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NIGERIA CONSTRUCTION & REAL ESTATE OVERVIEW

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Construction grew to comprise 4.1% of GDP in the first quarter of 2017

On the rebound

Local contractors see a return to growth and increased use of domestic inputs

The country currently has 68 major building projects with a total capital expenditure of

$73bn

Following a difficult 2016 the Nigerian construction sector showed signs of stronger growth in the first half of 2017. The uptick in activity comes on the back of a low base, however, as the country's first recession in 25 years affected private investment in real estate building and oil companies had to scale back investment plans due to lower global oil prices.
The stabilisation of the naira, the utilisation of new contract structures and an increase in local suppliers are now helping to provide fertile ground for activity. Local content, in particular, is playing a larger role in the market, with domestic companies active as both standalone contractors and as subcontractors for foreign firms. While public sector tenders - which have traditionally been the source of major works - remain limited compared to the booming years of the 2000s, the increase of private development in the residential and commercial building segments offers promise.

PERFORMANCE: According to data from the National Bureau of Statistics, the construction sector shrank by 6% in 2016 compared to growth of 4.4% in 2015. Growth had picked up by the final quarter of 2016, with activity expanding 7.7% year-on-year (y-o-y), and in the first three months of 2017 the sector bounced back in a big way, registering y-o-y growth of 21.3%.

Also noticeable in early 2017 was the growing role of construction in the overall economy, accounting for 4.1% of total GDP in those first three months compared to recent quarterly contributions of around 3%. "Things were slow in the second half of 2016, our clients were still recovering from the shock of the slowdown in 2015," Igbuan Okaisabor, CEO of Construction Kaiser, told OBG. "In the first quarter of 2017, however, things have opened up. We are seeing increased inquiries and tenders, and business confidence is clearly improving."

REGIONAL STANDING: Much of the construction activity in Nigeria has traditionally been driven by public infrastructure and energy projects, but this is changing. According to the "Africa Construction Trends Report 2016" published by Deloitte, the proportion of West African construction spending funnelled to energy projects fell from 24% in 2014 to 18% in 2016.

The report states that 78% of major projects in the region are owned by state governments, and one-third of funding for these projects comes from the public sector. However, tighter fiscal belts have led to financial challenges for the development of government projects. Still, Nigeria is highlighted as one of the most attractive markets in Africa for construction works. In West Africa, of the nearly $120bn committed to infrastructure spending across 92 projects identified by Deloitte, 61% is earmarked for plans in Nigeria. The country currently has 68 major building projects with a total capital expenditure of approximately $73bn, second only to South Africa on the entire continent.

STIMULUS: The government's response to the recession of the last few years has been to increase spending. In December 2015 President Muhammadu Buhari announced that capital and current spending would triple to N6trn ($21.2bn) in the coming three years. As part of this, the government announced plans to establish a $25bn national infrastructure fund to be dedicated to projects set out in the National Integrated Infrastructure Master Plan (NIIMP), a long-term roadmap that includes projects for energy, transport, ICT, water, housing and social infrastructure. The national fund will draw from local pensions and the country's sovereign wealth fund. "The fund seeks to raise the stock of infrastructure from the current level of 20-25% of GDP to at least 70% by 2043," Udoma Udo-Udoma, the minister of budget and national planning, told local media.
"A total investment outlay of $3.05trn will be required for the implementation of the NIIMP."

Local content requirements in the oil industry are now extended to the construction, ICT and power sectors

Real estate construction has shown a positive trend in early 2017 due in no small part to the weakness of the naira and high inflation. "We have seen middle class Nigerians invest in real estate rather than keep their money in the bank," Victor Jolaoso, marketing communications and research manager of Nigerite, told OBG. "We have seen growth in new residential and commercial projects in the major cities."
"We have to come up with innovative ways of making contracts attractive, " Okaisabor told OBG. "One way is to break projects costs down into low-, medium- and high-risk segments based on the likelihood of price fluctuations during the duration of the project. A client - depending on his cash flow and risk aversion - might choose to pay the high-risk items up front."

SKILLS: As is the case throughout West Africa, skilled construction and engineering labour is limited in Nigeria. According to the Nigerian Institute of Building, 5m-10m construction artisans will be required by the industry in the coming 20 years. However, while the sector's potential for job creation is significant, there is a need to improve training and development. Speaking at the annual general meeting of the institute in October 2016, Anthony Okwa, the project director of Construction Skills Training and Empowerment Programme, told attendees, "In order to salvage Nigeria from its decaying infrastructure and huge housing deficit, all relevant stakeholders - including the federal and other arms of government, construction companies, real estate developers, professional bodies and trade associations - must invest more resources in vocational training to boost the number, competence and quality of manpower in the construction industry."

While the government has announced its intention to increase vocational training, the private sector is launching its own initiatives.
Construction Kaiser, for example, hosts summer camps for teenagers where key construction skills are taught.

Over 5m construction artisans will be required in the next 20 years

The fall in value of the naira has prompted firms to restructure client contracts in a way that addresses price fluctuations and exchange rate risk.

The government is prioritising $2.1bn in arrears owed to contractors from work during the recession, in addition to interest accrued.


Prices for many inputs, such as concrete, have risen since mid-2016

Up and up

More than

60%

of components needed to build water supply systems are imported

When Nigeria's economy was flourishing a decade ago, the country earned a reputation as one of the most expensive places in the world for construction undertakings. Strong demand for expertise, labour and supplies for major hydrocarbons projects pushed up prices and ensured hefty profits for construction firms. Yet while it may have slowed activity, even the country's recent recession has not stopped the continuous rise of building costs.

SCOPE: Contractors across the industry agree that prices climbed steadily in the 12 months to July 2017. "I estimate that construction costs have increased between 30% and 40% over the last year," Igbuan Okaisabor, CEO of Construction Kaiser, a local construction and civil engineering firm, told OBG. "The sector has been impacted by the weaker exchange rate and general inflation, as well as increased wage costs due to inflation."

In August 2014 the exchange rate stood at N160:$1. Three years later Nigeria's currency has more than halved in value, with one US dollar fetching 360 naira in August 2017. At the same time, inflation rose from 8% in January 2014 to 18.7% in January 2017 before falling to 16% mid-year.

The impact these two factors have had on project budgets is significant. Nigeria imports many of its construction materials including an annual spend of $3.3bn on steel despite having the world's second largest reserves of the essential road building material bitumen, at 600,000 tonnes. As a result, foreign exchange risk spiked over the course of 2015 and 2016 when the country experienced a recession.

Prices have been rising even for those materials in which the country is self sufficient. "In 2016 we saw the price of steel rebar go up 80% and later fall in 2017, yet it is still up 40% on 2015 prices," Okaisabor told OBG. "Concrete has also risen 40% in the last 12 months. Although the cement is produced locally, there is high foreign content in terms of some aggregate ingredients, equipment purchases and transportation costs, the last of which are linked to the rising price of diesel."

By August 2017 the price of a 50-kg bag of Portland cement ranged from N2500 ($8.84) to N2650 ($9.37), depending on the supplier. A tonne of high-tensile 12mm rebar was selling for N155,000 ($548) if sourced locally and N204,000 ($721) if imported. However, the reliance on imported goods is more accentuated in non core materials. According to Suleiman Adamu, the minister of water resources, more than 60% of components needed to build water supply systems are imported, making the essential undertaking too expensive for many state and local governments.

RESPONSE: The factors contributing to increasing construction costs are many, and range from the limited output of local producers and a small mining and quarrying sector, to a weakened currency and capital controls. However, there have also been concerns over the appropriateness and transparency of procurement and billing practices in the segment to satisfy personal financial interests.

At a summit hosted in Abuja in April 2017 with the theme "Fighting corruption through proper project costing in Nigeria", Babatunde Raji Fashola, the minister of power, works and housing, told attendees that deliberate inflation of project costs was one of the root causes of construction price increases, and that was why he supported the institution of a national construction costs database. "The ministry will continue to collaborate with the Quantity Surveyors Registration Board of Nigeria, the Nigerian Institute of Quantity Surveyors and other stakeholders in the construction industry with a view to establishing a reliable cost database that will ensure realistic costing of buildings, roads, bridges and other civil engineering projects across the nation's geopolitical zones," Fashola said at the conference.

To combat intentional inflation, the government will establish a construction costs database to reflect realistic costs across various materials and geopolitical zones.

Ikoyi, Victoria Island and Lekki Peninsula host many luxury homes

Changing direction

Profits from high-end properties are slowing, and middle-income housing is getting a more serious look

Nigeria's real estate sector has traditionally been defined by an abundance of demand and relatively limited supply, whether in residential, commercial or retail space. The boom in the country's economy in the years following the global financial crisis of 2008 led to a surge of investment in Nigeria and attracted a range of businesses, leading to a short-age of grade-A office space.

Although a flurry of construction activity ensued, supply could not catch up with demand, and rental prices in Lagos have subsequently matched those of London and New York City. Since 2015, however, the situation has changed for some segments. In the office market, for example, supply is beginning to catch up or even outstrip demand. The real estate sector continues to account for around 7% of GDP, but the return on investment for developers is far less than it was five years ago, as Nigeria's first recession in 25 years hit in 2015.

Residential, commercial and retail markets were all impacted in 2016 by factors such as falling rents, tighter consumer budgets and foreign exchange risk. The industrial segment was the sector's single bright spot, avoiding negative returns by seeing steady rental rates in a market that gained little to no new supply. Industry players say the effect on the country's metropolitan areas varied, but the availability of city-by-city figures is limited; the NBS gathers data on real estate transactions, yet the market suffers from a lack of up-to-date data.
The broader economy had begun to recover from the recession by the third quarter of 2017, holding promise for a rebound in the country's property markets. "Before the drop in global oil prices in mid-2014, the real estate market was one of the shining stars of the Nigerian economy, attracting inflows of foreign direct investment," Erejuwa Gbadebo, CEO of Cluttons Nigeria, an international chartered surveyors and property consultancy firm, told OBG. "In 2016 the macroeconomic conditions worsened considerably and, following years of bullish growth, Nigerians were not prepared. In 2017 economic con-ditions remain tough, but the attitude has changed, and the government and the private sector are working to bring growth back to the economy.

OFFICE SPACE: During the foreign investment boom following 2008, commercial property developments in these exclusive neighbourhoods were the first to benefit, seeing soaring rental prices and demand for new grade-A office facilities. In 2016, however, demand for office space fell, even as projects began to open for tenants. According to the "Commercial Outlook Report" by Cluttons published in late 2016, during the first nine months of the year real estate transactions in Ikoyi and Victoria Island saw contractions of 17.6% and 20%, respectively. The average annual rental costs in these areas fell from $910 per sq metre in 2014 to $700 per sq metre in Ikoyi in 2016 and $600 per sq metre on Victoria Island.

Cluttons estimated that a total of 37,000 sq metres of office space entered the Lagos market in 2016, down 42% on the initial expectation of 63,900 sq metres. However, the rate of new openings shows no sign of slowing over the course of 2017 and 2018.

Lagos, the coastal city of 21m people in the country's south-west, sees the greatest volume of activity in commercial, retail and high-end residential property.

With many high-end developments priced in dollars, currency depreciation has led to a drop in demand and renters asking to pay in naira.

Although rental rates are falling, 37,000 sq metres of new office space entered the Lagos market in 2016

In 2016 the country reached

500,000

sq metres of retail space

Between March 2015 and March 2017 the Federal Mortgage Bank of Nigeria facilitated the construction of

1878

housing units

18m shortfall in houses in Lagos

RETAIL: In line with markets across the continent, Nigeria is undersupplied in terms of retail real estate. According to a March 2015 report published by PwC entitled "Real Estate: Building the Future of Africa", rising consumerism in Africa would allow the continent's buying strength to grow from $860m in 2008 to $1.4trn in 2020. Nigeria was highlighted as being particularly attractive for retail projects due to its stable economy, growing middle class and shortfall of existing retail space. The report noted that 10 major shopping mall projects were under development at that time in Lagos alone.

Nevertheless, developers remain bullish about the longterm outlook of the Nigerian retail segment, with several projects having opened over the course of 2016 and many more planned. In August 2016 the 22,000 sq metre Lekki Mall, developed by South African investment group Novare, opened its doors, and in December 2016 the 7500 sq metre Asaba Mall was inaugurated along the Niger Delta. According to South African research and property management firm Broll, this pushed the total retail space in the country over 500,000 sq metres.

WAREHOUSE: The growth of the retail segment over the last decade has created strong demand for well-managed warehousing space. According to Cluttons, the industrial segment was the only one not to experience a decline in rental values during 2016, with average annual rates varying from N600 ($2.12) per sq foot in Ikorodu and Abule Egba to twice that in Ikeja and up to N1400 ($4.94) in Ilupeju, closest to the country's port infrastructure.

Geoffrey White, CEO of Kuwaiti firm Agility Logistics, said that following the opening of a logistics facility in Accra, Ghana in June 2016, the region now has the storage and distribution complexes in place to conduct efficient business. "The fast moving consumer goods market [in Africa] is really strong and currently very underserved," he told local media. "Moving goods for that sector is fundamental to our growth story and we are very bullish."

In Nigeria, domestic firms are taking to the segment. "The country's well run warehouses are typically owner occupied operations and we have seen little foreign investment in that area," Gbadebo told OBG.

RESIDENTIAL: The high-end residential market has seen similar challenges to those described in other segments. The recession has led to foreign firms scaling down expatriate staff numbers in the country which, when combined with the continued opening of new luxury residential units, has led to a surplus of supply. Given the expensive and complex nature of acquiring land and the rising costs of con-struction, there has been little incentive for developers to build residences for middle-income earners. However, with vacancy rates of luxury apartments ranging from 40% to 60% in areas of Lagos, according to Gbadebo, that trend could change."The sector needs to move from the luxury segment to affordable mass housing," Vinay Mahtani, CEO of Churchgate, a local property development firm, told OBG. "There is an 18m shortfall in houses in Lagos. The challenge is to service this demand in an environment that is less than enabling. Resources from the Federal Mortgage Bank of Nigeria (FMBN) are limited and there is little access to capital for middle-income, would be home buyers."

RED TAPE: " When speaking about the current hurdles, the process has indeed improved significantly compared to a decade ago in terms of bureaucracy and transaction costs. "The government has streamlined the process, reducing the volume of paperwork and stamps required for real estate transactions," Henshaw said. "In addition, the overall cost of buying and registering has fallen from 15% of the value of the property to around 3%."

One of the consequences of the complexities and costs involved in buying property has been growing demand for professional property consulting services. "In the past, appraisals and valuations were overly optimistic. Now we are seeing investor demand for increased due diligence and certified surveyors to help them identify the true status and value of their property," Gbadebo told OBG.

Nigeria is one of the most attractive markets in Africa for retail

DRIVE: To date, government attempts to increase home ownership among the middle class have had a limited impact, although recent efforts suggest a new impetus could be on the horizon. The National Housing Fund was established in 1992 to gather 2.5% of Nigerian workers' salaries to go towards the provision of affordable mortgages through the FMBN. Under the scheme, the bank provides mortgages at a maximum rate of 6% per annum for a period of up to 30 years. Between March 2015 and March 2017 the FMBN granted 2044 mortgage loans valued at over N15bn ($53m) in total, and facilitated the construction of 1878 housing units.

In September 2017 the government also introduced the Family Homes Fund (FHF). This public private partnership, funded with approximately N500bn ($1.8bn), aims to deliver 100,000 affordable homes each year and provide mortgages valued at up to 90% of the price of a home at rates of under 10% per annum, payable over 20 years. Around 70% of houses built under the scheme would be in the N2.5m-4.5m ($8840-15,900) price range, according to Kemi Adeosun, the minister of finance. Struc-tured as a real estate investment trust (REIT), the FHF sources funds from the private sector, pension funds, insurance funds and impact investors with the goal of reaching N1trn ($3.5bn) under management.

PUBLIC HOUSING: In March 2016 President Muhammadu Buhari announced that his government was targeting the provision of 1m homes per year up to the end of his term in 2020, of which one-quarter would be provided by the federal government and one-quarter by 22 states, with foreign investors and local private companies expected to provide the remaining 500,000 units per year. That would be a major step forward in public housing development efforts, given that new home construction has been around 100,000 units per annum in recent years. At the opening of a 250 unit project in Kwara State in February 2017, Mustapha Baba Shehuri, the minister of power, works and housing, restated the government's commitment to reducing the 17m unit housing deficit and said that the FMBN would be refinanced by the government to the tune of N500bn ($1.8bn).

REIT OF RETURN: Other new financing mechanisms have entered the Nigerian market. In addition to the FHF, there are four REITs listed on the Nigerian Stock Exchange (NSE) with a combined market capitalisation of N45bn ($159m). REITs are exempt from withholding taxes, value added tax and capital gains tax, and have proved successful in sourcing capital from foreign firms looking to gain access to Nigerian real estate without having to go through the process of buying and registering property.

Speaking at the launch of the Real Estate Investment Trust Conference in Lagos in May 2017, Oscar Onyema, CEO of the NSE, told delegates, "African real estate markets are well positioned for a long term growth phase given the significant supply deficit across the continent. We believe that this growth can be accelerated by deploying capital market tools such as REITs, listing real estate companies and creating real estate exchange traded funds to unlock capital in the sector." Onyema noted that over the course of 2017 the NSE would propose changes to promote transparency, disclosure and liquidity of listed REITs, and promote easier access to information for investors.

Real estate investment trusts are exempt from withholding taxes, value-added tax and capital gains tax, and have proved successful in sourcing capital from foreign firms

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