GLOBALIZATION, SECONDARY MORTGAGE BANKING AND CHALLENGES BEFORE NIGERIA

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ABSTRACT

The paper addresses the problem of inadequate funds for primary mortgage institution to finance long-term loan for housing development in Nigeria. Studies have shown that developed countries particularly the United States of America have overcome this problem through the establishment of secondary mortgage markets.

The study aims at examining the viability of this secondary mortgage market in a developing country (Nigeria) so as to reap the benefits of globalization. The research examined the views of primary mortgage institutions, financial and real estate experts on the prospects and implementation difficulties of secondary mortgage market in Nigeria. It was revealed clearly that this secondary mortgage market is likely to be a viable option in Nigeria provided that the problem of mindset of the people and political will of the government are addressed through proper and intensive enlightenment campaigns. The paper recommended among others, a model that combines savings and mortgage for housing provision and that government should try to create an enabling environment (Legal framework, regulatory institutions, and enlightenment campaign e. t. c) for this secondary mortgage market to become operational within the next five years.

Key words: Primary Mortgage Banking, Secondary Mortgage Banking.

INTRODUCTION

Shelter has been universally accepted as the second most important essential human need after food, housing goes beyond mere shelter to embrace all the social services and utilities that go to make a neighborhood live able [National Housing Policy 1991]. Provision of housing has been a global phenomenon that drew the attention of the government of most countries over the years. Despite this given attention, the problem of housing has continued unabated till date particularly in developing countries (Nigeria). Housing problems in Nigeria are enormous and complex which exhibit apparent and marked regional differences: Housing in Nigerian urban centres is characterized by problems of quantity and poor quality of available housing units and the environment; while the rural areas are faced with the problem of quality of housing and inadequate infrastructural facilities like roads, drainage, water, power supply e.t.c.

Presently, the major housing problem globally, is the shortage of affordable accommodation for the urban poor and majority of the low-income earners. Encouraged by the array of national and international initiatives which were stimulated by International year of shelter for the Homeless [1987], the United Nations General Assembly resolved to formulate a global strategy for shelter by the year 2000 to encourage governments to assist the current and potential participants in housing development and create an enabling environment for adequate shelter production.

Consequently, the National Housing Policy of 1991 was formulated by the Federal Government of Nigeria with the realization of the major role of finance; the National Housing Fund came into being with the responsibility of making fund available to meet the target for the entire policy. The National Housing Fund scheme was structured such that the Federal Mortgage bank of Nigeria would function as the sole institution at the federal level to encourage the flow of funds from various sources to the housing sector. The primary mortgage institutions (P M Is) were adopted as channels through which lending to individuals to fund building, purchasing or renovating their own house would be effected.

Increased housing demand as a result of increase in population is an inevitable phenomenon as a nation develops [Lea 2000]. This situation is often characterized by high demand for mortgage credit, which unmatched the supply of loan able funds in developing countries (Nigeria). Presently, most Nigerians are yet to own their houses due to lack of enough capital from the existing primary mortgage institutions to cater for the large number of applicants to finance long term loans. Consequently, the study tries to look at the viability of establishing a Secondary mortgage market as an improvement on the existing arrangement in the country to solve the problems of inadequate fund as being practiced in developed countries (America) in order to reap the benefit of globalization.

The problem

Any system of housing finance is sustainable only if it is relevant to the economic, social, political and regulatory environment of the country concerned. The experience of mortgage banking in Nigeria can simply be summarized as utter failure as observed by Nubi [2003]. Without a well-organized and efficient housing finance system, it is difficult to mobilize substantial financial resources for channeling funds into the housing sector. Nigeria’s present housing finance system is severely underdeveloped and iII- equipped to mobilize and channel savings to the housing sector. Although a Federal Mortgage Bank has been created to essentially serve as a wholesale and apex institution, the other institutional components of the finance market in terms of primary mortgage institutions have not developed.

The present scenario for funding housing delivery in Nigeria is that the primary mortgage institutions are faced with inadequate funds to finance long-term loans. Their financial base can only cater for a few people, so once loans are disbursed to a set of people on a long term, the needs of other sets of people who require loans for house construction are not met by these primary mortgage institutions simply because the little amount of money at their disposal is tied down in the hands of the few beneficiaries, hence they appear ineffective. However, the global slogan of ‘Housing for all by the year 2000’ that brought about the Nigeria's National Housing Policy of 1991 has not been achieved due purely to poor financial arrangement to fund the housing sector among others. Most Nigerians are yet to own or have access to a decent accommodation even four years after the target of year 2000.

The capacity of secondary mortgage market to tap broader source of fund across national boundaries especially with the advancement in information technology and globalization makes it an inevitable option in mortgage banking development. It also facilitates improved risk management for primary market lenders.

Arising from the above discussion, the study tries to examine the workability of establishing a secondary mortgage market in Nigeria with a view to strengthening the financial arrangement towards housing delivery in the country so as to reap the benefits of globalization. Also to be addressed by this study, are the necessary frameworks to be put in place to make the secondary mortgage market work in developing countries (Nigeria).

Concept of secondary mortgage banking

A secondary mortgage market is a transaction that involves the selling of primary mortgages (mortgage portfolios) by a holder of a mortgage portfolio (e.g. a primary mortgage institution) to a secondary mortgage institution that makes cash payments to the holder of mortgage portfolio. The secondary mortgage institution can then hold the mortgages in its portfolios and the lender (mortgagee) in turn uses the cash received to create more mortgages for more house owners.

It involves a transaction whereby, the secondary mortgage institution can issue mortgage-backed securities (MBS) in exchange for pools of mortgages from lenders instead of paying cash. That is, instead of paying cash, the secondary mortgage institution buys by paying through the means of mortgage-backed securities to the primary mortgage institutions. These mortgage- backed securities (MBS) are guaranteed by the secondary mortgage institution to the investor and the investor will receive timely payment of principal and interest regardless of what happens to the underlying mortgages. In return for the guaranty, a fee is charged. The advantage of these MBS (Which are highly liquid investments are tradable through security dealers) is that it provides the lenders with a more liquid asset to hold or sell to achieve desired liquidity options.

A secondary mortgage market transaction that is more sophisticated involves the buying of mortgage portfolios from lenders (mortgagees) repackaging the mortgages into securities and selling the securities duly guaranteed to investors. This process is termed securitization. Securitization is defined as the conversion of property assets into tradable instruments [Ebie 2002]. The underlying principle is that the investor receives in return for his capital outlay the benefit of income and capital growth arising from the underlying. It is the quality and value of the underlying collateral of the mortgage that is critical to the success of the securitization. Secondary securitization is the repackaging of existing loan assets into securities as distinct from primary securitization, which relates to the process of raising new finance by issuing securities on the capital market.

To fund the mortgages being bought, the secondary mortgage institution issues debt securities to investors, banks, savings institutions, insurance companies, pension funds, and credit monies. Significant income is derived from the difference between the yield on these mortgages and the cost incurred to buy them. Secondary mortgage market is meant to be a constant source of replenishing and increasing the stream of funds available for primary mortgage transactions. It links mortgage lenders with security investors. It is a means to an end (to increase the flow of funds to housing).

Globalization

The world is gradually becoming a global village and for developing countries like Nigeria to reap the benefits of globalization, there is need to improve on the mortgage financing processes. Globalization is the integration of national economics through trade and financial interaction [Obaseki 1999]. Globalization has progressed with developments in the world economy. The phenomenon has benefited immensely from the multilateral trading and investment arrangements, advance in technology and communication, and the opening up of trade and investment through liberation of current and capital account of transactions.

Recent developments in the world economy had shown that it is futile for countries to isolate themselves in a rapidly integrating world. The search for flexible funding sources further enabled the globalization of the capital markets. Over the years, securitization of credit, proliferation of mutual funds and financial consolidation all have propelled global markets in the 1990s alone; the global bond market has also tripled [Nubi 2003].

Methodology

The study requires information on the present mortgage financing arrangement in Nigeria with a view to determining the problems that hamper the effective mobilization of funds for financing real estate developments. In addition, information on how these problems can be solved with the establishment of a secondary mortgage market in the country as obtains in developed countries like the United States of America is required if Nigeria is to reap the benefits of globalization. Information on the viability of this secondary mortgage market in the Nigerian situation is also needed.

Accordingly, primary mortgage institutions and financial and real estate experts in Nigeria were contacted on the prospects and implementation difficulties of secondary mortgage market as a way out of the present mortgage financing problems in the country. Simple descriptive statistical methods were used for data analysis and presentation.

DATA ANALYSIS AND DISCUSSIONS

The data gotten from the interviews conducted with the officials of some primary mortgage institutions and some financial and real estate experts coupled with the secondary data from the Federal Mortgage Bank of Nigeria form the bases of analysis.

An overview of the present housing finance system in Nigeria.

Nigeria's present housing finance system is severely underdeveloped and ill equipped to mobilize and channel savings to the housing sector. Although a Federal Mortgage Bank has been created to essentially serve as a wholesale and apex institution, the other institutional components of the finance market in terms of primary mortgage institutions have not developed.

It is generally accepted that despite high demand for mortgage loans, the Federal mortgage bank has not been able to meet up with such demand and for it to make any meaningful impact on the housing sector; other sources of funds must be found. The above situation later improved with the establishment of some primary mortgage institutions, that is a two-tier financial structure, with the Federal Mortgage Bank as an apex institution and a decentralized network of Building Societies, Housing co-operatives, Housing Associations, Credit Unions and Saving Banks forming the second tier at the grass root level. With this development, the Federal Mortgage Bank concentrates on wholesale mortgage lending to primary mortgage institutions that in turn perform retail mortgage lending to private individuals.

Table 1. Status report on approved / disbursed N. H. F loan as at 18th September 2000.

S/N	Names of Primary Mortgage Institution	No of Beneficiaries	Loan Amount Approved/ Disturbed N
1	Co-operative Savings & Loans Ltd Ibadan Oyo State	101	31,202,247.28
2	Federal Mortgage Finance Ltd. Abuja FCT.	9	3,039,200.00
3	Union Homes Savings & Loans Ltd. Lagos.	145	130,448,782
4	Aso Savings & Loans Ltd. Abuja	10	7,685,585,00
5	Kebbi State Home Saving & Loans Ltd. Birnin Kebbi.	29	10,840,000.00
6	Stallion Savings & loans Ltd. Lagos	49	38,202,233.00
7	Atiba Iyalamu Savings & Loans Ltd. Ilorin Kwara State	2	1,564,400.00
8	Sakkwato Savings & Loans Ltd. Sokoto	30	8,132,668.00
9	Dala Building Society Ltd. Kano	5	4,216,333.00
10	Lagos Building Investment Company Ltd. Lagos.	13	9,984,400.00
11	Akwa Savings & Loans Ltd. Uyo Akwa-Ibom State	22	6,613,582.00
12	Abbey Building Society Ltd. Lagos.	2	1,726,400.00
13	KeGuardian Trust Savings & Loans Ltd. Lagos	1	158,992.00
14	Benhins Building Society Ltd. Markurdi Benue State.	12	7,357,382.00
15	Finacorp Building Society Ltd. Lagos	1	1,200,000.00
16	Accord Savings & Loans Ltd. Lagos.	3	2,960,000.00
17	Federal Mortgage Finance Ltd.	43	64,673,179.50
	TOTAL	**489**	**334,540,360.17**

Source: Federal Mortgage Bank of Nigeria. (FMBN).

Table 1 above clearly shows the beneficiaries from the housing finance scheme across the country. It should be noted that a total number of 489 beneficiaries as at 2000 is not encouraging since there are lot of applicants that could not be attended to due to limited funds. This manifests itself into stringent conditions upon which loans are approved and disbursed.

Secondary mortgage market: experience from other countries

The United States of America

Secondary mortgage markets originated from America with the establishment of the Federal National Mortgage Association (Fannie Mae) in 1938 as a government owned agency. It was authorized to buy only Federal Housing Administration insured loans to replenish the supply of lend able funds by primary mortgages. Later in 1981, it started doing business in mortgage Backed Securities as an alternative for the purchase of mortgages instead of paying cash. However, it does not lend money directly to home buyers but works with lenders. It current mission statement is “our mission is to tear down barriers, lower costs and increase the opportunities for home – ownership and affordable rental housing for all Americans.

In 1970, the Federal Home loan mortgage corporation (Freddie Mac) was created to stabilize the nation’s mortgage market and expand opportunities for home ownership and affordable rental housing. However, it is privately owned by shareholders. It buys mortgages from lenders and repackaging them into securities and selling them to investors. Through this securitization technique, mortgage lenders obtain and use the proceeds to fund new mortgages constantly replenishing the pool of funds available to mortgagors. Later, Ginnie Mae that is purely a government agency was created and was adequately funded for government loans insured by Federal Housing Administration. Competition among these agencies ensures that the benefits of the secondary market are passed on to homebuyers.

Indonesia

In 1992, the feasibility and process of establishing a Secondary Mortgage Facility (SMF) (which differs from a true secondary mortgage market) a government supported institution that refinances bank-originated mortgages funded through the issuance of bonds was carried out. They opted for this because of relative lack of sophistication of the Indonesian institutional investors, their bond market was thin and illiquid; the nascent state of the legal and regulatory system as regards securitizations; the lack of performance history on mortgages and unknown servicing capabilities of primary mortgage lenders. The beneficial effects of SMF as put forward by Ebie [2002] include the fact that it would provide a source of long-term financing for private banks, removing major obstacle for mortgage investment; it would facilitate investment in mortgages by pension funds and insurance companies potentially improving their investment performance and increasing the supply of funds available for housing and it would help stimulate development of a bond market, which would benefit private companies and government enterprises in their efforts to raise capital.

Prerequisites for secondary mortgage market development

Lea [2000] proposed international requirements for effective implementation of secondary market. The criteria are listed as follows:

1) Stable macroeconomic Environment.

Ideally, stable macroeconomic environment is very vital to the success of a secondary market since it affects the demand for mortgages. A volatile economy has the features of high rates of inflation and nominal interest rates which reduce the affordability of conventional mortgages. A volatile economy affects the supply of funds thereby making disbursement to be on stringent conditions. Lenders become reluctant to offer long term loans thereby making loans unaffordable to consumers.

Investors must be able to forecast cash flows with a tolerable level of variance in order to price and evaluate the risk of their investments.

The Nigerian macroeconomic situation is fairly stable with unpredictable level of inflation. Since the introduction of the structural Adjustment Programme (SAP) in 1987, the exchange rate in the autonomous market was N10.00 to $1.00 but today, it is about N140.00 to $1.00. Export is dominated by oil, and the propensity for foreign goods has continued to increase thereby encouraging inflation push. Nigerian economy being import based the weak value of the naira against U.S dollar accounts for high prices of consumer goods and high level of poverty. (FOS) 1998.

2) Developed legal environment

A well functioning title and lien registry is an important underpinning of both the primary and secondary mortgage markets. Without good title, borrowers cannot use their homes as effective collateral for loans and investors will not view securities backed by such loans as safe. A key legal prerequisite is the timely and cost effective registration of title and lien. A barrier that exists in many developing countries is the imposition of transfer taxes or stamp duties on title and lien registration or transfer. Long delays in the registration process can also increase the risk of both primary market and secondary market transaction. A workable fore closure and repossession system is an important although not essential component of an effective legal environment.

In Nigeria cost of transfer and documentation of title are relatively high and includes agency fees, legal fees, governor’s consent, stamp duty, capital gains tax, registration e. t. c. it takes long time for title registration.

3) Competitive market structure

Mortgage must be an attractive investment, the interest rates on the mortgages must be market determined and provide investors with a positive, real risk-adjusted rate of return. The return must compensate investor for the risks of the investment including credit risk, liquidity risk and interest rate risk. The more competitive the mortgage market, the greater the potential for secondary market development. This is particularly the case if the market environment will support the entry of mortgage companies that rely on securitization for funding. In countries in which the dominant lenders are depository institutions with abundant capital and access to relatively cheap retail funds, securitization is often not a cost effective form of finance and it is difficult to create a secondary market. There must be a significant volume of loans to justify the up-front costs of developing the secondary market infrastructure.

The Nigerian culture encourages home ownership hence there is high demand for housing. The national Housing policy of 1991 targeted 700,000 housing units annually on the estimated population of 80million in 1991 and this target has not been met up till today which makes housing demand to be very high. This situation is conducive for secondary mortgage market to thrive.

4) Mortgage instruments

The cash flows from mortgages must be predicable. There must be relative standardization of the instrument, documentation, and underwriting, standardization of the mortgages should be pooled with similar characteristics to facilitate large pool size and more liquidity and to reduce the due diligence costs of investors and rating agencies.
In Nigeria, buildings vary in size, shape, height and construction, pooling them will be difficult because of the array of risk combination they possess. Origination of mortgage in Nigeria depends to some extent on the existing relationship between the borrower and the lender hence loans given are hardly recovered.

5) Proper origination techniques

Solid and consistent underwriting is a key to secondary mortgage market development. Investors must have confidence that lenders are properly judging risk and using a consistent set of criteria in evaluating loans. A degree of due diligence and allow investors, rating agencies, guarantors to quantify credit risk. An accurate assessment of the value of the property is fundamental to determining whether, in the event of borrower default, the lender could recoup enough from the sale of the home to cover losses. A repository for credit information that can be used to ascertain a borrower's track record of handling credit is an important component of underwriting. Credits bureaus can provide lenders with detailed credit files; they also can provide a credit information into one number reflecting an individual' expected credit performance.

Presently, PMIs originate, fund, underwrite and service mortgage. i.e mortgage is unbundled. This doe not allow for transparency of information, but rather creates high-risk mortgages. Unregistered lands are sometimes used as collateral making foreclosure difficult.

6) Secondary Marketing Expertise

Secondary marketing is the function of financing and, subsequently, selling the originated mortgage to institutional investors. This activity includes the warehousing of the mortgage is closed and subsequently sold to an investor. There are least 3 major risks the seller must manage as part of the secondary marketing function:
Commitment risk: The risk that an interest rate commitment ("rate lock") offered to a home buyer before a loan is made and the firm is unable, generally due to market forces, to earn an adequate sales price to cover the costs of providing the commitment.
Pipeline risk: The risk that a close loan will change in value between the time of closing and shipment to an investor. This risk is often hedged using forward, option or future contacts.
Document risk: The risk that a closed loan is underwritten improperly and does not confirm to the investor's requirements. These loans are known as "lame loans" and frequently can be converted into acceptable loans for delivery, but usually after months of seasoning and additional documentation. The delays in delivery, or inability to deliver, produce costs for the originator.

The country is still struggling to understand traditional mortgage practice. The good news is that the banking sector is evolving and is trying hard to meet with international standard. Diversification into secondary mortgage market will only require short-term training. The insurance industries in Nigeria also present opportunity for understanding what unbundling is all about. In the insurance sectors, there exist main insurance companies with network brokerages firms, working on commission. Other service provides like value adjusters also exist. Unbundling will not be totally strange if perceived from the insurance point of view.

7) Proper Servicing Technique

The servicing of mortgages is a critical component of a viable secondary mortgage market. The collection of mortgage payments and the periodic remittance of these payments to the investor (or conduit) are the major tasks of services (whether they are originators of third parties). In addition, services are the primary repositories of information on the mortgage loans. Thus, they must maintain accurate and up-to-date information on mortgage balance, status and history and provide timely reports to investors, the ability to collect payments on delinquent loans and institute timely foreclosure, repossession and collateral sale in the interest of the investor is necessary to safeguard the investor's interest.

This is not in existence. The mortgage method remains traditional. Servicing of mortgages are being carried out by PMIs who are also the originator. Unfortunately, the PMLs are restricted to state capitals. Effective strategies are not adopted for servicing mortgages other than that the beneficiaries walking into the bank to pay. Irregular payments is only reflected in the Shagari low cost housing scheme especially in Oyo state, beneficiaries find it difficult to get to the only collection center of the bank in the state (at Ibadan).

Recommendations and Concluding Remarks

It is obvious from the paper that an enabling environment for secondary mortgage market to operate effectively has not been created in Nigeria; it is also clear that the mortgage environment in Nigeria is not adequately developed for both primary and secondary mortgage banking. The paper has however shown that the introduction of secondary mortgage banking (if it is well understood) would solve some of the problems particularly that of inadequate finance hence the need to improve and strengthen the existing traditional mortgage practice through the followings:

1. The essence of mortgage is to make housing affordable to both medium and low income earners, to achieve this, the pre-requisite high equity participation of 20% - 40% by most PMIs should be discouraged since this arrangement makes mortgage loan unattainable to them. The Government through the Central Bank can reduce the lending policies in order to increase the credit expansion of primary mortgage institutions so that more borrowers will have access to credit. Central Bank guidelines that stipulate a particular percentage of loan able funds of banks be earmarked for the housing sector should be enforced.
2. Public enlightenment is necessary so as to change the mindset of the general public who are not keen about investing in the mortgage sector. They should be educated about the various investment opportunities in this sector and should be

encouraged to explore them. Government needs to be educated about the benefits of mortgage banking so as to win it political will towards creating a vibrant mortgage sector. This awareness can be carried out by the mortgage Banking Association of Nigeria. Defaults in repayment of borrowed loans by uninformed borrowers will be addressed also.

3. In creating an enabling environment, the legal framework and the regulatory institutions are very important aspects that the various primary mortgage institutions that seem redundant will become very active in this sector. Economic policies that can combat economic problems should be formulated so as to reduce the problem of inflation in the country. Accessibility to land by those who need it for housing purposes should be encouraged as part of creating an enabling environment.
4. The paper therefore recommends a model that combines savings and mortgage for housing provision, in this model; primary mortgage banking would continue to be used to facilitate housing provision through mortgage while secondary mortgage banking would be employed to strengthen the ability of the primary mortgage institutions to continue to provide mortgage funds. However, this model would only work if the country understands traditional and secondary mortgage practices. A lot of effort is therefore required to educate all stakeholders on how primary and secondary mortgage banking work, what the benefits are e.t.c

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