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Mortgage Financing in Nigeria; Issues and Challenges

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ABSTRACT

Mortgage financing refers to the process property purchasers realize funds to buy real estate. Some procure loans from the bank or from other financial institutions. This article examines different housing polices in Nigeria, illuminates the Mortgage financing Industry and highlights their objectives with a view to identify the issues and challenges impeding mortgage financing in Nigeria while identifying solutions. The study found that poor awareness about existing mortgage financing programs and arrangements, low financing capacity of the mortgage institutions and inefficient title/legal framework among others remain the major impediments to the growth of the sector. It recommended that introduction of innovative sources of financing for mortgage institutions, execution of the revised PMB guidelines, reformation of title/legal documentation structure and an active involvement of the private sector (including cooperative and credit unions) would encourage the optimal performance of the sector and boost the housing economy.

Keywords: *Mortgage Financing; Nigeria; Mortgage Market*

Introduction

A mortgage is a loan provided by a mortgage lender or a bank that enables an individual to purchase a home (Corporate Finance Institute, 2020), but are not limited to houses. In the Longman Business Dictionary, Mortgage finance is the funding or finance for individuals and companies to buy property. Common sources are Banks, mortgage brokers and federal credit agencies. However, a larger percentage of potential real estate owners do not take advantage of these resources.

Independent mortgage financing seems far-fetched to the greater Nigerian population. The required capital for housing construction or the acquisition of real estate property requires substantial amounts of capital often beyond the financial capacity of middle and low income earners. According to the National Bureau of Statistics (2020), More than 82 million Nigerians live on less than $1 a day. That is to say, forty percent of Nigerians cannot afford decent housing. The challenge of housing, both qualitative and quantitative, has always been an existing national issue, even before the 1960's and our nation's Independence. If housing- a basic need of man, cannot be easily achieved solely, how much more the accumulation of property, hence the need for external financial aid in the general housing sector. One of such examples is the bank.

Banks are the first port of call in the financing of real estate through mortgage loans. They give out loans for the acquisition of existing buildings or the purchase of land for development. They finance construction projects, they lend to Individuals, groups and they finance real estate companies. In the USA, residential constructions are largely dependent on mortgage loans. Almost all family housing of one to four in USA are purchased with the aid of mortgage loans (Herzog and Earley, 1970) causing an expansive growth in the real estate and housing sector in America.

In procuring mortgage financing, a legal agreement is drawn up between the two parties. Also, in most cases, loan recovery strategies are put in place by lending institutions to guard against the breach of agreement. Taking a measure of precaution, properties are mortgaged and the financial institutions (lender) enjoys the collateral or lien (legal claim on borrower's property) to keep or sell the property as security for the debt (Microsoft Encarta Dictionary, (2009, DVD). Nwankwo (2014) views the mortgage financing model as a catholicon to remedy housing related challenges in Nigeria. In agreement with the very well-known Abraham Maslow's hierarchy of needs hypothesis, on the position of housing, the government of Nigeria created the National Housing Fund (NHF) Scheme in 1991. In order to increase the efficiency of this financing model, the Primary Mortgage Institution (PMI) was established so as to extend the liquidity of the housing business (Acha, 2007).

The problem associated with accessing mortgage financing by the Nigerian citizenry is the main objective of this work. It has often been pointed out to be one of the most difficult hurdles in the development of the housing sector. The housing sector occupies a largely significant position of influence in a country's welfare as it notably impacts not only the welfare of the Nigerian population but also the absolute performance of other sectors of the country's economy. While the government and other statutory bodies have designed programs of assistance in finance, their impact are yet to be felt.

Asabere, McGowan and Sang (2014) espouses the importance to promote mortgage markets in Africa, while mortgage markets are slowly emerging in many African countries, substantial barriers still hinder their growth and expansion. A recent study based on Kenya by the World Bank enumerated some major constraints including: lack of affordability; lack of information necessary for risk assessment; absence of long-term funding; and title insecurities. It is against this anchorage that this current article examines the issues compounding mortgage financing in Nigeria.

Mortgage Financing Issues

Mortgage financing in Nigeria refers to the access of funds by individuals, firms and business enterprises for mortgage in Nigeria. These services are mostly utilized by new home owners, real estate firms and expanding businesses. In Nigeria, Individuals can access the needed finance by either procuring a loan from financial institutions capable of lending or from existing schemes elaborated below. These institutions lease the required funds necessary for the intended mortgage if the project and borrowing individual meets laid down requirements. A greater majority of the mortgage financers are Primary Mortgage Institutions.

A Primary Mortgage Institution (PMI) is a licensed company engaging in the mortgage business. They carry out activities which include granting loans and advances to people for building, improvement, renovation and extension of a habitations and commercial infrastructure, and the purchase of a dwelling or commercial house amongst others (Guidelines for PMI and OFID, 2003: 1). It could be locally owned, privately owned or a corporation. This establishment is a lender of money to potential homeowners who in turn utilize the acquired loan to purchase a house, paying back the loan in monthly installments to the mortgage establishment. There are other institutions such as this that provide financial aid for real estate owners. They include:

Credit Policies, Insurance Companies Funds, Specialized Institutions, State/Municipal Government Financing, The Federal Mortgage Bank of Nigeria, Primary Mortgage Institutions, The Federal Mortgage Finance Limited, National Housing Fund (NHF), Voluntary schemes, Compulsory schemes, Financial transfers and Government budgetary allocation.

Mortgage Financing Models

Over time, different mortgage financing models have been identified. The common types include:

Bundled Mortgage Finance System: Under a bundled mortgage finance system, a single actor/player performs roles in the mortgage process, acting as the loan originator, lender services provider and the risk manager, among others. As a sole investor, the portfolio lender has deposits as his major source of funding. The sole investor creates a close and long-term relationship with his clients. This gives him the opportunity to enter into transactions in other financial products. This model of mortgage financing however is characterized by liquidity and interest rates risks, as borrowers often expect long-term funding, but depository funds are traditionally short-term. The single-entity lender in this system makes efficiency and expertise, which are valid in any credit system, very difficult to achieve.

Unbundled Mortgage Finance System: All the market players in this system play different roles in the execution of a mortgage process in contrast to the arrangements under the bundled mortgage finance system. Here, the borrower goes through a mortgage banker to source funds from investors, other depositories and the secondary market. The key benefit of this system is the assurance of specialization. Every loan goes through the necessary due diligence of underwriting, marketing, packaging, and risk management, among others. This procedure minimizes cost and promotes market discipline. However, where many entities/players are involved, there is the tendency for bureaucratic delays, which could add to cost as well.

Depository-Based Mortgage Finance: The depository-based mortgage finance is a system where deposit money banks enter into mortgage lending. This system became popular in Nigeria after the recapitalization of the depository institutions in 2005. Banks with excess liquidity began to consider setting up mortgage desks in their branches. Others went further to diversify by adding mortgage banking to their investment portfolios. The major challenge with depository-based mortgage finance has to do with mismatch of tenor and interest offered. Whereas depository institutions (money market) offer short-term loans, mortgage loans are traditionally longterm, with maturities ranging to 30 years. In Nigeria, the depository institutions currently offer mortgage facilities at interest regimes between 14 and 28 per cent. This is relatively high when compared with what obtains in the secondary market based system.

Secondary Market Based Mortgage Finance System: The secondary market-based mortgage finance system is so far believed to be the system that best suits the long-term liquidity needs of the housing market. The market is regarded as an organized system that involves loan origination, ware-housing, securitization and sale to investors. Funds realized from sale of mortgages are ploughed back into the system to create more mortgages, thereby deepening the system and increasing the housing stock in the economy. The secondary market system begins with the borrower, who takes a decision to access a mortgage loan and approaches a mortgage institution (primary market) to express his intention. The mortgage firm determines the loan affordability, based on the borrower's disclosures and standardized underwriting criteria. On determining the affordability of the borrower, the loan is granted. This and other mortgages of similar characteristics are brought together, purchased from the originators by a Special Purpose Vehicle (SPV) or issuer, warehoused and later securitized for onward sales to investors as mortgage backed securities (MBS). The funds obtained from sales are ploughed back into the mortgages. This cash flow sustains and promotes home ownership and delivery by ensuring constant liquidity in the system. Interest and principal payable to investors are expected to be funded from mortgage loan repayments of borrowers.

Mortgage Financing Types

There are various types of mortgage in use in the mortgage market. They include but are not limited to;

1. **Fifteen-year fixed rate mortgage**

The fifteen-year fixed-rate mortgage has an interest rate that remains the same over its fifteen-year term. Often used for refinancing. Interest rate is set for the life of the loan. It has lower interest rate than with longer term loans and higher monthly payment than with 30-year loans, with less total interest paid. Refinancers and home buyers who want to build equity and pay off the loan faster usually go for this option. Payments are stable and predictable as the interest rate remains the same. Total interest payments are lesser because interest is paid for fewer years by borrower.

2. **Adjustable-rate mortgage**

An adjustable-rate mortgage is a loan with an initial rate fixed for a specified period with rate adjusting afterwards periodically. For example, a 6/1 ARM has an interest rate that is set for the first six years and then adjusts annually. The pros of adjustable-rate mortgages; Initial "teaser rate" is lower than on most other loans, giving comparatively lower monthly payments at first. Initial rates can often be locked for one, five, seven or ten years.

3. **FHA mortgage**

An FHA mortgage is a home loan insured by the Federal Housing Administration. FHA loans are backed by the government and designed to help borrowers of more modest means buy a home. FHA mortgages allow down payments as low as 3.5%. Also, mortgage insurance premium payments are required.

4. **VA mortgage**

VA loans are mortgages backed by the Department of Veterans Affairs and are available to military service members and veterans. No down payment is required, upfront VA funding fee is required but there is no mortgage insurance.

5. **DA mortgage**

DA home loans are mortgages backed or issued by the Department of Agriculture.

Most properties do not require down payment. Facility improvement loans and grants are also available.

Income limits and property value caps apply.

6**. Jumbo mortgage**

Jumbo mortgages are home loans above a certain threshold sum. Jumbo loan limits differ and are adjusted from time to time. They can have a flat or an adjustable rate. Jumbo mortgages usually require a 10% down payment or more.

7. **Interest-only mortgage**

An interest-only mortgage only requires payments on the lender's interest fee. The principal or loan balance, is not reduced for the duration of the interest-only payment period.

Can be appropriate for borrowers who are disciplined enough to make periodic principal payments.

It is useful to home buyers who do not anticipate remaining in a house for the long term.

Substantial assets or a proven ability to pay is often required.

Major Challenges of Mortgage Financing in Nigeria

Poor Awareness about Existing Mortgage Financing Programs and Arrangements: Available data on the implementation of the National Housing Trust Fund over the years indicate that the people who take up mortgages are mostly public servants and those in formal employment. This is, perhaps, because they make monthly contributions to the National Housing Trust Fund and are thus more aware than their private sector or self-employed counterparts. These will further impact on the level of participation in the Fund. Furthermore, state by state analysis indicates that those in the city and urban areas are more likely to show interest in homeownership than their country-side counterparts. There is, therefore, the need to undertake advocacy among the rural dwellers on the existence and benefits of mortgage facilities and how to access them.

Low Financing Capacity of the Mortgage Institutions: There is firm evidence that the PMBs do not have sufficient funds to finance or support home ownership in Nigeria. As a result, property sales in Nigeria are usually on a "cash and carry" basis. Other reasons that have been adduced are the relatively low income-earning capacity, which constrains both savings and the ability to meet the loan re-payment terms and conditions required to secure a mortgage. Anecdotal research evidence indicated that, in the Federal Capital Territory, for instance, annual rental payments for a 2-bedroom residential accommodation are in the range of N400,000 - N500,000 in the suburbs and N1million - N1.5million in the City. This makes it almost impossible for the average worker to be considered for a commercial bank mortgage loan, since such a client is more concerned about meeting and providing for the other basic needs of life.

High Interest Rates Charged By Domestic Financial Institutions: The prevailing high interest rate on mortgage loans granted by commercial banks acts as a disincentive and makes them unattractive. Where such loans are taken, servicing them becomes financially burdensome and unbearable for the borrowers. Furthermore, it has been observed that commercial banks often tout commercial loans as mortgage loans which are granted at high interest rates and tenors of not more than two years. For instance, commercial and mortgage interest rates in Nigeria are in the range of 17-24 per cent, compared to 3-5 percent in most developed economies, making mortgage affordability almost impossible for low- and middle-income earners in the Country. As a result, most Nigerians would opt for drawdown of personal savings, family contributions, government subsidy on public sector houses, and funds derived from sale of previous houses than approach a bank for a mortgage loan

Inefficient Title/Legal Framework: In its 2012 Doing Business Report, the World Bank ranked Nigeria as 180th in a pool of 183 economies on the ease of registering a property. According to the statistics, it takes, on the average, 1.6 years to obtain title documents in Nigeria, owing to the encumbrances of seeking for Governor's consent, and registration of title documents. Local studies have indicated that the processing time varies across regions and could take as long as 3 years in some regions of the Country. The factors responsible for such delays include bureaucratic bottlenecks (arising from delays from the time of submission of an application and when it is approved) and corruption evidenced in the form of private financial charges imposed by staff of land registries on people trying to perfect their title documents when applying for Governor's consent. These bottlenecks limit the possibility of using the land or property in question as collateral for mortgage. If mortgage lenders cannot exercise their right to collateral, mortgage lending will be constrained. According to a 2008 World Bank Study, the cost of registering a mortgage and transferring title documents in Nigeria is estimated at 19 per cent of the property value, compared to 0.04 and 0.08 per cent in Canada and New Zealand, respectively. To alleviate these delays associated with property titles, some Governors had begun to authorize their State Commissioners of Land to sign the Certificates of Occupancy and Governor's consent. However, the situation seems not to have improved significantly as indicated by the 2012 Doing Business Report of the World Bank.

Low Interest Rate on National Housing Fund: The low interest rate level stipulated by law on investment on NHF makes the banks and insurance companies reluctant to invest in the Fund especially, as there are some more profitable investment avenues.

Low Level of Participation in the NHF: The number of contributors to the NHF has been relatively small compared with the national work force. There are about 9 million workers who are yet to be registered and are therefore not making any contributions. There are also alleged cases of diversion of workers contributions to the fund by employers to other investment purposes.

Macroeconomic Environment: The high inflation rate negatively affected the macroeconomic environment. There is need to continue to keep the rate of inflation moderate as high inflation rate and structural bottlenecks in the economy do not encourage contribution toward the fund.

Non-Vibrancy of some PMIs: The redirection of focus by some PMIs in favor of non-core activities such as trading as well as the slow disbursement of NHF to the PMIs, resulted in the competition with the banks in fund sourcing for purposes other than mortgage financing.

Cumbersome Legal Regulatory Framework for Land Acquisition: The existence of a burdensome process of title documentation of land ownership reinforced by inadequate cadastral system makes mortgage financing complicated. This has been seen as one of the factors responsible for slow disbursement of NHF.

The Structure of Bank Deposit Liabilities: This is preponderantly short term; therefore, the deposit money banks tend to avoid fund mismatch i.e. borrowing short but lending long, which is required in mortgage financing. The key issue that emerges therefore revolves around how to ensure adequate long-term lending by financial institutions rather than the current short-term lending practice. This requires significant intermediation 17 efforts, especially, since housing finance is very sensitive to inflationary environment. Another related issue is the inability of the financial institutions to mobilize resources effectively for low-income housing.

Conclusion

The challenges in the area of mortgage financing in Nigeria has affected both the housing system and the mortgage business. However, they can be remedied. Introduction of innovative sources of financing for mortgage institutions, execution of the revised PMB guidelines, reformation of title/legal documentation structure and an active contribution of the private sector (including cooperative and credit unions) would abate these problems and encourage both individuals and lending firms promote the mortgage market.