Real Estate Investment Schemes (REIS) in Nigeria: A Regimentation and Underperformance

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Introduction

The world over, investing in real estate is ordinarily done using direct methods such as purchasing, building, licensing and leasing out properties and earning returns therefrom. The advent of real estate investment trusts ("**REIT**") in the United States of America in 1960[1] gave a new dimension to investing in real estate. REIT became popular real estate investment vehicle and an alternative to direct real estate investment. Investment in REIT eases the burden of directly seeking, evaluating, running and managing the properties by the investors and gives them an opportunity to invest and earn dividend from a real estate asset. REIT are vehicles for investment by which investors place money with a trustee who selects, invests and operates real estate physical assets and/or securities for gain and/or income.

In Nigeria, Real Estate Investment Schemes ("**REIS**")[2] were introduced in 2007.[3] This is about five (5) decades after the introduction of REITs in the United States of America. REIS had started in Nigeria with the establishment of Skye Shelter Fund in 2007 with a capitalization of ₦ 2billion ($6,535,948). This was followed by Union Home Hybrid REITs in 2008 and UACN Property Development Company REITs (UPDC) in 2013 with capitalizations of ₦50billion ($163,398,623) and ₦30billion ($98,039,216) respectively.[4] Notably, the above are still the major REIS vehicles in Nigeria.[5] The number of REIS vehicles in Nigeria has not significantly increased, perhaps because the existing REIS vehicles have recorded low, and at some point, negative, return values on their respective investments.[6]

In this article, the authors will analyse the legal regime for REIS in Nigeria and the rate of performance of REIS as a vehicle of investment in the Nigerian capital market. We are of the view that, although, the regulatory regime of REITS in Nigeria appears to be well-structured, REITS have continued to perform poorly in Nigeria in large part because the law does not support them as it should. This poor performance is due to several factors ranging from the unfriendly provisions of the Land Use Act and Tenancy Laws, strict conditions for the investment of pension assets in real estate, lack of attractive incentives (e.g., tax efficient options for pooling large investment monies by expert managers) and so forth.

The Nature of Reis

Unlike direct investments in real estate, REIS denotes an investment vehicle (a trust, company, or any other approved corporate structure) through which investors pool capital with which the vehicle acquires real estate assets, manages and holds the same for the benefit of the investors. REIS in Nigeria may take either of two the forms: (a) real estate investment company ("**REICO**") or (b) real estate investment trust ("**REIT**"), duly established for the sole purpose of acquiring intermediate or long-term interests in real estate or property development and may raise funds from the capital market through issuance of securities. A REIT typically issues unit certificates to investors. These confer such investors

[1] Olusegun Olanrele, Rosli Said et al. 'Real Estate Investment Trusts (REITS) Industry in Nigeria: The Influence of External Factors on Returns' (2014) Conference Paper <https://www.researchgate.net/publication/336136203> accessed on May 12, 2023.
[2] Similar to REIT with little nuances explained in this article.
[3] Dabara D.I 'Evolution of REITs in the Nigerian Real Estate Market' (2022) JPIF 40 <https://doi.org/10.1108/JPIF-09-2020-0098> accessed on May 12, 2023.
[4] Daniel Ibrahim, Olusegun Adebayo 'The Structure, Conduct and Performance of REITs in Emerging Markets: Empirical Evidence from Nigeria' (2019) JARER 4 <https://journals.uct.ac.za/index.php/JARER/article/download/827/656> accessed May 12, 2023.
[5] Abubakar Bokani, Abubakar Madaki 'An Appraisal of the Legal Regime for Regulation of Real Estate Investment Trusts in Nigeria' (2022) NAU.JCPL 9 (4) https://journals.unizik.edu.ng/index.php/jcpl/article/view/2006 accessed May 11, 2023.
[6] *Supra* note 4.

with rights to a share of income from real estate while a REICO issues its shares to the investors which confer voting and distribution rights in the REICO to the investors.[7] REIS are established for the sole purpose of acquiring intermediate or long-term interests in real estate or property development.[8] Their constitutional documents typically say clearly that by law they cannot engage in any activity not connected with such a purpose thereof.

The Securities and Exchange Commission Rules and Regulations 2013 (as amended) ("**SEC Rules**") defines REIS as a company, a trust or other such corporate structures as may be approved and regulated by Securities and Exchange Commission ("**SEC**"), which primarily engages in, and invests in income generating real estate assets or real estate related assets.[9] A distinctive feature of REIS vehicles is that its securities may be traded on recognized stock exchanges which can be bought or sold through authorized brokers as stocks or shares.

The Constitution of Reis

As discussed, REIS may take the form of either a REICO or a REIT.[10] The following documents are required for a REICO to be established and registered by SEC;[11] (i) certified copies of the certificate of incorporation issued by the Corporate Affairs Commission ("**CAC**"); (ii) certified copies of memorandum and articles of association with at least one object authorizing the company to invest in real estate and real estate related business; (iii) certified copies of CAC form stating the particulars of directors[12]; (iv) copies of the draft prospectus and abridged prospectus; (v) evidence of increase in share capital where applicable; (vi) evidence of appointment of property manager duly registered with SEC; and (vii) a valuation report made by a real estate valuer registered with SEC in respect of any real estate property acquired.

In the case of a REIT, established as a trust, an application for registration as a real estate investment trust is made to SEC with a prospectus and trust deed in a prescribed form.[13] Notably, an initial public offer for a REICO or REIT must not be for less than ₦1billion while subsequent offers must not be less than ₦500million.[14]

Interestingly, since the selection, investment, and monetization of real estate assets are the basis for REIS, SEC mandates the insurance of such real estate assets by a REICO within ninety (90) days of the commencement of the scheme and within thirty (30) days of any subsequent acquisition. Unlike REICO, a REIT is required to insure the assets but is not mandated to file evidence of such insurance with SEC.[15]

Furthermore, REIS is required to (**a**) derive a minimum of 90% of its revenue (excluding capital gains) from both rental and dividend incomes (**b**) make annual distribution of not less than seventy-five *per cent* (75%) of its rental income or dividend income to its unit holders and/or shareholders; and (**c**) distribute seventy-five *per cent* (75%) of its rental income and dividend at least once a year. Where a

[7] *Investment and Securities Act 2007 s.193 (1).*
[8] *Ibid.*
[9] *New Rules and Amendment to the Rules and Regulations of the Commission as at June 2017, Rule 508.*
[10] *Investment and Securities Act 2007 s.193*
[11] *Securities and Exchange Commission Rules and Regulations [2013] Rule 511.*
[12] CAC Status Report (where applicable).
[13] *Ibid. Rule 526.*
[14] *Supra note 13, Rules 515 and 530.*
[15] *New Rules and Amendments to the Rules and Regulations of the Commission as at June 2017, Rule 510 (2) (3) (a) and (b).*

REIS fails to comply with these requirements, it is liable to a revocation of its operating licence by the SEC.[16]

Classification of Reis

Generally, REIS may be classified into three main categories as, (**a**) equity REIS (**b**) mortgage REIS, and (**c**) hybrid REIS. These categories reflect the underlying assets subject to the REIS.

(a) Equity REIS: This is a scheme which invests in, owns and manages money-making real estate assets, and its revenues are generated primarily through the collection of rent.[17] Most REIS are equity REIS and are also referred to as REITs. The main business operations of REIS include the acquisition or sale of properties, property management, leasing, property rehabilitation, repositioning, and property development.[18]

(b) Mortgage REIS: A mortgage REIS involves on-lending money to real estate owners and operators either directly through mortgages and loans that are secured by real estate assets, or indirectly through the acquisition of mortgage-backed securities and earning income from the interest on these investments. Essentially, a mortgage REIS finances real estate transactions[19] rather than owns or manage such real estate assets. Thus, the income of a mortgage REIS is generated principally by the net interest margin calculated on the basis of the interest accrued on mortgage loans and the cost of funding the loans.

(c) Hybrid REIS: This is a combination of both the equity REIS and the mortgage REIS and involves the participation of the REIS in real estate acquisition, development, management, and financing of the investment.[20]

Furthermore, REIS may also be categorized into close-ended and open-ended. A close-ended REIS can only issue units or its shares to the public once (as in the case of an initial public offer). Any subsequent issue of additional shares or units is subject to the approval of the existing holders. A unit holder in a close-ended REIS may typically redeem his units. An open-ended REIS, on the other hand, like an open-end unit trust, is permitted to issue additional units or shares from time to time as the REIS deems appropriate.

Investment of Reis Assets

Another notable feature of a REIS is that only a maximum of twenty-five percent (25%) of its total assets can be invested outside Nigeria and this is limited to investments within Africa[21] The country of investment within Africa must have a minimum investment credit rating given by an international

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[16] *Ibid*.
[17] Keke and Emoh 'Real Estate Investment Trusts (REITs) and Mortgage-Backed Securities (MBS) as Emerging Trends for Financial Real Estate Development in the Nigerian Capital Market' (2015) International Journal of Civil Engineering, Construction and Estate Management V. 3 pp 1-7 <http://www.eajournals.org/wp-content/uploads/Real-Estate-Investmen-Trusts-Reits-And-Mortgage-Backed-Securities-Mbs-As-Emerging-Trends-For-Financing-Real-Estate-Development-In-The-Nigerian-Capital-Market.pdf> accessed May 16, 2023
[18] Jaclyn McLellan 'The Basics of Real Estate Trusts (REITs)' (2018) American Association of Individual Investors Journal, 625 Michigan Aye, Chicago < https://www.cannonfinancial.com/uploads/main/10165_the-basics-of-real-estate-investment-trusts-reits.pdf > accessed May 16, 2023
[19] *Ibid*
[20] *Daniel Ibrahim, Olusegun Adebayo 'The Structure, Conduct and Performance of REITs in Emerging Markets: Empirical Evidence from Nigeria' (2019) JARER 4 <https://journals.uct.ac.za/index.php/JARER/article/download/827/656> accessed May 12, 2023.*
[21] *New Rules and Amendments to the Rules and Regulations of the Commission as at June 2017, Rule 521 (3) and 539 (3)*

rating agency. The REIS shall own a minimum of seventy-five percent (75%) of the legal interest in any real estate or REIS special purpose vehicle within its portfolio, and must have effective control over the assets.[22] Noteworthy is that, in the case of an investment outside Nigeria, no single assets should constitute more than twenty-five percent (25%) in the case of a REICO and twenty percent (20%) in the case of REIT, by value of the gross asset value of the REIS.[23]

Further, it is interesting to highlight that investment of pension funds cannot be made directly in real estate assets, in principle such investment could only be made through the instruments of (i) REIS; (ii) mortgage-backed securities; and (iii) similar non-interest compliant instruments.[24]

Tax Implications of Reis

REIS enjoys a certain level of tax exemption in respect of a REICO's rental income and dividend subject to fulfilment of certain conditions.[25]In 2021 the Federal Inland Revenue Service ("**FIRS**") issued an information circular[26] (the "**Circular**") providing clarification on tax exemptions for REICO. The Circular has for the purpose of tax exemption classified the income of REICOS into:(**a**) rental income; (**b**) dividend from another REICO; (**c**) gains from disposal of assets; and (**d**) fees and other income not related to REIS.[27]

The rental income and dividend flowing into a REICO are exempted from companies income tax, provided the REICO[28] (**a**) distributes a minimum of 75% of the dividend and or the rental income; and (**b**) made the distribution within 12 months of the end of the financial year in which the rental income or dividend was earned. Thus, any failure to meet these two conditions will expose the rental income to tax under Companies Income Tax Act (**"CITA"**).[29] Notably, such dividend and rental income once distributed to the shareholders become taxable.[30]

In the case of distribution or dividend payment made to a REICO by a REIS, withholding tax under companies income tax[31] will not apply.[32] However, where a distribution is made by the REICO to its shareholders, the REICO is required to withhold tax at the rate of 10% and remit the same to the relevant authorities.[33]

On the other hand, fees and other income of REICO that are not related to REIS are taxable in accordance with the relevant tax laws.[34] Additionally, 'interest in land and buildings' with the exception of fittings are not exchangeable to value added tax.[35] Therefore, the exclusion will considerably cover lease and rental of real estate assets, as such rental income and dividend of REICO are not vatable. It

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[22] *Ibid*
[23] *Ibid Rule 521 (4) and 539 (4)*
[24] Regulation on Investment of Pension Fund Assets, 2019, s. 5.2.6
[25] *Companies Income Tax Act 2004 (as amended by Finance Act 2019 and 2020) s 9, 19, 23, 24 and 80*
[26] *Circular on Tax Implications of Operation of Real Estate Investment Companies ('REIC') in Nigeria (2021) No: 2021/17*
[27] *Ibid Paragraph 5.0*
[28] *Ibid Paragraph 6.1.1*
[29] *Companies Income Tax Act 2004 (as amended by Finance Act 2019) s. 19*
[30] *Circular on Tax Implications of Operation of Real Estate Investment Companies ('REIC') in Nigeria (2021) No: 2021/17 Paragraph 6.1.2*
[31] *Companies Income Tax Act 2004 s. 80*
[32] *Supra Note 40, paragraph 6.1.4*
[33] *Ibid Paragraph 6.1.5*
[34] *Ibid Paragraph 6.2*
[35] *Finance Act 2020, s. 44 and Finance Act 2023, s. 24*

is however not clear if REICO is exempted from tertiary education tax as the relevant tax legislations are silent on the issue.[36]

Performance of Reis in Nigerian Market

In analysing REIS performance, it is necessary to consider the operational success of the existing REIS and the profitable returns that investors may gain from the REIS.[37] Positivity in the operation of REIS and the profitable returns to investors will beyond doubt open windows for the wider acceptance of REIS. There is a paucity of data on the performance of REIS in the Nigerian market. The studies available have recorded low performance or underperformance by the Nigerian REIS. For instance, from 2008-2012, Skye Shelter REIT (which is among the top three listed REITs in Nigeria) declared dividends and gained 5.7% in 2008 and 3% in 2011. As for Union Homes REIT, it has from its listing day recorded consistent losses.[38] Noteworthy is that the number of listed REITs in Nigeria has not significantly increased, perhaps because the existing REITs have recorded low, and at some points negative, return value in their respective investments.[39]

The underperformance of REIS is not unconnected with the extant real estate laws in Nigeria (*i.e*, the Land Use Act 1978 (the "**LUA**") as well as the state tenancy laws). The LUA vests the ownership of all lands comprised in the territory of each state (except those vested in the Federal Government or its agencies) solely in the Governor to hold in trust and administered for the use and common benefit of all Nigerians in accordance with the provisions of the Act.[40] The governor is empowered by the LUA to grant statutory right of occupancy to persons seeking to acquire lands or invest in real estate, however such grants are subject to the powers of the governor to revoke such grants on grounds of overriding public interest.

Thus, where a landowner has not made improvements on the land and the land has no economic troops on it, and his right or interest in the land is revoked by the governor, such landowner/real estate investor loses his investments without compensation from the government. In practice, even where there are improvements on the land and the government revokes and demolishes such buildings on the land, the owners barely get compensated with ease. These provisions of the LUA and the way government treats compensation in a way raise concerns and discourage investments in real estate business in Nigeria.

Further, the state tenancy laws place onerous conditions and requirements on a landlord to successfully evict a defaulting tenant. It stipulates that in the absence of any agreement between the landlord and the tenant, for a landlord to evict a yearly tenant, such tenant must be served with a six (6) months-notice to quit. If after the expiration of the notice to quit, the tenant still refuses to give up possession, the landlord is again required to serve the tenant another seven (7) days' notice of the owner's intention to recover possession. At the expiration of the seven (7) days-notice, the landlord is

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[36] *Oluwatobi Olafaju, 'Are Incomes from Real Estate Investment Scheme Taxable' <https://www.mazars.com.ng/content/download/1049446/54690483/version//file/Business%20Day%2035th%20edition.pdf> accessed November 30, 2023.*

[37] *Olusegun Olanrele, Rosli Said et al 'Real Estate Investment Trusts (REITS) Industry in Nigeria: The Influence of External Factors on Returns' (2014) Conference Paper <https://www.researchgate.net/publication/336136203> accessed on May 12, 2023*

[38] *Ibid*

[39] *Daniel Ibrahim, Olusegun Adebayo 'The Structure, Conduct and Performance of REITs in Emerging Markets: Empirical Evidence from Nigeria' (2019) JARER 4 <https://journals.uct.ac.za/index.php/JARER/article/download/827/656> accessed May 12, 2023*

[40] Land Use Act, 1978 s. 1.

still not entitled to resort to "self-help" but to apply in the appropriate court to recover the premises even where the tenant wilfully refuses to give up possession.[41]

Where the notices are not served on the tenant as required by law, it amounts to a fundamental issue capable of robbing the court of its jurisdiction to entertain the suit. These onerous requirements of the law couple with inordinate delay in the judicial process do not make for ease of business where a landlord has to serve notices and wait months to be able to replace a tenant who is failing to pay his rents.

Other factors resulting in the underperformance of REIS in Nigeria relative to other jurisdictions like United States of America include (i) lack of market openness/responsiveness; (ii) insufficient market information; (iii) a paucity of skilled real estate professionals;[42] (iv) poor real estate documentation; (v) absence of title insurance; (vi) limited spending power and (vii) limited investible funds (as discussed above, pension funds).

Conclusion and Recommendation

It is evident that despite the legal regime set in place for REIS and the tax privileges that they enjoy, there is a high level of poor performance by REIS in the Nigerian capital markets. This is particularly discouraging considering that Nigeria has a housing deficit crisis which has worsened in recent times as studies show that the housing deficit has been on a steady rise from 7.0 million in 1991 to 14 million in 2010.[43]A World Bank report in 2018 has shown that Nigeria requires about 700,000 housing units annually spanning through a 20-year period to accommodate the rising population.[44]

REIS, if effectively harnessed and utilized will help solve Nigeria's housing deficit crisis, create more opportunities for investors and increase government revenue. It is our recommendations that:

a. favourable legislation should be put in place to encourage real estate investments in Nigeria as well as protect investors and their respective investments. In addition, the LUA and other state tenancy Laws should be amended in light of the issues discussed previously, to attract investors and boost investments in real estate sector;
b. reduced dominance in the real estate sector by finance experts. Instead. Policies should be put in place to attract more real estate developers;
c. more awareness and advertisement should be done to boost participation in RIES market as a lot of Nigerians are not aware of the existence of the scheme;
d. government should provide more incentives to REIS to make the scheme more attractive and profitable to investors such as more tax reliefs or reduced taxation;
e. adequate legal framework should be set in place; and
f. institutions such as the Urban Development Bank, Federal Mortgage Bank of Nigeria and Federal Mortgage Finance Limited should be encouraged to help provide special funding to enable REIS access funds required to successfully run its business.

[41] Sec 8 Recovery of Premises Act 1990; Sec 13 Recovery of Premises Law of Lagos State, 2011

[42] Daniel and Joshua et al 'Organisational Structure and Performance of Nigerian REITs' (2021) <https;//ssrn.com/abstract=3904879> accessed May 12, 2023

[43] Prof. Akpan Ekpo, 'Housing Deficit in Nigeria: Issues, Challenges and Prospects' (2019) <https://www.cbn.gov.ng/out/2020/rsd/efr%20vol%2057%20no%204%20december%202019%20housing%20deficit%20in%20nigeria%20issues,challenges%20and%20prospects.pdf> accessed May 23, 2023

[44] Ibid Paragraph 3.

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