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Behavioural Analysis of Insurance Companies in Real Estate Investment in Nigeria

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Abstract
Insurance companies play two major roles in the economy. First is providing indemnification and second is institutional investment. This study's focus is on the latter role in Nigeria. The study examined the perception of insurance companies about real asset in their portfolio and factors that influence investment in the asset. Structured questionnaires were distributed to fifty-two insurance companies in Lagos State. Data collected were presented in tables and analysed with statistical tools such as percentages, mean and relative importance index for ease of understanding. It was found that capital security and portfolio stability (diversification) were the principal driving motive for investing in real estate while liquidity concern, high transaction costs, inadequate infrastructure development in the country and unreliable valuation data among others constitute major factors militating against investment in real estate. It was further found that investment in real estate is currently far below what the law stipulates in Nigeria. The paper therefore concludes by suggesting that insurance companies need to see real estate as attractive investment asset and invest in creating comprehensive real estate submarket rather than cherry-pick manner investment in properties.
Keywords: Behaviour, Insurance Companies, Real Estate, Investment, Portfolio, Institutional Investors

1 Introduction

Wozala, Sirmans and Zietz (2000), stated that institutional investors perception of risk and returns on various investment vehicles have important implications throughout financial markets. The authors further observed that how large investors such as pension funds, insurance and fund managers discern risk and returns on specific investment and subsequently make allocations in these assets have significant impacts on their portfolios. Dubben and Sayce (1991) also observed that investor's perception of what constitutes a high or low risk investment may change over time and with it, the pattern of yield will alter. Insurance companies are regarded as channel of nations' economic development because of the large fund reserve and ability to commit to long term investment. Insurance companies in Nigeria have either restructured or recapitalized at various times not only to meet the primary obligations but also to empower the industry to mobilize fund for investment in other economic sectors including the real estate. Akinwumi (2009) opined that insurance industry was expected to make direct investments in acquisition of primary mortgage institutions and sectoral lending to real estate. The author however observed that the industry's involvement in real estate nose-dived prior to the latest re-capitalisation in 2005. However, whether the trend improved after the exercise was not clear and to a large extent, depends on the perception of real estate in the mixed asset portfolio of these companies.

Generally, it is acknowledged that investments are often characterized by risk and uncertainty. The deteriorating economic and political climates in many countries have made investment decisions more precarious. In real estate investment, the consummation of a project is subjected to intrigues of decision making at various stages and by different parties. Real estate investment could be in form of property acquisition or modifying existing property through conversion, adaptations, alterations, renovation, refurbishment, development or wholesome redevelopment with the primary objective of improving its earning capacity. Underlying any course of action is that the anticipated return justifies the proposed investment. Butler and Domain (1991) however noted that deciding how to allocate assets in a portfolio is the most important financial decision facing individuals and portfolio managers. Consequent upon this, the study examined the perception of real estate as an asset in a mixed asset portfolio of insurance companies with a view to identifying factors that influence investment in the asset.

2 Rationale for Real Estate Inclusion in the Portfolio of Institutional Investors

The inclusion of real asset in the portfolio of institutional investors and portfolio managers has been a topical issue especially the question of why and what proportion in the portfolio. Real estate investment could either be securitized (small cap) or unsecuritized (large cap). Two principal reasons were advanced for the justification of unsecuritized real estate in the mixed asset portfolio of an institutional investor. First is to stabilize the portfolio by reducing to the barest minimum, the volatility in returns thereby providing investors with positive real rate of returns. Second is that real estate provides an edge against either expected or unexpected inflation. Different empirical studies asserted that real estate have consistently been found to hedge at least unexpected or expected

inflation. For instance, Ibbotson and Siegel (1984) examined hedging abilities of unsecuritized real estate from 1947 through 1982 and concluded that the degree of co-movement between real estate and inflation is an incredible 85 per cent. Wurtzbach, Mueller and Machi (1991) identified vacancy rates as a crucial factor in determining real estate hedging capabilities and concluded that when vacancy rates are low or moderate, unsecuritized real estate serves as a good hedge against inflation. Montezuma (2003) also upheld this supposition and corroborated existing studies that unsecuritized real investment does not only generates risks-adjusted returns comparable to those on bonds and shares, but also provides low correlations with shares and bonds. This low correlation implies that real asset is an effective hedge against fluctuations in the capital markets.

More important to decision-making however is the proportion of resources that should be allocated in real estate. Different studies showed significant variations in what should constitute ideal or optimal allocation into real estate. Fogler (1984), Gold (1986), Irwin and Landa (1987), Firstenberg, Ross and Zisler (1988) opined that between 15 to 20 per cent should be allocated to real estate. Hartzell (1986) suggested between 3 to 11 per cent while Brinson, Diermeier and Schlarbaum (1986) opined that 20 per cent would be ideal. Webb and Reubens (1987) suggested at least 43 per cent. Furthermore, Webb, Curico and Reubens (1988) indicated two-thirds of any portfolio should be real estate. Ennis and Burik (1991) came up with between 10 to 15 per cent while Giliberto (1992, 1993) suggested between 5 and 15 per cent and 19 per cent optimal allocations respectively. Kallberg, Liu and Greig (1996) however felt that real estate should compose of 9 per cent of optimal portfolios. Contrary to the different figures proposed by earlier studies, Chun, Sa-Aadu and Shilling (2002) found that all the available data on ownership of real estate reveal that institutional investors hold between $3^1/_2$ to 4 per cent of their assets in real estate. Dhar and Goetzmann (2005) in a survey of major institutional investors across USA, observed that the modal allocation to real estate asset was between 3 and 5 per cent.

Different reasons were identified as responsible for the lack of consensus and wide variation in what should represent an ideal allocation. These include indivisibility of real estate assets, illiquidity, lags in return data, appraisal smoothing and high transaction costs (Seiler, Webb and Myer 1999). Beyond this however, the diverse opinion as to ideal resource allocation showed that decision making have both objective and subjective faces and that allocation decisions are made in an environment of incomplete information, changing estimates of return and shifting definition of risk. Eichholtz et al. (1995) noted that the top-down approach to portfolio allocation involves first, the decision as to how much to allocate to each asset category; and second, a decision on an optimal strategy within each asset category. This according to the authors involved the management of risk through diversification within the asset category and effective analysis of expected return. The real estate investment practice of insurance companies in Nigeria was therefore x-rayed in the light of the foregoing in order to gain insight into the perception of real estate in the asset portfolio, the various elements of risks and factors influencing investment in real estate.

3 Evolution of Insurance Industry in Nigeria

In order to strengthen insurance companies and enhance global competitiveness, government introduced series of interventions. Okwor (2005) and Barros, Caporale and Ibiwoye (2008) highlighted major legislation in this direction as well as their respective thrusts. These include the Insurance Companies Act of 1961 which provided for the registration of insurance companies and stipulated a mode of limited control; the Insurance (Miscellaneous Provision) Act of 1964 which regulate insurance funds; the Insurance Companies Regulation of 1968 enacted to strengthen pre-registration conditions; the Insurance Acts of 1976 which introduced the registration and supervision of intermediaries; the Insurance Acts of 1991 that addressed the problems encountered in the implementation of 1976 Act; the Insurance Acts of 1997 which re-classified insurance business and re-categorised minimum paid-up share capital requirements. Furthermore, Section 3 of Insurance Act of 2003 stated explicitly that no insurance company can invest more than 35 per cent of its assets in real estate property and also introduced the first major re-capitalization process which raised the minimum capital requirement by as much as 650% leaving the capital base below N500 million (Ojo 2012). In the year 2005, the re-capitalization directive further raised the capital base to 2billion Naira for life insurance, 3billion Naira for non-life insurance and 10billion Naira for re-insurance companies.

According to Nubi (2005), insurance companies can extend loans for real estate development based on capital value of the policies, investment in mortgage and debentures or direct investment in real property by acquiring or developing landed properties. The Nigerian Insurance Report (2010) remarkedly stated that re-capitalisation of insurance sector in Nigeria has no doubt recorded a huge volume of business. For instance, the sector was able to pull an aggregate gross premium income of 90 billion Naira in 2007, which was over 18 percent more than what was obtained in 2005. Growth in premium maintained an upward trend of 25 per cent in 2008 and 30 per cent in 2009 (Nigerian Insurance Report, 2010). The overall impact of this growth on real estate investment is however not clear. Akinwunmi (2009) analyzing fund allocation to real estate by insurance companies prior to re-capitalization, observes decline in fund allocation to real estate from 12.1 per cent in 1985

to 7.2 per cent in 1986 and allocation to mortgage loans decline from 4.8 percent in 1985 to 3.9 percent in 1986 and 3.6 percent in 1987. The situation after re-capitalization exercise is not clear. Ujunwa and Modebe (2011) concluded that the astronomical increase in the number of insurance companies in Nigeria and the recent improvements recorded in the industry between 2006 and 2009 has serious research question on the strategies for economies of scale and optimum performance of insurance companies in Nigeria.

4 Research Methods

The population for this study comprises the 58 licensed insurance companies listed on the official website of the National Insurance Commission. These include 16 life insurance companies, 31 non-life insurance companies and 11 composite insurance companies (http://naicom.gov.ng/). For ease of administration and since most of them have head offices located in Lagos State, data collection were restricted to the 54 insurance companies in the State. However, only 52 was accessible. The relatively small population was adopted as the sample size. The primary objective of the study is to examine the perception of real estate in the mixed asset portfolio of these companies with a view to understanding its effect on resource allocation. Questionnaires were structured to elicit information on motives of investment in real estate, fund allocation to real estate, identification of risk items and their significance to decision-making. Fifty-two questionnaires were administered to the chief investment officers of each of the insurance companies in Lagos State. Tables were used in the presentation of data while percentages, mean and relative importance index are used to weigh the investment motives. A 5-point likert scale was also used to determine the significance of some parameters such as risk factors.

5 Data Analysis and Results

5.1 Response Rate

As earlier stated, fifty-two questionnaires were distributed out of which forty-eight were returned representing 92 percent rate of response. This was presented in Table 1. Response rate recorded from each category indicated overall high response level. This could be attributed to the fact that some of the respondents showed interest in the result of the research and were willing to make their contribution. Information gathered from the exercise was therefore deemed sufficient enough to make reasonable and reliable conclusions.

Table 1: The Response Rate

Category	Number Administered	Number Returned	Response rate
Life	15	14	93%
Non-life/General	27	25	93%
Composite	10	9	90%
Total	52	48	92%

Source: Author's Field Survey 2015

5.2 Motives for Investing in Real Estate

Respondents were requested to indicate the motive(s) of investing in real estate and the level of importance attached to it. This was presented in Table 2. The importance level was weighed on a 5 point Likert scale and the mean score derived subsequently ranked. Various reasons listed for investing in real estate include: low correlation with financial assets, inflation hedging ability, potential for appreciation, capital security, anticipated profit, cashflow flow from operation and diversification. Capital security, diversification and inflation hedging ability emerged the most important rationale for investing in real estate coming first and second on the relative importance index scale. This followed closely by low correlation with other assets, anticipated return and potential for profit which come third, fourth and fifth position respectively on the index. It could be inferred that most insurance companies have not seen real estate as attractive investment vehicle other than an avenue to secure capital or stabilize portfolio. By implication, where much is not expected in terms of quick and tangible returns, investors may be reluctant to commit more into such asset.

Table 2: Motives for Investing in Real Estate

Motives of investing in real estate	Weights					Rankings	
	5	4	3	2	1	RII	Ranks
Low correlation with other assets	75	72	18	18	0	3.813	3rd
Inflation hedging potentials	145	60	0	8	0	4.438	2nd
Potential for appreciation	55	44	57	12	6	3.625	5th
Capital security	175	52	0	0	0	4.729	1st
Anticipated profit (return)	80	68	6	26	0	3.750	4th
Cash flow from operation	45	56	0	44	3	3.083	6th
Diversification	135	72	0	6	0	4.438	2nd
Others	20	24	42	24	12	2.542	7th

5.3 Risk Elements in Real Estate Investment

Table 3 showed different risk elements often associated with real estate investment and respondents were requested to indicate the risks according to their level of importance to decision making process. Amongst the listed, liquidity, competition risk, lack of data, valuation reliability and managerial risk emerged as the topmost risk elements in real estate investments. The activities of private developers and institutional property development and investment companies create direct competition in property investment in the country thereby making competition a critical risk element. Liquidity is critical to insurance business and a critical factor during investment decision making. However, elements such as location and indivisibility constitute less impactful items of risk.

Table 3: Risk elements in real estate investment

Elements of risk	Frequency	Percentage
Legal	21	44%
Valuation reliability	41	85%
Lack of data	39	81%
Indivisibility	17	35%
Inconsistent return	26	54%
Liquidity concern	42	88%
Macro-economic	34	71%
Managerial	37	77%
Location	19	40%
Competition	42	88%

5.4 Factors Influencing Real Estate Investment Decision

Furthermore, enquiries were made concerning those factors that influence real estate investment decision making among insurance companies and their respective level of significance weighed on a 5-point likert scale: very important(5), important(4), undecided(3), less important(2), not important(1) and subsequently ranked on relative importance index scale.

Out of all the factors examined and analysed in Table 4, majority ranked close next to each other. Factors such as real asset performance, historical portfolio performance, current asset market value, competitors, and consultant's opinion emerge as the top main factors affecting real estate investment allocation decision. Surprisingly, factors such as the estimates of risks and return, opinion of investment team, current market trend and decision of peers came out with relatively low level of importance. This could be attributed to the fact that estimates of risk and returns are more of qualitative analysis and less of quantitative evaluation. Moreover, lack of absolute confidence in internal investment team predictability of market indices are also held responsible. In addition, the factors that ranked high on the scale of the relative importance index measure the potential of the real asset to meet up on sustainable basis the motives for including real asset in the portfolio.

Table 4: Factors influencing real estate investment decision

Factors influencing real estate investment/allocation decision	Weights					Rankings	
	5	4	3	2	1	RII	Ranks
Estimates of risks and return	75	68	15	14	4	3.667	8th
Opinion of Investment team	65	44	18	26	5	3.292	9th
Opinion of consultants	95	84	0	16	0	4.063	6th
Economic forecasts	95	60	27	12	0	4.042	5th
Current asset market value	105	76	6	6	5	4.125	3rd
Current market trend	45	56	33	18	5	3.271	10th
Real asset performance	165	48	0	6	0	4.563	1st
Historical portfolio performance	135	56	3	6	3	4.229	2nd
Decision or action of peers	55	36	21	22	10	3.000	11th
Competitors	95	88	0	14	0	4.104	4th
Managerial skill & experience	80	64	36	2	3	3.854	7th

5.5 Capital Allocation to Real Estate Asset

Enquiries were made from the respondents about the proportion of capital allocation to real asset in the portfolio of assets. Table 5 shows that modal mode of resource allocation is between 3-5% of capital to real asset. This is followed by 16 others indicating between 1-3%, 11 companies investing between 5-10% of the investment capital to real estate. Only 2 insurance companies indicate between 11-20% fund allocations while none indicates real asset allocation of capital of between 21-35%. It was noted in the literature that investment in real estate by insurance companies nose-dived particularly prior to the recapitalization of 2005. Yet, as observed

from responses in Table 6, insurance companies still have some reservations in the real estate market which consequently guide resource allocation to the medium.

Table 5: Percentage of Fund Allocation to Real Estate

Capital allocation to real estate (in percentage)	Frequency	Percentage of Respondents
1-3%	16	33%
3-5%	19	40%
5-10%	11	23%
11-20%	2	4%
21-35%	0	0%
Total	48	100%

Source: Author's Field Survey 2015

5.6 Perception of Real Estate Asset in the Portfolio of Insurance Companies

Questions relating to the perception of the riskiness of real estate in the portfolio of insurance companies were asked with a view to providing insight into how this influences fund allocation to the assets. The result in Table 6 shows that 8(17%) perceive real asset to be highly risky, 25(52%) perceived it to be risky, 6(12%) were undecided, 9(19%) perceive it to be less risky while none admitted it is not risky. The level of riskiness attached to real asset at a particular time could be as a result of different factors such as the performance of the portfolio or the asset in particular, market trend and macro-economic indices as well as liquidity considerations which impliedly guide toward subsequent investment in the asset.

Table 6: Perception of the riskiness of real estate assets

Institution/Riskiness	Highly risky	Risky	Undecided	Less risky	Not risky	Total
No of respondents	8	25	6	9	0	48
Percentage	17%	52%	12%	19%	0	100%

6.0 Results and Discussion

This study has identified amongst other things the motives for investing in real estate, the different risk elements, factors affecting resource allocation, proportion of investment in real asset as well as the overall perception of real estate in the portfolio. This describes the behaviour of insurance to investment in real estate, Rather than for pecuniary motives, analysis of responses as shown in Table 2 shows that diversification, capital security, inflation hedging, ability and low correlation with financial assets are the foremost reasons for investing in real estate among insurance companies. This shows that due to the nature of real estate, insurance companies do not invest to earn immediate return but for the purpose of securing capital and stabilising the portfolio. Moreover, except in the cases of natural disaster, war and epidemic that may enforce mass relocation, real estate naturally appreciate in value thus making it a watermark rationale particularly for the group of institutional investor. This will also account for why other motives such as the potential for appreciation, anticipated profit and cashflow from operation rank lower on the Table.

Moreover, a number of risks are identified and respondents asked to indicate how these come to play in real investment decision. As shown in Table 3, of more significance for evaluation are liquidity and competition risks, lack of data, managerial, macro-economic and valuation reliability risks. By implication, allocation decision in real estate are significantly affected by policy dictate of the company on liquidity level, competition from peers and rivals, poor database in the sector, managerial experience and skill and valuation reliability. However, beyond risk consideration, other factors that influence real investment and allocation decisions were also examined. Table 4 shows the leading factors influencing resource allocation in real estate. These are real asset historical performance, historical performance of overall portfolio, current real asset market value and competition of peers and rivals. Others are economic forecast, opinion of consultants, managerial skill and experience as well as advice from investment team. This shows that qualitative the practice of real estate investment and allocation decision. This shows that resource allocation decision in real estate of insurance companies is significantly biased to qualitative consideration of other important factors mentioned in the study.

Various studies have shown the proportion of fund allocation into real estate. Table 5 shows what the scenario is among insurance companies in Nigeria. This study shows that 19(40%) of the companies surveyed invest between 3-5% of the portfolio asset value in real estate while 16(33%) invest between 1-3%, 11(23%) invest between 5-10%, while 2(4%) invest between 11-20%. It would have been expected that these companies allocate more into real estate because of the inherent capacity to do so, this capacity however appears to have been decimated or reduced by the different risks and the other factors. This is could be observed in the overall perception of the asset in the portfolio where 8(17%) respondents indicates real assets to be highly risky, 25(52%) as risky, 6(12%) undecided and 9(19%) as less risky while no one respondent agree that the asset is not risky.

7.0 Conclusion and Recommendation

Real estate development represents the skeletal framework for overall national development and as such, requires adequate and sustainable financial support from large institutional investor particularly the insurance sector. To ensure this, cognizance of the picture of engagement of insurance companies in real estate development must be taken and the factors that affect investment and fund allocation decisions must be addressed. Presently, 73% majority of the responding companies invest between 1-5%, 23% between 5-10% and just 4% between 11-20%. This shows that greater number of these companies become skeptical to invest or allocate more resources into real estate. This is not unconnected to the perception and other important factors that affect real estate investment decisions among insurance companies in Nigeria. In order to improve insurance sector's involvement in real estate, it is suggested that the sector handle real estate as income generating, profit-making assets thereby changing their rather passive role into a very active direct investment in real estate. In order to improve return on real estate and make it more attractive among insurance companies, it is recommended that institutional investor undertake sustainable investment by creating property submarket rather than financing developments in existing market that grossly lack adequate infrastructure and long term marketability potentials. A submarket investment would be equipped with adequate capacity to drive and sustain demand and such include provision of necessary infrastructure, mixed and balanced developments as well as employment opportunities.

In addition, a database should be kept for real estate transaction in the country. In order to overcome the challenge of liquidity, government should be ready to avail these companies with cash whenever such need arise. Alternatively, the investment could be turned to unit trusts and sold in the securitisation and unitisation market. The recapitalization of the insurance companies is a step in the right direction. Moreover, insurance companies could also engage state and local development authority to provide real products that are actually demanded by the people. Such project could as well be guaranteed by the government. Example is in the areas of housing provision which has continued to eluded individual and government capacity.

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