

RELATIVE PERFORMANCE OF LOAN RECOVERY IN REAL ESTATE AND NON-REAL ESTATE SECTORS IN LAGOS METROPOLIS

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ABSTRACT

Purpose: The paper investigates the recovery of loan granted for economic activities in some selected sectors of Nigerian economy. This was as a result of the growing trend of unrecovered loans with its debilitating effect on the overall economy which has become a worrisome challenge for sustainable economic development.

Design/methodology/approach: The targeted population for the study comprises all commercial banks and Primary mortgage institutions in Lagos Metropolis. Fourteen (14) and forty (40) commercial banks and primary mortgage institutions respectively were randomly selected for the study. Furthermore, 3,197 loan accounts comprising of the fully recovered and partially recovered loans in different sectors of the economy were purposively accessed from the databases of the selected lending institutions between 2000 and 2015. Collected data were analysed using descriptive statistics, t-test and analysis of variance (ANOVA).

Findings: The result revealed that the amount of loan recovered from various sectors of the economy is significantly different from one another. The t-test result reveals that the percentage of loan recovered from real estate sector is significantly higher in the fully recovered loan category than those in the partially recovered category, while the percentage value of loan recovered from agriculture, oil, mining, manufacturing and telecommunication sectors are significantly lower in the fully recovered loan category than in the partially recovered loan.

Practical implications: The paper recommends that lending institutions should continue to make funds available and more accessible to all sectors especially real estate sector in order to boost economic activities thereby affecting the growth of the Nigeria economy. A study with larger sample that focuses on loan recovery across all lending institutions in African continent may be considered as a further study for a more adequate representation

Originality/value: The research revealed that all the sectors under review achieved more than 50% loan recovery rate, however, the amount of loan recovered from the real estate sector is significantly higher than the amount of loan recovered from non-real estate sectors.

Keywords: Real estate; non-real estate; sector; loan; recovery

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1. INTRODUCTION

For any economy to grow there is the need for all the sectors to be effectively functional. However, the major ingredient needed for any sector to thrive competitively is the availability of credit usable for the effectiveness of these sectors. Financial institutions lend considerable amount of money for investment activities in various sectors of the economy, e.g. Agriculture, Real Estate, Industry, Manufacturing, Service sectors, etc. Financial institutions provide the needed credit by way of lending considerable amount of money for investment initiation and expansion. This amount lent is however expected to be repaid to the lending institution to enable same to be extended to other sectors of the economy. It is pertinent to note that this lending intermediation role of lending institutions carries with it some risks; this lending more often is fraught with a number of risks which include the risk of recovery of the defaulted loans. The consequences of this trend include, decline in bank's profit level (Somoye, 2008), restriction in credit expansion (Caprio and Klingebiel, 1999), decrease in the level of private investment, increased deposit liabilities (Fofack, 2005), bank instability and distress (Caprio and Klingebiel, 1999 and Hoang, 2006) and hampering of future economic expansion (Fofack, 2005). The continued increase in loan default and bad debt with low corresponding recovery of same has reached a challenging level. Sanusi (2009) also affirmed that the bad debt in the financial industry stands in excess of N300 billion with the percentage of non-performing loans ranging from 19 % to 48 %. out of N461, 988 billion loan in default state in Nigerian commercial banks only N15, 962.60 billion were recovered representing just 3.4% (CBN, 2010).

It must be noted that loan recovery is the main factor that determines the quality of loan asset of financial institutions and if the loans are not adequately recovered, it erodes into the profit of the bank and impedes the growth of developmental projects (Ahmed, 2010). The huge credit losses arising from unrecovered defaulted loans have begun to attract attention among practitioners and academia but with mixed findings and sometimes with contradictory evidences (Khieu, Mullineaux, and Yi, 2012). Aluko (2007) asserted that loans are recovered primarily from the cash flow of borrowers and lamented that where the primary source of loan repayment fails; a secondary source of repayment becomes the last resort. Nargundkar and Prtestley (2010) deduced that accurate prediction of a customer likelihood of loan repayment at the point of loan origination is particularly important because it improves lender's understanding of the inherent risk. The need to fully recover outstanding loan in the different sectors has become more compelling in view of the rising cases of huge credit losses arising from loan default and unrecovered defaulted accounts. A good estimate of the probability of recovery of defaulted account offers important signal to lender before lending decision is made and this helps in understanding conditions and terms to be attached to a particular loan account based on the peculiarity of the sectors. Most of the few studies on loan recovery were carried out in the United States of America (USA) and United Kingdom (UK) with less attention given to it in the developing countries. For instance, in Europe, Carty and Lieberman (1996) measured the recovery rate on a sample of 58 bank loans in the USA using secondary market prices of defaulted loans for the period of 1989- 1996, the study reported an average loan recovery rate of 71%. Grossman, Breman and Vento (1998) analyze recovery rate on 60 syndicated bank loans in the USA over the period of 1991-1997, the study revealed an average loan recovery figure of 82% with standard deviation of 24%. It is pertinent to note that despite the implications of unrecovered loan to the soundness of financial sector and the economy at large; research efforts have been sparse on the subject of loan recovery in Sub-Sahara African countries (Fofack, 2005). In the same vein, previous studies seem to have concentrated on default

rate among borrowers but much is yet to be done on sector by sector loan recovery. It is against this backdrop that this study aims at examining the recovery performance of the defaulted loans in the different sectors of the economy.

The remainder of the paper is structured to include, brief review of literature, research method, empirical analysis and conclusion.

2. LITERATURE REVIEW

Loan is defined as being in default if it is overdue for more than 90 days (Wong, Fong and Size, 2004). Loan recovery rate is the ratio of total recovery of the defaulted loan at the end of the loan divided by the amount of outstanding at the date of default (Bandyopadhyaya and Saha, 2009). Dermine and De Carvalho (2005) showed that the loan recovery is a function of collateral asset, loan size, the industry factor and the age of the borrower. The study further established that when the cost associated with recovery is high, the ultimate recovery is low. Inwon (2002) emphasised that to enhance full recovery of loan there should exist a robust legal environment that prevents multiple pledging of asset that provides an efficient process for asset realisation. Bassell Committee and Banking Supervision (BCBS) (1999) made a list of factors that enhance loan recovery, which include, borrower's current financial condition; borrower's paying ability, the current value of collateral and other factors. Somoye. (2010) affirmed that poor recovery level of loan in default by financial institutions has turned into a huge problem and it has brought negative influences on bank's profit, government income and decline in the performance of the different sectors of the economy. This poor recovery of loan calls for mechanisms that ensure early recovery of debts (Oloyede, 2004).

Aremu, Suberu and Oke (2010) opined that effective and aggressive loan recovery is the foundation upon which the superstructure of sound banking system is built. The study further enumerated the functions of the recovery unit to include; determination of action plan, pursuance of all alternative to maximize recovery (place the borrowers into receivership or liquidation), ensuring that adequate and timely loan loss provisions are made on actual and expected losses, regular review of deteriorating loan, assigning the substandard account to a specific account manager in the recovery unit. In the view of Momoh (2009), loan recovery could be achieved through constant visit to the borrower, appointment of rent receiver, liquidator and legal actions for sum outstanding at foreclosure. Also, Oloyede (2004) enumerated options available for the recovery of an outstanding loan as: garnishment of the borrowers wages in the case of people on salaries, collection from guarantor by garnishment of their wages where such a guarantor is on paid employment, sale of the mortgaged property in situation where the value of the unpaid loan with accrued interest and seizure and management of the mortgaged property in situation where the property is in good tenable condition and the rent recoverable over time would be in excess of the anticipated monthly repayment and the cost of management.

Asarnow and Edwards (1995) presented a univariate analysis of bank loans default data on 831 commercial and industrial loans and 89 structured loans made by Citibanks over 24 years. It was found that there was an average recovery of 65% and 85% for unstructured and structured loans respectively. The study confirmed that the higher recovery rate recorded for structured loans reflects the fact that such loans are heavily collateralised and contain many restrictive covenants. Caselli, Gatti, and Querci (2008) used a large sample of 11,649 loans to household (small and medium enterprises) from the five largest Italian banks between 1990 and 2004. The study found that loan recovery and

default depend on various macro-economic variables. Furthermore, Grossman *et al.* (1998) analysed secondary rate of 60 syndicated bank loans over the period of 1991 – 1997. It was revealed that there was an average recovery figure of 82%. Hurt and Felsovalyl (1998) analysed 1,149 bank loans losses in Latin America over the period of 1970 – 1996, the work discovered an average recovery rate of 68.2%. On the factors that influence loan recovery in lending institutions, Khieu and Mullineaux, (2009) classify factors that affect loan recovery into four groups which include loan characteristics, borrower characteristics, macroeconomic characteristics and industry characteristics. The work also found that loan characteristics and certain types of collateral are significant determinants of loan recovery. Aremu *et al.* (2010) noted that since default and bad debt are peculiar to credit transaction, the issue of recovery of loan should assume the topmost priority.

3. METHODOLOGY

The study adopted survey design and structured questionnaire instrument was used as a means of collecting information from the databanks of selected commercial banks and PMIs in Lagos Metropolis. The target population in this study is all the lending institutions in Nigeria. These include commercial banks, Primary Mortgage Institutions (PMIs), Agricultural bank and Development bank. Others include, bank of Industry and Development Finance Institutions (DFIs). The study populations for the study comprise of commercial banks and Primary Mortgage Institutions in Lagos Metropolis. The sampling frame for this research was 21 commercial banks and 65 Primary Mortgages Institutions as confirmed by CBN (2012). For constraints of time and resources, 14 out of 21 commercial banks representing 66.6% and 40 out of the 65 licensed PMIs representing 61.5% were randomly selected. A total of 3,197 loan accounts in the categories of fully and partially recovered loans after default were purposively selected from the sampled lending institutions. For the population of commercial bank and PMIs, primary data such as; background information of respondents, bank's lending activities and data on defaulted borrowers' accounts were collected.

Both the descriptive and inferential statistics were used for the analysis of the data. Frequency distribution was used to analyse the amount of loan recovered from the various sectors of the economy. Student t-test was adopted to compare the sampled loan accounts in the fully and partially recovered categories. The analysis of variance (ANOVA) was used in testing the null hypothesis of no variation in the amount of loan recovered across the selected sectors of the economy, while post hoc test was also carried out to determine the point of variation (if any) in the amount of loan recovered across all sectors under review.

4. PRESENTATION AND DISCUSSION OF RESULTS

The results of the analysis in the study are presented in this section. Table 1 indicates that a total of three thousand, one hundred and ninety-seven (3,197) individual loan deals were sampled out of which One thousand, four hundred and thirty (1,430) are in the partially recovered category representing 44.7% while the remaining 1,767 (representing 55.3% of total) are in the fully recovered category. Table 1 also indicates that the percentage of the loans granted for real estate purpose is the highest (31.1%) followed by loans granted for agricultural purpose (26.5%) while the percentage of loans granted for mining related

purpose is the least being 3.7%. Other loan purposes include oil, industry, manufacturing and telecommunication 11.7%, 11.9%, 9.6% and 6.2% respectively.

Table 1: Frequency distribution of the sampled loans granted to different sectors

		Number	Percent
Recovery Status	Partially recovered	1430	44.7
	Fully recovered	1767	55.3
	Total	3197	100.0
Loan Sector	Agriculture	846	26.5
	Oil	353	11.0
	Real Estate	993	31.1
	Mining	119	3.7
	Industry	381	11.9
	Manufacturing	308	9.6
	Telecommunications	197	6.2
	Total	3197	100.0

The total amounts of loan recovered from different sectors are presented in Figure 1. The result shows that the amount of loan recovered from the selected sectors are above 50% with minimum being 67.73% from mining and maximum being 90.4% from real estate sector.

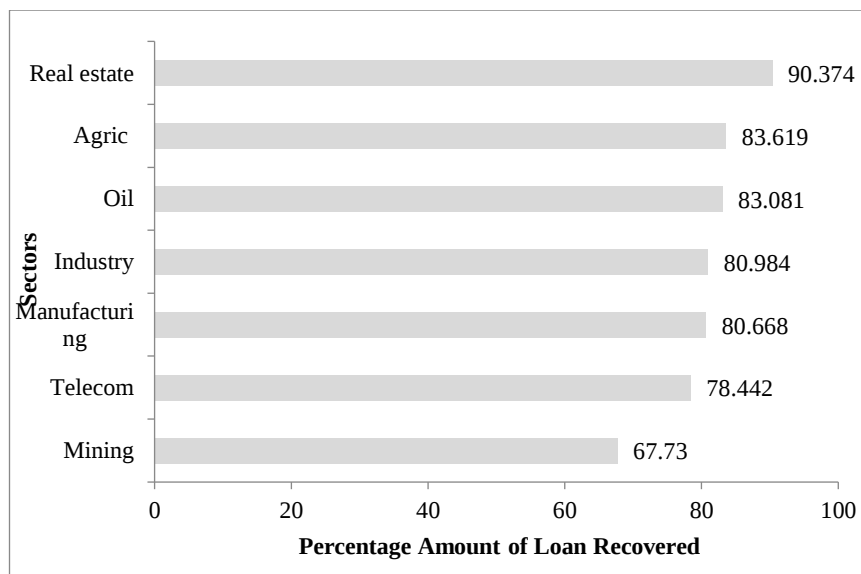


Figure 1: Percentage of loan recovery in different sectors

The result in Figure 1 indicates that real estate has a recovery percentage of 90.37% followed by Agriculture sector (83.061%), oil sector (83.08%), industrial sector (80.66%), manufacturing sector (74.44%) and mining (67.73%). Furthermore, the result of analysis of variance used in testing the null hypothesis that there is no variation in the amount of loan recovered from all the sectors is presented in Table 2.

Table 2: Analysis of Variance (ANOVA) of loan recovery in the various sectors

	Sum of Squares	Df	Mean Square	F	Sig.
Between Groups	85158.065	6	14193.011	18.949	.000
Within Groups	2389332.775	3190	749.007		
Total	2474490.840	3196			

From Table 2, the F statistics is 18.94 which is significant at 99% confidence level indicating that the null hypothesis be rejected and accept the alternate hypothesis that there is variation in the amount of loan recovered across the selected sectors. Having established the fact that there is a variation in the amount of loan recovered from the sectors, a post hoc test was adopted to determine the point of variation in the amount of loan recovered from the sectors and the result of same is presented in Table 3.

Table 3: Post-hoc test on loan recovery in each sector

(I) Loan Sector	(J) Loan Sector	Mean Difference (I-J)	Std. Error	Sig.	95% Confidence Interval	
					Upper Bound	Lower Bound
Real estate	Agriculture	6.75460(***)	1.2808	.000	2.8613	10.6479
	Oil	7.29280(***)	1.6951	.000	2.1364	12.4492
	Mining	22.64312(***)	2.6549	.000	14.5709	30.7154
	Industry	9.38988(***)	1.6490	.000	4.3752	14.4046
	Manufacturing	9.70519(***)	1.7847	.000	4.2780	15.1324
	Telecommunications	11.93153(***)	2.1346	.000	5.4414	18.4217

*** Significant at 0.01 level

The result of post hoc test indicates the points of variation in the amount of loan recovered from all the sectors. It shows that the amount of loan recovered from real estate sector is significantly higher than the amount recovered from Agriculture, Oil, Mining, Industry and Telecommunications by 6.7540, 7.2928, 22.6431, 9.3898, 9.7052 and 11.9315 respectively. Table 4 presents the result of the independent t-test between the fully and partially recovered categories.

Table 4: Independent t-test of the sampled loans in the fully and partially recovered loans categories

Variables/Sector	Fully Recovered (N=1037)		Partially Recovered (N=918)		T-Test Statistics			
	Mean	Std. Dev.	Mean	Std. Dev.	Mean Diff	t	Sig. (2-tailed)	
Agriculture	0.17	0.37	0.19	0.40	-0.03	-1.55	0.12*	
Oil	0.11	0.32	0.13	0.34	-0.02	-1.14	0.25	
Real Estate	0.47	0.50	0.32	0.47	0.15	6.96	0.00***	
Mining	0.01	0.08	0.04	0.19	-0.03	-4.69	0.00***	
Industry	0.10	0.30	0.14	0.34	-0.04	-2.73	0.01**	
Manufacturing	0.10	0.30	0.11	0.31	-0.01	-0.68	0.50	
Telecommunications	0.05	0.21	0.07	0.26	-0.03	-2.57	0.01**	

(***) significant at $p \leq 0.01$ (99.0% confidence level); (**) significant at $p \leq 0.05$ (95% confidence level); (*) significant at $p \leq 0.1$ (90% confidence level); N= total population in each group.

Table 4 presents the result of the unpaired (independent) t-test used in comparing the characteristics of the sampled loans in the two categories. The result shows that the amount of loan recovered from Agricultural, Mining, Industrial and Telecommunications sectors are significantly higher in the partially loan recovered category than in the fully loan recovered category. However, the amount of loan recovered from real estate sector is significantly higher in the fully recovery category than in the partially recovered category at $p \leq 0.000$ confidence level.

5. CONCLUSION AND RECOMMENDATIONS

The study attempts to examine the amount of loan recovered from different sectors of the Nigerian economy between 2000 and 2012. Data for the analysis were collected from the databases of commercial banks and PMIs in Nigeria. Descriptive statistics, independent t-test statistics ANOVA and post hoc test were adopted in analysing the data collected. The study concludes that all the sectors achieved more than 50% loan recovery rate. This finding was corroborated by Dermine & De Carvalho (2006) which maintained that the rate of loan recovery in many sectors has improved significantly. As good as this discovery may be there is the need for due diligence on the part of lenders to assess the prevailing general economic conditions of the nation before extending loans to any sector. Taking any sector as a priority in terms of lending is a function of the current and projected states of such a sector (Khieu and Mullineaux, 2009). It is also concluded that the amount of loan recovered from real estate sector is significantly higher than non-real estate sector. This is in line with the report of Pfister and Sartori (2015), the recovery in real estate lending activity is more apparent across the dominant and established economies in Europe based on banks' feedback. Given this kind of feedback from the study as touching real estate sector, lending institutions in Nigeria may take real estate sector as a priority sector in lending like her counterparts in other countries, such as, Austria, the UK, Italy, the Czech Republic and others.

The paper recommends that lending institutions should continue to make funds available and more accessible to all sectors in order to boost economic activities thereby affecting the growth of the Nigeria economy. A study with larger sample that focuses on loan recovery across all lending institutions in African continent may be considered as a further study for a more adequate representation.

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