



Enhancing Real Property Investment Ventures for Profit Sustainability and Realization of Expected Returns in Nigeria

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Abstract: Real estate investment is one of the investment options available to investors. The goal of most investors is to maximize return and minimize risk and to ensure that such returns are sustained. Real estate investment is associated with all types of risks and it is usually difficult to predict with precision the future rate of return in view of these risks. This paper is set to examine how real estate investment venture should be carried out to optimize returns and to sustain such returns with a minimal risk. It highlights various steps adopted to enhance and ensure positive returns and profitability. It also exposes impediments and challenges associated with real property investment. It highlights the role of estate surveyors and valuers in ensuring that real estate investments expected returns and profitability are achieved for economic empowerment of Nigerians. The paper concludes by recommending way forward – initial project appraisal, efficient property and portfolio management, valid title document etc to surmount these problems as to enhance high returns and profitability in real estate investment.

Keywords: Enhancing, real estate, investment, sustainability, profitability, expected returns.

1. Introduction

Investment in a general sense can be seen as parting with present capital in return for future income. Real estate investment is a peculiar medium of investment with complex and clearly distinguishable characteristics different from financial investments (Ogbuefi, 2002 and Kalu, 2011). For some odd and yet unexplained reasons this broad classification of investment (real estate and financial investments) has become common place in spite of the fact that real estate investment involves the use of finance. Perhaps those peculiar characteristics of real estate account for the classification. Not until recently, analysis of real estate investment was not scrutinized in terms of performance as done in financial investments. While all the investors cared for was the returns and capital appreciation. The (investors) paid little or no time attention to those risks which affect the real estate performance negatively, and this, in no small measure did not allow the expected returns to be realized.

Essentially, the primary purpose of real estate investment is the future income or profit. The profit or income an investor expects according to Ogbuefi (2002), can take two basis forms:

- i. income earned in the form of interest, dividends or rents from investment.
- ii. profit realized from appreciation in value especially when the investment is mortgaged, leased or sold for more than the original cost of investment.

However, special attention ought to be given to risk factors which affect the maximization of profit negatively.

Messner (1984) categorized risk into four broad units, namely purchasing power risk, financial risk, business risk and interest risk. On the other hand Baum and Crossly (1988) enumerated certain sources of risk and Ajayi (1998), dealt extensively on these sources of risk to include tenant risk, sector risk, structural, taxation risk, planning risk, legal risk, and comparative risk, timing risk and holding period risk. Since the utmost goal of an investor is to maximize return and minimize risk, the above risks should be put under strict surveillance and control in order to achieve the expected goal.

2. Procedures for Enhancing Positive Returns and Profitability in Real Property Investment

A project of any kind, be it real estate project must be subjected to certain conditions and precautionary measures if such project is aimed in actualizing its conceptional goal and objectives. A lot of measures abound in this circumstance but most importantly, the following steps are taken to enhance positive return and profitability of real estate investment:

- i. Subjection of the proposed real estate investment to feasibility and viability appraised (Preliminary appraisal).
- ii. Adoption of diversification principles
- iii. Proper maintenance and management of properties.
- iv. Environmental impact assessment (EIA) analysis.
- v. Application of life cycle costing (LCC).

2.1 Pre-Liminary Appraisal:

An investor before parting his money into real estate investment must carry on feasibility and viability appraisal to determine the worthwhileness of the proposed investments. Feasibility study could be regarded as a study to determine if a proposed investment is achievable under a certain specific situation and time within a given location and must be situated within the context of certain economic and non-economic criteria as well as clients objectives. Simply put “feasibility” means ‘possibility’. Is it possible? Can it be done? (Ogbuefi, 2002; Hemuka, 2012; Umeh 1977). In answering this question many factors come into play and many parameters are considered. These are called feasibility indicators – namely Technological Feasibility (TF), Economic Feasibility (EF), Legal feasibility (LF) Financial Feasibility (FF), Physical feasibility (PF) and Socio-Political Feasibility (SPF).

On the other hand, the viability of the proposed investment must be articulated and analysed. Viability looks at necessity and economic desirability. It asks the question “Why”? Why must this be done having regard to other things that can, or should also be done with the same funds. Is it worth while to embark on prestigious projects while the masses suffer from abject poverty and hunger? It provides the basic tools, the basic ingredients in decision making. Viability periscopically examines all the pros and cons, the implications – socially, politically, legally, technologically, physically and socio-politically (viability indicators). Any real estate Investment that fails to pass this litmus test of feasibility and viability appraisal should not be embarked upon otherwise the investor will incur a huge lost at the long run.

2.2 Adoption of Efficient Diversification Principle

The more variance the investor expects in the equity portion of the return generated by the property, the greater the risk associated with receiving the cash flow. Expected returns can be characterized by normal distribution that is when upside and downside fluctuations in return are likely

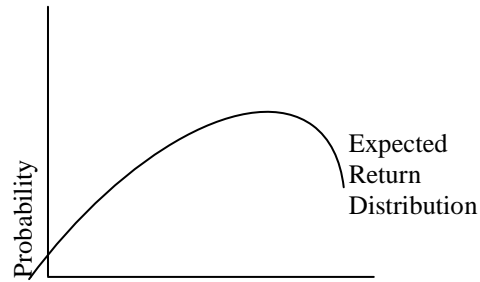


Figure 1: Distribution of Expected Future Returns

Expected return and variance of return can be calculated from historical data using:

$$X = \sum_{t=1}^N \frac{xt}{N}$$

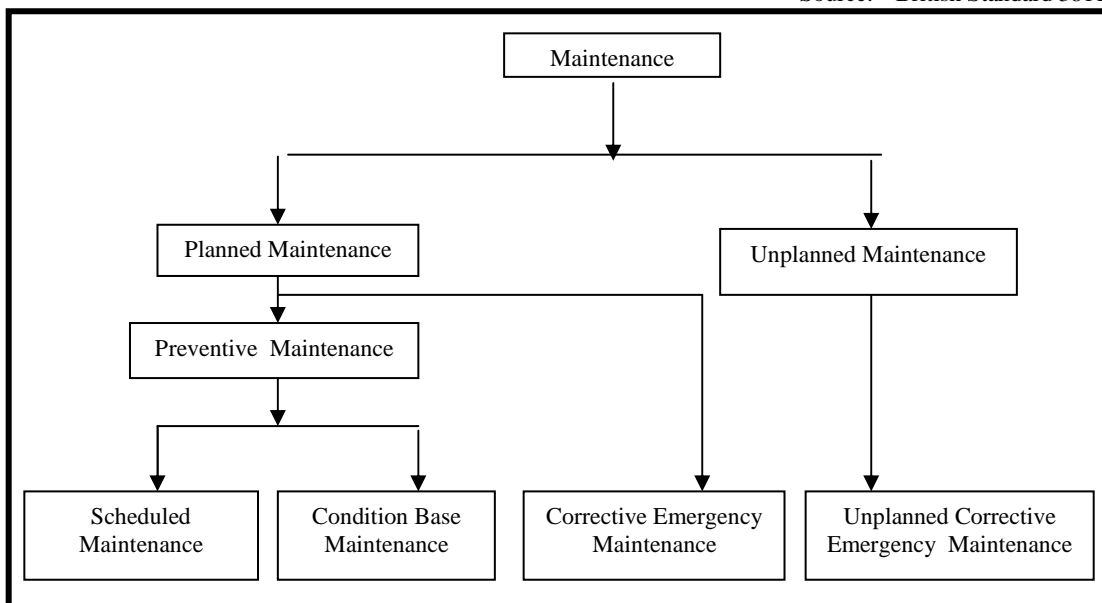
2.3 Regular Maintenance and Management

It is not enough to develop properties for investment purposes - without constituting regular maintenance and management of the investment properties if optimum returns and high profitability is expected to be realized. Maintenance is defined in BS 3811 (1984) as the combination of all technical and associated administrative actions intended to retain an item or restore it to a state which can perform its required function. Nwosu (2005), defines maintenance as a step taken to preserve a building in its initial state so that it continues to serve its purpose and is an essential component in the life cycle of a building. The definition of acceptable standards recognizes three separate categories which serve to illustrate some of the complexities of maintenance:

- i. Functional performance, quality and reliability, which relate to user needs.
- ii. Structural, electrical, fire and other safety aspects, for which maintenance personnel are generally responsible.
- iii. The preservation of the asset and its amenities in which the owner has the primary interest.

Figure 2: Types of Maintenance

Source: British Standard 3811



Expressed in another way, the prime benefits of maintaining a building is to retain the value of the investment, to maintain the building in a condition in which it continues to satisfactorily fulfill its function and to present a good appearance to the public. Maintenance may be planned or unplanned depending on the circumstances. It is planned when work is carried out to prevent failures of facilities or defects observed. Unplanned maintenance is work resulting from unforeseen breakdown or damage due to external forces or causes.

On the other hand, on a broader perspective management is defined as the systematic process of planning, organizing, leading and controlling (land, labour, capital and entrepreneurship) in order to achieve goal(s). It is the act of science of getting things done through people that is the coordinating of all resources through the process of planning, organizing, leading and controlling in order to attain stated objectives (Udechukwu, 2006).

Estate management may be defined as the direction and supervision of an interest in landed property (building) with the aim of securing optimum return. The return need not always be financial but may be in terms of social benefits, status, prestige, political power or some other goals (Thorneroft, 1965).

In this context, property maintenance and management should be carried out simultaneously on a property in order to ensure adequate returns from the investment.

3. Environmental Impact Assessment (EIA) Analysis

Some investors, if not all, neglect to carry out EIA before commencing real estate/property investment. This negligence has sometimes resulted to a huge loss of capital. According to Uchegbu (1998) EIA which involves the analysis of both positive and negative impacts of a project on the environment is a key mechanism for translating the principles of sustainable development into action. It cannot be mistaken to say that it is a tool for decision making along the path of sustainable development. EIA as an environment management tool is the process of evaluating the various aspects of the environmental effects both adverse and beneficial of a proposed development and /or investment, including the identification of measures for ameliorating the adverse effects.

The EIA study usually provides the alternative course of action, hence it qualifies as a management tool. The document is required for major projects affecting the environment by the public authority or its agencies, the host communities and even the financial institutions who may need environmental impact Assessment along with the feasibility and viability report of a project. It is pertinent enough to analyse and evaluate how properties or real estate will be affected on where they are located or sited. If EIA is carried out before commencement of an investment it is possible to envisage possible dangers if any that will besiege

the investment and if such negative impacts are exposed, an investor may not go on with the decision to site his investment on that environment. In articulating the intention to protect the environment EIA Degree No 86 of 1992 was promulgated to actually take care of all environmental vital issues. EIA is simply an integral part of real estate investment and for profitability to be sustained total adherence of EIA is advocated (Udia, 2003).

4. Application of Life Cycle Costing (LCC)

Life cycle costing concept is a concept which relatively attempts to optimize the cost of physical assets (buildings) over their whole life. The choice of buildings is often based solely on original capital cost without regard to subsequent operating costs, maintenance costs or replacement interval (Mott, 1989). The philosophy behind ICC is that it brings together all costs of ownership and operation over the whole life of an asset, using the present value technique. It can therefore be used to evaluate trade-off situations. It is important to realize that the lowest purchase cost is not necessary but the lowest overall cost over the whole life of a building or asset. Higher maintenance costs at a shorter life may outweigh the higher acquisition cost of an alternative choice.

It becomes necessary that prediction for expected Life Cycle Costs (LCC) be critically considered when developing or investing in real estate as to articulate holistically the costs now and expected cost in the future. It is equally of great importance to introduce terotechnological concept at the initial time of proposing to develop properties. This concept according to (Mott, 1989) embraces this idea of life-cycle costing. Terotechnology is defined as a combination of management, financial, engineering and other practices applied to physical assets (buildings) in pursuit of economic life-cycle costs. It is concerned with designing for the reliability and maintainability of physical assets together with economy of their installation, commissioning, operations and eventual disposal.

5. Challenges of Real Estate Investment in Nigeria

The challenges of investing in real estate are multi-lateral in nature and they include but not limited to the following;

- i. Lack of sufficient funds: at present, what seems to be the only affordable finance to real estate investors is the Estate Development Loan (EDL) from the Federal Mortgage Bank of Nigeria (FMBN). The loan is granted for only two years at 10% interest rate and the loan does not finance infrastructural facilities. The risk is that if the loan facility granted by the mortgage bank is not enough to complete the project, it may lead to abandonment of the proposed real Estate development.
- ii. Provisions of Land Use Act (LUA) provisions of LUA particularly as regards alienation, expropriation and compensation are big problem in real estate investment. The real Estate investor is a prudent and rational businessman and as such will always desire the liquidity of his investment. At

most parts of the world, real estate is treated as a liquid asset, thus transactions on it flow quite freely, easily and simply. This is not so in Nigeria.

- iii. Inconsistency of Law and Policy: This has dealt seriously on real estate investment. In some cases, legislations and regulations conflict and the investor is pitifully left at the receiving end. It has been observed and rightly so, that Nigeria has quite enough housing related legislation and policies and the only thing being lacked is enforcement of all these policies. Moreso, a good number of other obsolete legislations still stall real estate investment in Nigeria.
- iv. No real estate sector can actually excel without a well developed mortgage system. It is obvious that our mortgage practice here is unpopular and is almost driving towards extinction. This also affects real estate investment.
- v. Land Acquisition: Most reforms in real estate development do not have positive effect on real estate development, for reforms to have positive effect on real estate development and economic empowerment, the process of land acquisition, registration and transfer need to be addressed to remove the weakness, bottlenecks and cumbersome procedures involved in our current enforcement of planning and building regulations, such as difficulties in obtaining title to land.
- vi. The current high cost of building materials experienced in Nigeria is a big threat to real estate investment.

6. The Role of Estate Surveyor and Valuer in Real Estate Investment in Nigeria

The estate surveyors and valuers have significant roles to play in real Estate investment in Nigeria. The success of this sector depends very much on the competencies of the professional Estate Surveyors and valuers. Their contributions can come through his different roles;

- i. Project Appraiser: The valuer carries out feasibility and viability appraisals to determine whether it is worthwhile to carry out proposed real estate development or not and advises the developer (investor) accordingly.
- ii. Land Acquisition: He is on hand to help the developer or real estate investor to acquire land for the development and carries out such activities as site identification, consolidating of existing interest in land, coordination and preparation of valid lease or conveyance, advice on suitability of the site for the proposed development, ensuring that planning permission is obtained and that the development conforms with both the master plan and all Town Planning Regulations affecting the area.
- iii. Securing Loan for Investment: He knows the best source of financing a particular project e.g bridging finance, short, medium or long term finance. The valuer can arrange how the investor gets access to loan facilities for the proposed venture.

- iv. Project Supervision: He coordinates the activities of the development team if he acts as a project manager on behalf of the client. He assists in planning the network analysis to identify the most suitable critical path network. This helps in taking decision regarding the duration of the project in order to avoid cost and time overrun.
- v. Project Maintenance and Management: The valuer is an expert in project maintenance and management so as to optimize maximum returns and profits from the real estate investment.
- vi. Portfolio Managers: Risks are associated with real estate investment. These risks are best handled by the professional valuer who knows how to combine various stocks of properties to ensure minimization of risks associated with the investment. (Diversification).
- vii. Land Registry: The valuer helps to register various deeds and title documents as required by the law on behalf of investors.
- viii. Certificate of Occupancy (C of O): The valuer helps the investor to process and obtain C of O of his property which will serve as collateral to obtain loan from the bank.
- ix. Adviser to Government and Its Agencies on property Taxes and Rates: The valuer advises the government and its agencies on the negative implications of imposing high taxes on properties. High levels of taxes on properties do not encourage development as most potential real estate investors may be scared to invest into it and this may jeopardize the zeal to invest in this sector.

7. Conclusion

Real estate investment venture if properly guided, taken precautionary measures abinitio will not only optimize high expected returns, but such returns will be sustained all through the like cycle of the investment properties. Full implementation and strict adherence to all the steps recommended will, without doubt, go along way to promoting high returns in investment returns and ensure sustainability of profit.

To be able to enhance and sustain high returns and profitability in real estate investment the following recommendation are made:

- i. Initial Project Appraisal: Real estate investment involves a huge amount of capital and be it so, adequate precautions should be taken by the investor. Therefore feasibility and feasibility studies ought to be carried out before actual commitment of capital. Again this will also help in selecting an investment option that has the highest comparative advantage or least comparative disadvantage relative to other alternatives.
- ii. Efficient Property and Portfolio Management: One of the problems hindering optimizing returns in real estate investment and sustaining high profit is lack of efficient property and portfolio management. Diversification of real estate investment provides reasonable steps to reduce and / or minimize risk

inherent in this venture. Planned maintenance will help to keep investment property in a good and Valid Title Document: Equity capital along perhaps will not be enough and sufficient to procure real estate facility. The investor should ensure that his title documents of the interest he is holding on the land are valid, duly signed and certificate occupancy (C of O) obtained from the appropriate quarters. This document can serve as an collateral to obtain loan from the banks with which to execute the project.

- iii. Use Professional Estate Surveyors and Valuers:
The use of quacks simply can ruin an investors investment. The investor should hand the management and maintenance of his properties to Estate Surveyors and valuers who can achieve the mission, vision and goals / objectives of the investment
- iv. Periodic Investment Performances Appraisal:
It is highly necessary to determine the performance of your investment from time to time to know if it is performing well or not. In developed countries such as United Kingdom (U.K), United State of America (USA) and Europe, real estate investors engage the services of experts who collect various data based on rental value, income and outgoings, detents of leases, capital value and property market indicators to assess or measure the performance of real estate investment. This, if possible can be done by Nigerian real estate Investors.
- v. Functionability of Investment Properties: Real Estate Investment (properties) should be absolutely "housing". The houses should be functional in all respects ie all the facilities required or needed to make liveability comfortable must be provided namely: water, electricity, parking lots, security, good roads etc should be provided. These will enhance the values (rental and capital values) of the properties.
- vi. The Need for Environmental Impact Assessment (EIA): An investor may go extra mile to carry out the environmental appraisal to simulate inter-boundary relationship between environmental elements, their characteristics and implications and how all these will affect his investment. Dangers that might arise in future will be avoided if this steps are taken by the investor.

tenantable condition to enable it hold its value through the tenure of its holding

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