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Re-Structuring of Real Estate Investment Ventures in a Dwindling Economy in Nigeria

By

MICHAEL KALU OKORO
Department of Estate Management and Valuation,
Akanu Ibiam Federal Polytechnic, Unwana,
Ebonyi State.

IDUMA AKA IBIAM
Department of Estate Management and Valuation,
Akanu Ibiam Federal Polytechnic, Unwana,
Ebonyi State.

And

AGARA OKPAN
Department of Quantity Surveying,
Akanu Ibiam Federal Polytechnic, Unwana,
Ebonyi State.

Abstract

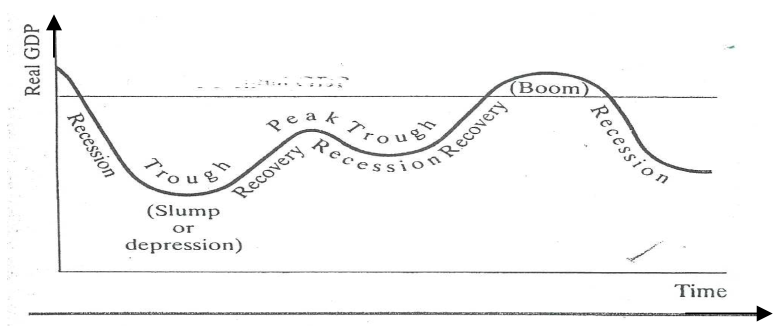
Real Estate investment is one of the investment options and media open to potential investors in Nigeria and other parts of the world. Investment in real estate is capital-driven and as such requires good planning and cautious execution so as to meet the target and objectives of such investment despite any investment climate (Ozigbo, 2011 and Wogu & Anya-Igwe 2011). The realization of the long term and overall purposes of real estate investment is the function of good management. An investment can only stand the test of time if it is properly managed. A good colossal economic loss results whenever there is failure of real estate investment. This paper is made to articulate various mechanisms and strategies put in place by real estate investor(s) during dwindling economy/recession and seasons of crunch, depression and slumps. It highlighted hindrances inherent in real estate investment in Nigeria. It concluded by recommending different ways by which real estate investment can survive during the periods of depression, recession, slump and dwindling economy in Nigeria.

Investment in capital equipment provides capacity for future production. Its expected profitability depends on expected future market conditions. Generally speaking, expectations of all investment ventures are uncertain at the best of times and may occasionally be influenced by waves of optimism or pessimism that sweep over the trading community (Libsey, 1989).

A dwindling economy or recession period is defined as a sustained fall in the level of economic activity. Demand falls off, and as a result production and employment fall. As employment falls, so do household's incomes; falling incomes causes demand to fall further. Profits drop and more and more firms get into difficulties. Investments that looked profitable on the expectation of continually rising demand suddenly appear unprofitable, and investment is reduced to a low level. It may not even be worth replacing capital goods as they wear out because much existing capacity is unused (Ozigbo, 2011, Libsey 1989).

Real estate investment in Nigeria during a dwindling economic recession can summarily be described in what Mc Vick (2009) described in what he termed the 3Bs – Bumps, Bonds and Bombs. He noted that "Bumps" depicts the initial apprehension one is bound to entertain at the very time the idea to invest is conceived even at the mental realm and this is driven by the ordinary knowledge and awareness of the facts and factors associated with the proposed investment environment. In his words, suppressing fear is surviving halfway. The second one, 'Bonds' represents the various regulations, guidelines, rules, policies, benchmarks and their likes which ordinarily speaking, are usual, since there should expectedly be a referee for the purposes of effecting checks and balances. Then "Bombs" according to him refers to the great unknown the unpredictable, sometimes referred to as the Nigerian factor. It could land by way of a bombshell, a directionless and merciless blow, an attack by way of policy somersault, a sharp plunge in monetary value, citizen/labour unrest, political upheaval, militant restiveness, faceless hostage-taking and such other jotting devastations.

Figure 1: Economic Depression Displaying Dwindling Economy



- **Real Estate Investment in Nigeria:** Real estate investment like every other investment type involves the commitment of resources in property based on capital analysis of expected risks with expectation of realizing profit either immediately or more often over an extended period (Nwanekezie, 1996) To Hemuka (2013), Sharp, Alexander & Bauley (1999), Ogbuefi (2002) described real estate investment as investments in landed properties (real estate). Ratcliff (1978, Kalu (2003) and Igboko (2002) classified real estate Investments as follows

- **Commercial Properties**
  - Offices, tourism and entertainment
  - Shops and stores
  - Warehouses
  - Parking lots
  - Petrol Filling Stations etc
- **Residential Properties**
  - Private Homes
  - Apartment flats
  - Duplexies
  - Detached Houses etc
- **Industrial Investment**
  - Factories
  - Storage
  - Cottage
  - Light Industries
  - Heavy Industries
  - Service Industries etc.

- **Recreational Investment**
  - Gymnasium
  - Parks and Gardens
  - Sea-side Resort
  - Swimming Pools
  - Sames Reserves
  - Stadia etc

Others include public property investment, Religious Property Investment. However, real estate investment is associated with risks which according to Kalu (2005), Ibenta (2005), Baum and Crosby (1998) includes

- Tenant Risk
- Market Risk
- Structural Risk
- Taxation Risk
- Planning Risk
- Legislative Risk

- Legal Risk
- Currency Risk
- Management Risk

Tenant Risk: This is the chance that the tenant will affect return by his action such as default in payment of his rent as at when due, refusal to perform other related obligation as contained in the lease agreement. These may significantly impact on the performance of property or real estate investment.

Market Risk: This could also be referred to as business risk. It reflects the possible unsuccessful operation of the particular project and this is determined by the type of project, its management and the particular market in which the product is located. All these affect the expected operating cash flow from the project.

Structural Risk: This is the risk emanating as a result of high repairs, high maintenance costs or refurbishment becoming necessary, either through structural failure or economic functional obsolescence.

Taxation Risk: Taxation risk involves the chance of imposing new taxes or the alteration of existing one. Such taxes that affect real estate investments are property rates, Capital Gain Tax (CGT), Estate Duty (ED), Withholding Tax (WHT) on property rent etc.

Planning Risk: This is the risk that the central or local government planning policies (including transport policy, regional policy, energy policy etc) impinge negatively or positively upon property investment values.

Legislative/Political Risk: This arises from the non predictability of political forces which affect investment outcomes. For instances policies like nationalization, indigenization, privatization etc. could cause decline in the return on investment.

Legal Risk: This kind of risk deals with the possibility that the title to a property is unsatisfactory or that it is encumbered, thus affecting the value. The nature of discovery, whether the property is marketable or not, will result in anticipated gains or losses, and this represents risk.

Currency Risk: This is the risk that income and capital values may be affected by movements in exchange rates irrespective of the performance of an individual investment in its national currency.

Management Risk: This risk arises from anticipated variations in profit performance which could be as a result of management incompetence.
An investor who is prudent will anticipate the above mentioned risks and plans to minimize their occurency or if possible avoid them completely for high profitability of the investment.

Measures, Mechanisms and Strategies Adopted to Curb with Dwindling Economic Situation

The appearance of dwindling economy, depression and economic melt-down cannot be predicted exactly when it will happen at any given time in any country. Sometimes, it occurs at unexpected time due to some volatile environmental economic factors. It could be a global, local and sectional issue depending on the geographical coverage.

In this direction, real estate investors must be prepared to tackle its effects when it comes by putting a hedge over their investment portfolios during this devastating period of economic depression. However, a good number of measures. Mechanisms and strategies have been articulated by eminent scholars that when adopted will cussion the negative effects on their investment. Some of these measures and strategies include but not limited to the following:

- Pre-Investment Appraisal
- Cash Flow Analysis
- Forecast
- Portfolio Diversification
- Risk Management and Minimization
- Performance Measurement etc.

Pre-Investment Appraisal: This concept is very crucial in real estate investment. The investor, in the first instance must determine whether the proposed investment is going to be feasible (can it be carried out within the legal frame work or other considerations) and viable (would there be demand / market for the product of the investment) (Ogbuefi, 2002 and Hemuka, 2013). Valid decision at this stage will guide the investment even during dwindling economic depression.

Cash Flow Analysis (CFA): It is important for an investor to have an idea of how the cash flow of the proposed venture is going to look like. This transcends specifically to cash inflows and cash outflows. The investor should be able to analyse the effect of tax on his overall cash inflow, the effect of depreciation on the cash outflow etc. (Ogbuefi, 2002) Umeh (1977). More importantly, the investor (Analyst) should be able to understand the different implications of cash flow interpretations and also know when the business is making progressive and positive profit. (See table 1).

Table 1: Showing Cash Flows of a Hypothetical Investment Proposal Over 8 Years Period

Year	0 →	1	2	3	4	5	6	7	8
Cost of machine	N600,000								
Overhauling of machine				N200,000					
Rents		N25,000	N25,000	N25,000	N30,000	N30,000	N36,000	N36,000	
Running costs		N50,000	N50,000	N50,000	N50,000	N50,000	N50,000	N50,000	
Scrap value									N50,000
earnings		N180,000	N280,000	N280,000	N280,000	N200,000	N200,000	N160,000	
Net Return	**N160,000**	**N105,000**	**N205,000**	**N205,000**	**N200,000**	**N120,000**	**N114,000**	**N74,000**	**N50,000**

Net Positive Return **=** Total Cash in Flows – Total Cash outflows
NPPV = N(1,630,000 – 1,157,000)
= N473,000.00

The interpretation of the above analysis (table 1) indicates profitability of the investment. The investor will always have an eye at the cash flow movement of his venture at all times to know if the business is making it or not especially during dwindling economy.

- **Forecast:-** This is essentially a future projection of events based on the analysis of collected, and collated information. It involves delving into the past, examining the present and projecting the future (Granger, 1989 and Ogbuefi, 2002 and Umeh 1979). A real estate investor should have a sound knowledge of forecasting and all its technicalities to be able to run his/her business at all times including dwindling (economic depression) economic situations. The real estate investor(s) who intend(s) to execute discretionary forecasting must be fully aware of the factors that condition the operations of the market and be able to know how to isolate most of them as to give way for profitable venture of his/her investment. His predictions will also specify turbulent business times ahead and he will be prepared to face it squarely when it comes.

- **Portfolio Diversification:** Efficient diversification of investment according to Markowitz (1959) has to do with the assembling of investments such as shares, bond, stock, real estate, precious metals to build a portfolio such that risks associated with such investments will be reduced drastically. Ezeano (2013) defined a portfolio as a combination of different investment assets mixed and matched for the purpose of achieving an investor's goal(s). Specifically speaking, portfolio diversification in real estate investment could mean spreading investment properties wisely so that if one sector is affected by economic depression, the other sectors not affected will sustain the business. These investment properties include commercial, residential, industrial, recreational, agricultural etc (Ozigbo, 2011). These investment properties must be meticulously and wisely selected for the purpose of waging war against unforeseen economic depression in the country.

- **Risk Management and Minimization:** Risk may be defined as a variance and in more specific terms being concerned with the possibility that the actual outcome may be something other than expected. In other words, it can be viewed as the possibility of difference between the actual and the expected income flows (Kalu, 2001).

Real estate investment is saddled with such risk as tenant, market structural taxation, legal and planning risks etc. which an investor in real estate must fight against for favourable financial returns from investment. There is a generally accepted belief that risk should be managed and minimized since it cannot be completely and totally ruled out of any venture. Udechukwu (2006) and Eze (2005) carefully articulated strategies of curbing and minimizing risks associated with real estate investment vis-à-vis:

- **Sound Maintenance:**
  - Simplicity in design and layout
  - Forward planning
  - Elasticity
  - Preservation of homogencity
  - Preservation of use balance.

The above mentioned scheme, if instituted by an investor will aid investment properties to continue its ‘rent’ generation all year round not minding dwindling economy and economic meltdown prevalent in the country at any given point in time.

- **Performance Measurement:** In a dwindling economic period, it is crucial to determine the progress of the investment. Performance measurement appraises the performance of the investment after it has been set up and gone into operation in order to determine its direction and degree of performance in relation to the targeted objectives. It is a form of investment appraisal used to monitor the current state of an investment, and if necessary ensure future improvement. According to Ogbuefi (2002) and Kalu (2007), sound investment strategy demands that investment performance measurement should be made on a regular basis to ascertain when dwindling economic situation has set in. Performance measurement allows resources managers to check progress and to confirm results. If the expected results are not achieved, adjustment will be made as required

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Hindrances to Investment in Real Estate in Nigeria

Real Estate Investment in Nigeria is hindered by so many factors but the following factors are highlighted here:

- **Provision of Land Use Act**: Particularly as regards alienation, expropriation and compensation, does not help matters. The real Estate investor is a prudent and rational businessman and as such will always desire the liquidity of his investment. In some advanced countries such as USA, Britain etc real estate is treated as a liquid asset, thus transactions on it flow quite freely, easily, and simply. This is not obtainable in Nigeria.

- **Law and Policy Inconsistency**: This has continued to deal deadly blows on real estate venturing. In some cases, legislations and regulations conflict and the investor is pitiably left at the receiving end. It has been observed that we have quite enough housing related legislations and policies here in Nigeria what we clearly lack is enforcement. Nigeria will be a viable place to do business if we overcome the spirit of selfishness, vested interest and mundane pursuit.

- **No Real Estate Sector can Actually excel without a well developed mortgage system**: Real estate investment can be described as capital intensive venture and equity capital alone cannot be adequate to execute it. There is the need to establish functional mortgage institutions where potential investors can source and borrow money for investment purposes.

- **Instability in Virtually every sector of our polity has hunted us to an unfortunate extent:** Nigeria politicians are empires unto themselves. It is difficult to believe that they have any positive stake in this country. Our banks are steadily passing through one form of storms or another with the usual consequences of illiquidity and failure. Nigeria has had a nasty business experience ranging from stock crash, poor Naira value / Monetary devaluation and exchange rate, inferiority, rising interest/lending rates, high cost of building materials and soaring inflation, insecurity all over the place, corruption etc. All these aforementioned have greatly affected real estate investment in Nigeria, **-** the Giant of Africa continent.

Conclusion

It has become very important to stress and emphasize the appearance of business down turn at any given point in time while doing business. The investor bearing in mind of this variance of expected occurrence should get prepared to hedge against any business turbulence whether, economic meltdown, economic depression, economic slump, recession, dwindling economy etc. so that his business/investment will remain a float. The need for an integrated effort to monitor, evaluate and measure the performance of the investment become relevant as to be able to ascertain the direction of the venture.

More importantly, the identified risks inherent in real estate investment should be isolated, managed and minimized by instituted strategies as to be able to achieve the expected economic returns of the investor at all time of the business cycle.

Recommendations

The following recommendations are therefore prescribed in order for real estate investment to thrive in a dwindling economy such as Nigeria's business environment:

1. There is the need to carry out feasibility and viability appraisal as to determine the whorthwhileness of the venture. This initial and preliminary stage is very crucial in real estate investment.
2. Fiscal and monetary policies that will address the issue of Naira to Dollar exchange rate downwards to two digit number should be formulated by the Central Bank of Nigeria. This done, will make real estate venture to thrive even in dwindling economy.
3. The high cost of building material and labour should be checked by the Federal Government as to make real estate venture viable and feasible.
4. The traditional land tenurial system on the southern parts of Nigeria should be discouraged to enable investors acquire land easily for development.
5. The Federal Government needs to rejuvenate and re-establish functional mortgage banks. This will enable the investors to borrow money since equity capital hardly becomes enough for the execution of property projects.
6. Risks inherent in the venture should be identified and strategies to reduce, manage and minimize same adopted by investors for realization of investment returns.
7. Providing the enabling environment to do business in Nigeria by the Federal Government becomes an important issue to tackle ie issues on security in all parts of the country.
8. Cash flow Analysis should be well articulated as to have clear insight of cash inflows and cash outflows direction even during dwindling economic periods.
9. Investment predictions and forecasting should be encouraged perhaps to determine in advance the performance of the proposed venture in future.
10. Portfolio Management should be put in place for appropriate selection among investment assets for diversification as to hedge against unfavourable and volatile economic predicament.

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