting the emergence of a secondary market.
- Develop and roll-out framework to enable the Central Bank swap mortgage asset of DMBs with treasury bills and also weigh mortgage asset for liquidity reserve requirement.
- Develop and roll-out incentive framework (Tax concessions, Matching contributions etc.) to encourage institutions (Banks, Insurance Companies, Government) contribute to the Second Tier National Housing Fund as contained in the existing laws.
- Encourage the creation of additional Second Tier Institutions that will also serve as conduits for mortgages originated by PMIs (To enhance competition).
- Restructure and convert existing NHF levy for salaried workers to operate as a mandatory savings scheme to be held with re-capitalized PMIs.
- Recapitalize and refocus scope of operations of PMIs.
- Review existing asset allocation framework of Pension funds to channel greater funding to mortgages.

Enhance the use of market mechanisms to improve housing delivery system

- Encourage financiers to focus on providing end-to-end funding for real estate developments.
- Develop and introduce incentives to encourage private sector market specialization at different housing tiers and income levels.

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