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AN APPRAISAL OF 'DEVELOPER-FINANCE' OPTION FOR THE REDEVELOPMENT OF FAMILY PROPERTIES IN LAGOS, NIGERIA

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Abstract

Family properties bequeathed by deceased parents are to be found in considerable numbers within the core and central business district (CBD) of most Nigerian older cities. A number of these properties are old and derelict having suffered considerable physical deterioration and functional obsolescence. Such properties are therefore not making the highest and best use of their respective sites while they possess considerable latent values waiting to be released by injecting capital into their redevelopment. However, given their ownership structure and title deficiency among others, this category of properties hardly qualifies for funding through the conventional methods. More often than not, 'developer-finance' happens to provide the only pliable method of financing their redevelopment. Regretfully, this mode of financing often runs into trouble with the project either poorly executed or abandoned midway. This paper examines the manner in which 'developer-finance' is currently practiced in Lagos Metropolis with a view to identifying grey areas and making recommendations for needful improvement. The study revealed, among others, that the use of 'developer finance' in the study area is limited in scope - limited to certain geographical areas, certain categories of properties, and also limited in terms of the scale of development. The study also revealed a number of fundamental but avoidable pitfalls which tend to endanger the practice and aggravate the associated risks. Remedies are suggested to forestall abuses and eliminate observed lapses.

Key words: *Developer-finance, Inherited property, Redevelopment, Nigeria.*

Introduction

Among the factors militating against property development, finance is foremost and universal. The importance of appropriate financing to the overall success of property investment is well documented in almost all the nations of the world. The collapse of the property market in UK in 1974, which forced many property companies into liquidation has largely due to inappropriate financing, has remained a common reference (Darlow, 1982). As finance assumes increasingly pivotal role in property investment of all types, the source and method of finance remain issues for careful consideration by investors and their advisers. Prominent methods of property finance include mortgage, bridging finance, sale-and-lease back, reverse leaseback, unitization, property unit trust, REITs, property bonds, and developer-finance. Important sources of finance include retained earnings, pension's funds, cooperative societies, savings and loans associations, mortgage companies, stock exchange, commercial banks and merchant banks.

A variety of partnership arrangement between landowners and private commercial developers exists whereby governments, corporations, families, or individuals make prime land available to developers on varying terms. Such partnership include Build-Operate-and–Transfer (BOT), Build-and-Transfer (BT), Build-Lease-and-Transfer (BLT), Build-Own-and-Transfer (BOO), Built-Transfer-and-Operate (BTO) and Rehabilitate-Operate-and-Transfer (ROM). A number of factors have contributed to the growing practice of this form of partnership in property finance. These include the prevailing acute shortage of fund for property development; double-digit interest rates regime; stringent loan conditions; escalating building costs; uncertain letting and sale prospects; diminishing supply of suitable development sites particularly within the

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city centers/ Central Business Districts (CBD), and other prime locations; as well as the low initial yields on property investments compared to prevailing interest rate on borrowed capital. This study examines one of the landowner/developer partnership - the "developer-finance", with particular reference to how this finance option is practiced in Lagos Metropolis.

Sourcing financial assistance in the conventional finance market for redevelopment of family land has always proved difficult because of multiplicity of ownership, lack of clear title, and susceptibility to dispute/ litigation, among others. Yet a number of these properties situate in prime residential and commercial districts, begging for redevelopment with finance standing as the main impediment.

Developer-finance has contributed immensely to the redevelopment of several of derelict properties at the inner core of Lagos Metropolis which could otherwise have been virtually impossible due to finance. This financing option also helps to actualize the latent values subsisting in such properties thereby guaranteeing the highest and best use of such land; stem blight at the inner core of cities; optimize returns on real estate investment and boost local authority revenue from property tax.

This study seeks to identify the prospects, limitations, and pitfalls inherent in developer-finance option for the redevelopment of bequeathed family properties in Lagos Metropolis. The ultimate goal is an improvement in the current practice for maximum benefits to all stakeholders and the economy as a whole. The study is novel as the authors are unaware of any previous studies on the same subject in Lagos State. The paper is divided into six sections. This introductory section is followed by a review of relevant literature. The third section discussed the study area. The method of study is contained in the fourth section, while we have the discussions of the results of the study in the fifth section. The last section concludes the conclusions and recommendations.

Real Estate Development Finance using the 'Developer-finance' Option

Developer-finance, otherwise referred to as 'building lease' or 'development lease', is a form of partnership, whereby the developer obtains from the landowner the use of the land in return for periodic rent payment (ground rent) over an agreed period of time. The developer covenants to erect a new building or to substantially improve or refurbish existing building or redeveloped sites with derelict buildings. At the end of the term, the land together with the improvement reverts to the landowner. Development lease varies in length but are usually long enough to allow the developer recover the cost of improvement plus a return for the risk and profit. (Frazer, 1990).

Developer-finance in its simplest form has been practiced as far back as the eighteenth century. In the early days, the grants were long (usually 125 years) and the rents were fixed. However, high rate of inflation, high cost of capital and rapid growth in property value have combined to shorten development lease terms considerably such that today we have terms as short as below 15 years. Beside shorter terms, development lease have assumed increasing details and complexities, often incorporating premium, risk and equity sharing formula, yield protection and participation clauses, and in the place of fixed ground rent it is now common to provide for periodic rent reviews.

Developer finance promises a number of attractions to the landowner and developer, and could be of great benefit to the economy as a whole. In particular, the developer does not have to acquire or own the site. This lessens his capital requirement and risk exposure considerably. This is particularly significant for instance, in certain areas of Lagos like Ikoyi and Victoria Island where the cost of land could constitutes as much as 60% of the total development costs. The arrangement also enables developers to participate in the development of prime sites which may otherwise not be available in the open market for outright sale. Furthermore, development lease enables finance for development to be arranged more easily and favorably, as most developers have established good track records with financial institutions which entitles them to ready supply of funds based on mutual respect and trust. Where a government or its agency is involve, the arrangement ensures that planning permissions is likely to be more easily obtained and information on proposed competitive developments more readily obtainable (Darlow, 1984).

Nature and Characteristics of 'development property'

Developer-finance is more or less synonymous with 'development property'. A development property is a property that possesses element of latent value that can be released by the expenditure of capital upon it. Three broad categories of development property can therefore be identified:

Sites for redevelopment, where existing building is demolished and replaced by a new one that meets the highest and best use for the site. Examples include properties within the inner city where old and derelict buildings are giving way to improved, modern and more profitable development. In Lagos Metropolis, examples include areas within or very close to major Central Business Districts (CBDs), and older prime residential areas - Ikeja CBD and GRA, Lagos Island, Oshodi and Ojuelegba Central Business Districts, Ikoyi, Yaba/Ebute Metta, and Surulere residential areas.

Building considered for modification or refurbishment through upgrading, conversion or change in use. These are properties that are upgraded and refurbished to modern standards of architecture; accommodation type, size and arrangement. This may involve works required to remedy obsolescence especially functional obsolescence such as change in roof structure and covering; change of obsolete windows, doors and other building components; modernization of facade; additional toilet/baths. In Lagos Metropolis, this category of development property are to be found particularly along major road axis where residential uses are giving way to commercial uses and old- fashioned buildings are undergoing modernization works. Bare or under development. This includes pockets of plots within the built up areas in prime residential and major CBDs of the metropolis.

The term ''development property'' therefore invariably covers properties that have suffered from a combination of physical deterioration due to age, abuse, effects of inclement weather, or lack of maintenance or a combination of these; functional obsolescence resulting from obsolete or inappropriate design, layout, fixtures or services or a combination of these; and economic obsolescence due to decline in demand for the use for which the property was originally designed. A site may also be considered a 'development property' that is ripe for redevelopment where the building(s) on it underutilizes the site potentials in terms of the plot ratio or building density, though the property may be in a good structural state and decorative repairs.

Study Area

The study area is metropolitan Lagos, Lagos State, South-West Nigeria. Lagos State is one of Nigeria's 36 states. Lagos Metropolis accounts for 37% of the land mass of Lagos State but hosts about 85% of the population giving an average population density of 20,000 persons per square kilometer (Jibunoh, 2009). The present population of Lagos metropolis is estimated at 17 million which confers on it the status of a mega city and is projected to become the third largest city in the world by the year 2015(Babawale & Omirin, 2011).

From its origin as a fishing settlement some hundred years ago, Lagos Metropolis has passed through various stages of urbanization to attain the present status of a mega city. The sprawling metropolis occupies "a primate" position in terms of concentration of industrial and commercial activities; concentration of financial institutions, largest and most patronized sea port, airport and capital market; the highest concentration of professional office, among others (Falade, 2005). More than 90% of the headquarter offices of post consolidated banks and insurance companies in Nigeria are located within the metropolis. Lagos has perhaps the most active property market with the highest average property value and stock of investment in the country (Babawale & Koleosho, 2006). Derelict residential areas are to be found in major CBDs and older parts of the metropolis including the Ikeja/Alausa, Agege, Oshodi, Mushin, Ojuelegba, Lagos Island, and Yaba/Ebute Metta.

Figure 1: Map Showing Major Transitional Areas of Lagos Metropolis

Research Methodology

Primary data was derived from face-to-face interview complemented by structured questionnaire served on forty-six landowners and thirty-four developers. The study employed a combination of convenience and snowball sampling techniques by which the researchers requested respondents to refer them to other property development companies that undertake development leases known to them. These referrals were also asked to identify other people like them. From the discussion with identified developers, a number of landowners that have used developer finance were identified out of which forty-six were reached through their representatives for interview and to fill the questionnaire. The interview and questionnaire sought information on various aspects of developer-finance as it is practiced in Lagos Metropolis. The interview was used, among others, to obtain information on the frequently encountered risks from both the landowner and the developer point of view; while the questionnaire was later employed to give respondents the opportunity to rank these risk elements. Secondary data were gathered from development leases prepare for eighty-five different development or redevelopment schemes. Information retrieved from the leases include the terms of the lease, premiums and other considerations, nature of existing property and proposed redevelopment. The data were analyzed using simple frequency counts and percentages.

Results and Discussions

Table 1 shows the geographical distribution of the 85 development properties covered in the study. The distribution suggests that the use of developer-finance is restricted to certain geographical areas of Lagos Metropolis. These include major Central Business Districts (Lagos Island, Mushin, and Ikeja) and older residential neighborhoods that are reasonably accessible to major central business districts (CBD) or principal commercial centers within the metropolis (Victoria Island/Ikoyi, Surulere/Idiaraba, Shomolu/Bariga, Ebutte Metta/Yaba). These are areas within the metropolis that enjoy large concentration of commercial activities; where property market is brisk and returns on property investment are reasonably high to attract investors and justify the risks involved in redevelopment.

Table 2 reveals that developer-finance is rarely used for construction of bare sites but chiefly for redevelopment of sites with old, derelict buildings – buildings that have suffered considerable physical deterioration and/or functional obsolescence such as inadequate accommodation size, poor arrangement and mix of accommodation, obsolete design and materials specifications, poor finishing standards and sub-standard facilities. The goal is therefore principally to achieve the highest and best use for the site by improving on the plot ratio; the number, size, mix and arrangement of accommodation; facilities and services, as well as aesthetics.

Table 1: Distribution of Sampled Properties within Lagos Metropolis

Location	Frequency	Percent (%)
Lagos Island	26	31
Ikeja	4	5
Ketu	3	4
Mushin/Isolo	6	7
Festac Town/Amuwo Odofin	1	1
Victoria Island/Ikoyi	7	8
Lekki /Epe	2	2
Ebute Metta/Yaba	9	11
Surulere/Idi Ara	9	11
Magodo	1	1
Shomolu/Bariga	8	9
Oshodi	8	9
Gbagada	1	1
Total	85	100%

Table 2: Nature of Existing Building(s) on the Properties Covered in the Study

Existing Development	Frequency	Percentage (%)
Bare site	7	8
Uncompleted building	9	11
Existing building – tenement	28	33
Existing building – detached	1	1
Existing building- bungalow	28	33
Existing building- block of flats	3	4
Existing building- warehouse/residential	2	2
Derelict building	7	8
Total	85	100

Table 3: The type of the Proposed Redevelopment Scheme

Proposed Redevelopment	Frequency	Percent (%)
Bungalow/tenement	7	8
Block of flats	36	42
Duplex	4	5
Shops/stores	11	13
Shop/Store/residential	21	25
Detached/semidetached/luxury apartment	6	7
Total	85	100%

From Table 3, developer-finance (as applied to bequeathed family property) is used mainly to develop commercial (shop/Store) or residential properties or a combination of both. Residential development comprises mainly of blocks of flats (maximum of five floors), while commercial development commonly comprised of shops and/or stores or a combination of shops, stores and residential accommodation (maximum of four floors). The summary in Table 3 therefore suggests that the application of developer finance for redevelopment of family property is limited to certain property type, and also limited to small and medium-scale development schemes.

Table 4 reveals that the term (or duration) of development lease vary greatly. From the table, 12 per cent of the 85 examined leases have terms of 15 years or less, while 44 per cent are to run for over 25 years. Naturally, the developer seeks a term long enough to guarantee recovery of the capital invested and in addition, a profit that is commensurate to the perceived risk. On the other hand, the landowner seeks early reversion. The negotiated term would generally depend, among others, on the size of development and other considerations contained in the lease, and the negotiating ability of the respective part.

According to the summary in Table 5, as at the time of our survey, works on 74 per cent of the 85 development schemes covered by this study were either completed or were in various stages of completion. This suggests a reasonably high success or performance rate. Works on 14 per cent were yet to commence, while 12 per cent have been abandoned. Reasons given for the abandoned schemes include one or a combination of shortage of funds, disagreement between developers and landowners, and in few cases, the activities of 'area boys' or miscreants who make reckless and endless demands on the developer at various stages of the development. Twelve per cent abandonment rate is worrisome considering the huge capital outlay required for an average real estate development.

Table 4: The Terms of the Development Leases

Term	Frequency	Percent (%)
Less than 15 yrs.	10	12
16-20yrs	37	44
21-25yrs	26	30
26-30 yrs.	8	9
31-35yrs	3	4
36 yrs. and above	1	1
Total	85	100

Table 5: The Completion Stage of the Proposed Development (N=85)

Stage	Frequency	Percent (%)
Not yet started	12	14
Work in progress	23	27
Abandoned	10	12
Completed	40	47
Total	85	100

Table 6: The Contents and Registration Status of the Development Leases (N=85)

Issues	Included	
	Frequency	Percent (%)
Duration of the lease	85	100
Building construction period	52	61
Reference to specific building drawings (s)	10	12
Reference to specific bill of quantities	2	2
Construction/ material details specifications	7	8
Insurance of completed development	7	8
Penalties for non-compliance	15	18
Provision for arbitration	2	2
Development lease registration	4	5

From Table 6, while all the developer-finance agreements (development lease) were documented, only 14 per cent made reference to specific building drawings, 2 per cent made reference to specific bill of quantities, and only 7 per cent contained construction details or building material specifications. Furthermore, only 12 per cent of the 85 development leases provide for the insurance of the completed development, 18 per cent specified penalties for breach of the covenants, and 2 per cent only made provisions for arbitration in an instance of dispute. In addition, only 5 per cent of the leases were duly registered with relevant government department authority. Failure to register the lease documents attributed to unwillingness to pay the required charges/fees. Lack of proper documentation and thorough supervision of the development scheme (preferably by an independent consultant), often result in substandard construction.

Risks associated with developer-finance

Table 7 ranks the nine principal risk elements that often endanger the interest of landowner(s) in a typical developer finance partnership as perceived by interviewees. The most often encountered of these is failure to complete the development within the stipulated time due to reasons such as delay in government approval; delay in securing the approval of all principal members of the family to give out the property to the developer as required under customary law; the nuisance often posed by miscreants otherwise called 'area boys' etc., Reasons such as these often lead the developer to come up with request for an extension of the term to ensure that the length of time originally stipulated for the developer to enjoy the benefits of the completed development is not compromised. Other risk factors like failure to build to specifications; surrendering the premises in an untenantable conditions or with unpaid bills; or leaving behind tenants that are difficult to dispossess; endanger the reversionary interest of the landowner(s). It was gathered during the interview that it is the developer that often initiate the proposed redevelopment; prepares the drawings and carries out the development with little or no inputs from the property owner(s) who are often initially carried away by the euphoria of the prospect of having their derelict property developed to a modern accommodation. With the terms and conditions loosely expressed and poorly documented, it is natural for either parties to be tempted to take undue advantage of the other, accounting for majority of the risk factors identified.

Six major risk elements that developers frequently faced are ranked in Table 8. The most frequently occurring is the demand by the landowner for a reduction of the lease term which often comes up after redevelopment works have reached an advanced stage or fully completed. Others emanate from the very nature and peculiarity of family property administration which often makes the required mutual agreement difficult or intricate. These include the lack of relevant title deed, litigation /disturbance from individual member of the owning family; non-availability or refusal to provide the developer with the property's title documents; landowner or beneficiaries/successors in title using their portion of the completed development in a manner that is detrimental to the profitable use or lease of remaining parts.

Table 7: Elements of Landowners Risks (N=34)

S/N	Risk Elements	Mean	Rank
1	Developer unable to complete development within stipulated time necessitating a request for extension of term originally agreed.	4.41	1st
2	Developer failed to build to specified/agreed building plan, accommodation details, and material specifications.	4.10	2nd
3	Developer used poor quality materials in order to save cost	3.87	3rd
4	Developer surrendered property in poor condition resulting from abuse and lack of maintenance	3.875	4th
5	Developer refused to yield up possession as and when due - the developer pressed for an extension of the lease claiming that he has not been able to recover the capital invested.	3.37	5th
6	Developer abandoned development half way due to lack of finance or change in local economic conditions that has negatively affected revenue and/or cost projections.	3.17	6th
7	Developer yielded up possession unceremoniously leaving behind difficult tenants that are difficult to eject.	2.90	7th
8	Developer yielded up possession leaving unpaid bills-electricity, property rates etc.	2.80	8th
9	Developer (or his successor in the title) contending for absolute ownership of the completed development.	2.23	9th

Table 8: Elements of Developer's Risks (N= 46)

S/N	RISK ELEMENTS	MEAN	RANK
1	Landowners or beneficiaries/successors in title insisting on amending the lease terms (often asking for shorter lease or additional premium) after the development has commenced, completed or even several years into the lease.	4.42	1st
2	Developers incurred irrecoverable expenses (cost of preliminary drawings, bills of quantities, feasibility studies) on proposals that invariably failed to secure landowner's approval) failure to obtain planning permission or inability to attract the required finance.	4.35	2nd
3	Difficulty in processing and obtaining necessary planning permission because the property lacks relevant title deed	4.35	2nd
4	Litigation /disturbance from individual(s) claiming to be co- beneficiaries, but were not party to the original building lease.	4.17	4th
5	Difficulty in meeting loan repayment as a result of low return on property in a regime of high interest on capital.	4.08	5th
6	Non-availability or refusal to provide the developer with the title document to the property to enable the developer process planning permission or short term loan.	3.80	6th
7	Landowner or beneficiaries/successors in title using their allotted portion of the completed development in a manner that is detrimental to profitable use or lease of remaining parts.	3.79	7th

Conclusions and Recommendations

The study revealed, among others, that developer-finance option, though very popular and frequently used has a restricted application in the study area. As it applies to bequeathed family land, this finance option is limited to family properties in vantage locations within major business districts or prime residential neighborhoods; it is limited to residential and/or commercial (shop or store) schemes, and also limited in terms of the scale of development.

Poor documentation, poorly drafted lease agreement, failure to register the development lease (to avoid payment of necessary fees/charges to the government), and lack of active participation of the landowners at the project conception and execution stages, are the bane of this of property finance option. These lapses create rooms for both the landowner and the developer, particularly the latter, to take undue advantage of each other. Developers are found to renege on the type, quality and scale of development initially agreed upon. In a number of cases, the developer failed to yield up possessions at the expiration of the term or may surrender the property with a lot of unresolved problems or unpaid bills.

Virtually all the identified risks, both from the point of view of developer and landowner, can be successfully mitigated or totally avoided by a process that allowed for mutually agreed, transparent, and well-articulated, properly documented and duly registered building lease with terms explicitly spelt out to forestall manipulations or private interpretations. In addition, appropriate penalties and sanctions be included; and provisions made for arbitration on any issues of disagreement. To forestall abuse, the proposed development must be jointly agreed by both parties. The parties must agree to material specifications and accommodation details; construction periods; moratorium; insurance; maintenance; use of property; sublease, among others. There must be clear proviso for possible alteration during construction or thereafter following formal request and approval in writing. A project supervisor jointly appointed by both parties would help to ensure strict compliance with material specifications and construction standards.

To prevent non-completion of development on schedule, or abandonment as a result of the developer's inability to raise sufficient funds, the developer should be made to provide performance bond from reputable financial house to guarantee that adequate fund is available as and when required for the completion of the scheme. The state government should put in place appropriate legislation for the sector aimed at improving the current practice taking into consideration the interests of all stakeholders. Studies have linked the rampart incidence of collapsed buildings in Lagos Metropolis with building constructed through developer-finance arrangement. Reasons often adduced for the collapse of buildings have always included poor materials, poor design, non-compliance with approved drawings, and poor standard of workmanship (Adenuga, 1999, Iyagba, 1989).

The problem that may arise with loan repayment due to initial low return on property in a regime of high interest, is being successfully addressed by some developers by selling off substantial part of their entire short-term lease rather than retaining the completed development as an investment i.e. receiving periodic rent which have been found to guarantee quick capital recovery with handsome developer's profit, even when the short lease have to be sold at substantial discount to facilitate their early/quick disposal.

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