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Securing Real Estate Investment: The Insurance Approach - A Comparative Analysis Between Nigeria and Developed Countries

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Abstract

This study delves into the role of insurance that is aimed at securing investments in real estate sector in Nigeria while comparing it to practices in developed nations. The study discloses the significant disparities that come from the adoption of regulatory frameworks of insurance policy as well as product offered in Nigeria and developed nations. While developed countries appear to have comprehensive insurance frameworks that aids in the mitigation of risks and protect stakeholders, Nigeria's insurance sector is fraught with myriad of challenges that hinder its effectiveness. The paper points out the key lessons for Nigeria which includes strengthening the regulatory frameworks, increasing awareness, developing an innovative product while encouraging public-private partnerships. Through the adoption of a well-developed insurance approach, Nigeria can ensure transparency, attract foreign investment and adopt the global best practices while unlocking the full potential of its real estate sector. This research no doubt provides valuable insights that are good for policymakers, investors and stakeholders in industry who are seeking to secure as well as grow the Nigeria's real estate investments.

Keywords: *Securing, Real Estate Investment, Insurance Approach, Nigeria and Developed Countries*

1.0 Introduction

Investment in real estate appears to be contributing significantly to the Nigerian economy even as the sector plays significant role in the country's GDP, (Ngong and Thaddeus, 2020). More so it serves as a key driver of economic growth, (Bello, 2015). The Nigerian real estate market features properties which include; residential, commercial, industrial and agricultural properties/asset, (Amidu et al., 2008). They attract both local and foreign investors who seek profitable returns. However, the real estate sector in Nigeria has its challenges which are issues related to market volatility, regulatory uncertainties and security challenges, (Abere et al., 2020). All these impact the financial stability and long-term viability of real estate investments.

With the perceived risks associated with real estate investments in Nigeria, securing these assets is crucial to safeguarding the interests of investors as well as ensuring the sustainability of their portfolios, (Adewunmi and Olaleye, 2011). Securing investments in real estate involves employing risk management strategies which will help to mitigate potential threats such as damage to the property, liability claims, interruption of business and legal issues, (Li, 2018). When risks are catered for through appropriate insurance cover, investors' assets are protected and financial losses minimized to a great extent, (Fenton and Gao, 2016). This will in turn enhance the overall stability and profitability of the real estate portfolios.

The approach to securing real estate investments via insurance in Nigeria deals with the acquisition of various insurance products which is tailored to the specific needs and risks that are inherent in the real estate sector, (Umeh and Okonu, 2018). The insurance approach to securing real estate investments in Nigeria deals with the purchase of various insurance products that is tailored to the specific needs and risks inherent in the real estate sector, (Olaleye and Adegoke, 2009). The insurance itself provides cover against a wide range of perils which includes fire, theft, vandalism, natural disasters, liability claims and other unforeseen events that may jeopardize the value of real estate assets, (Glickman and Stein, 2005). Through leverages of insurance as a risk management tool, real estate investors in Nigeria will be able to transfer potential financial liabilities to insurance companies, (Umeh and Okonu, 2018). This will help to mitigate the perceived impact of adverse events and in turn ensure the long-term sustainability of their investments.

Afolayan, (2017) observed that it appears that the Nigerian real estate market is fraught with challenging regulatory frameworks and market complexities. This approach poses a strategic and proactive way for protecting the investor's assets, thus upholding their financial interests as well as navigating the uncertainties of the market with greater confidence. This paper delves into the role of insurance in securing real estate investments in Nigeria through review of relevant literature. It highlights the importance of risk management practices, the available insurance coverage as well as the benefits inherent in integration of insurance strategies into real estate investment portfolios.

2.0 Theoretical Framework

Real estate investment security is a crucial aspect of risk management in the real estate industry. Theoretical framework for this work is captured in the integration of risk management theories, insurance theory as well as behavioral economics theory. While Risk management theories provide a foundation for identification, assessment and management of risks associated with real estate investments, (Demong and Lü, 2012).

Insurance theory plays an important role in protecting real estate investments through the provision of the financial cover against unforeseen events such as natural disasters, accidents and liability claims, (Vaynshtok, 2018), whereas behavioral economics theory examines how individuals make decisions under conditions of uncertainty and risk, (Kousky and Cooke, 2012). With the Integration of these theoretical frameworks into the real estate investment process, security of investments by the investors can be enhanced and potential risks mitigated. This approach can help investors achieve greater peace of mind and confidence in their real estate portfolios.

2.1 Risk management theories in real estate investments features

i. **Modern portfolio theory**: Modern portfolio theory (MPT) was developed by Harry Markowitz and it emphasizes the importance of diversification in investment portfolios to reduce risks,(Zhi-jian, 2023). In real estate investments, MPT opines that investors can optimize their portfolio through the allocation of assets across different property types or locations, (Gold, 1996). This is done in order to achieve a balance between risk and return.
ii. **Real options theory:** Real options theory (ROT) submits that real estate investments manifest option-like characteristics which allow investors to capitalize on future uncertainties as well as exercise flexibility in decision-making, (Reuer and Tong, 2007). The adoption of the real estate investments as real options will aid investors in managing risk strategically and uncertainty via timing and strategic choices.
iii. **Agency theory:** Agency theory emphasizes the principal-agent relationship in real estate investments. Here owners (principals) delegate decision-making or authority to agents (property managers or developers), (Reuer and Tong, 2007). Here, the theory addresses agency problems which are related to conflicts of interest, risk-sharing arrangements between principals and agents as well as information asymmetry.

2.2 Insurance theory and real estate investment security

i. Risk transfer and risk pooling: This theory of insurance revolves around the concept of transfer of risk, where individuals or organizations transfer the financial consequences of losses to an insurance provider for an exchange of a premium, (Mostert, 2003). Insurance companies aggregate risks from multiple policyholders to spread the financial burden of unexpected events through risk pooling, thus providing security and stability to real estate investors.
ii. Moral hazard and adverse selection in insurance: Moral hazard can be likened to the increased risk-taking behavior of insured parties once they are covered by insurance, (Nadler et al., 2022). This leads to potentially higher incidences of claims. When higher-risk individuals gain more as a result of insurance coverage and due to asymmetric knowledge between insurers and policyholder selection, this is known as adverse outcomes. Assimilation of these ideas is crucial for creating insurance

policies that can address the risks associated with real estate investments.

2.3 Behavioral economics theory in risk perception and insurance choices

i. **Prospect theory:** In this theory people' decisions is based more on their perceptions of rewards and losses as opposed to actual results. Here, the subjective assessments of possible gains and losses that affect investors' perceptions of risk and decision-making processes within the real estate investments are considered, (Li, 2018). Insurance options selected by the people are affected by this.

ii. **Loss Aversion:** This theory posits that people behave in a risk-averse manner when they are confronted with bad outcomes because they appear to be more sensitive to losses than profits of comparable size, (Ye, 2021). In contemplating insurance solutions in order to safeguard their interests, real estate investors may have loss aversion tendencies; this gives precedence to risk reduction over prospective benefits.

iii. **Anchoring and framing effects:** This explains how people go about making decisions based on initial reference points or react differently to information provided in different frames in behavioural economics, (Tversky and Kahneman,1981). The resultant effect is that investors may be affected by the way risks are presented when assessing insurance plans related to real estate investments. This could change their sense of risk and insurance preferences. Berk, (2017) observed that real estate investment security is a crucial aspect of risk management in the real estate industry.

Theoretical framework that can be utilized to secure investment in real estate could be captured in the integration of risk management theories, insurance theory as well as behavioral economics theory. While Risk management theories provide a foundation for identification, assessment and management of risks associated with real estate investments, Insurance theory plays an important role in protecting real estate investments through the provision of the financial coverage against unforeseen events such as natural disasters, accidents and liability claims whereas behavioral economics theory examines how individuals make decisions under conditions of uncertainty and risk, (Kunreuther and Pauly, 2018). With the Integration of these theoretical frameworks into the real estate investment process, security of investments by the investors can be enhanced and potential risks mitigated. This approach can help investors achieve greater peace of mind and confidence in their real estate portfolios.

2.4. For the Insurance theory and real estate investment security, emphasis is on;

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ii. **Moral hazard and adverse selection in insurance:** Eisenhauer, (2004), likened moral hazard to the increased risk-taking behavior of insured parties once they are covered by insurance. This behaviour, most often, leads to potentially higher incidences of claims. When higher-risk individuals gain more as a result of insurance coverage and due to asymmetric knowledge between insurers and policyholder selection, this is known as adverse outcomes. Assimilation of these ideas is crucial for creating insurance policies that can address the risks associated with real estate investments.

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3.0 Comparative analysis of insurance approaches in real estate investments

3.1. Institutional theory and insurance practices in developed countries

Cummins and Venard, (2008), observed the critical role played by insurance industry in safeguarding real estate investments through well-established regulatory frameworks and market structures in developed nations. Guidelines and standards for insurance companies which aid in ensuring compliance with laws and protect policyholders are made courtesy of Regulatory bodies. For instance, in the United States, the National Association of Insurance Commissioners (NAIC) are responsible for overseeing insurance regulations ensuring that insurers operate ethically and maintain financial stability.

The market structure in advanced countries appears to have featured a diverse range of insurance products which is tailored to meeting the needs of real estate investors. The common offerings which provide coverage against various risks, such as property damage, bodily injury and income loss are property insurance, liability insurance and business interruption, Glickman and Stein, (2005).

Insurance companies in advanced countries most times collaborate with real estate industry stakeholders which includes; property developers, managers as well as investors, to design customized insurance solutions that will aid in mitigation of risks and enhancement of investment security.

3.2 Resource dependency theory and insurance market dynamics in Nigeria

The insurance market in Nigeria as it relates to its dynamics in relation to real estate investments are largely influenced by market characteristics and stakeholder relationships based on Resource Dependency Theory, (Soye et al., 2022). This is characterized by challenges such as low penetration rates in case of insurance, fragmentation of market, lack of consumer awareness and regulatory constraints, (Kozlova et al., 2019). The identified factors impact the availability and affordability of insurance products that are tailored for real estate investments thus, making risk mitigation strategies less accessible to investors.

The relationship of stakeholders in the Nigerian insurance market is critical for enhancing insurance practices for real estate investments, (Soye et al., 2022). More so, the cooperation between insurance companies, authorities responsible for regulation, real estate developers and investors may create an environment that is conducive for the development of innovative insurance products, (Wolski & Załęczna, 2011). These products address specific risks within the real estate sector. Through alignment with interests as well as fostering partnerships, stakeholders may work towards the improvement of the insurance market dynamics and promotion of secure investments within the real estate industry, (Vaynshtok, 2018).

3.3 Institutional isomorphism and insurance adoption in emerging markets

In Nigeria as an emerging market, an adoption of insurance practice in real estate investments appears to be influenced by Institutional Isomorphism. This refers to the processes through which organizations in a specific field adopt similar structures, practices and norms. The spread of innovations plays a crucial role in shaping the adoption of insurance within emerging markets, even as insurers engages in the introduction of new products and services that would care for the needs as well as challenges of real estate investors, (Karabay & Çağıl, 2016).

Also, pressures such as mimetic and coercive influences insurance adoption in emerging markets, (Kajwang, 2022), this they do by encouraging organizations to emulate industry best practices and by complying with regulatory requirements, (Biener et al., 2014). In emerging markets, Insurers may replicate successful insurance models from developed countries or adopt existing practices to local contexts in order to build trust and credibility among investors. In order to improve transparency, accountability and risk management practices, coercive pressures from regulatory bodies and market forces could be applied to drive insurers(Vishwanath, 2001). This will in turn help to boost investors' confidence and promote sustainable real estate investments.

4.0 Risk factors in real estate investments

Various risks can significantly affect the success and profitability of an investment of real estate investments. Therefore, a good knowledge of and effective management of these risks is necessary for investors in mitigating potential losses and optimizing their returns. The risk factors in real estate investments may include; the market risk, liquidity risk, operational risk, legal risk and regulatory risk.

4.1 Market Risk

Market risk could be defined as the risk of financial loss due to the adverse movements in real estate market conditions. Property values and rental income can be impacted by some factors such as the trends economy, demand and supply dynamics, rate of interest, as well as geopolitical events, (Sutantio et al., 2019). Market risk is in-built in real estate investments and could lead to variations in valuation of property, rental yields including overall investment performance, (Berk, 2017).

Through diversification of their real estate portfolios across different types of properties, locations and market segments investors can mitigate market risk, (Seiler et al., 1999). More so, Sutantio et al. (2019), conducting detailed market research cum analysis could help investors in identifying emerging trends as well as potential risks thus, aiding them in making of informed investment decisions.

4.2 Liquidity Risk

In relation to real estate investments, Scholz et al. (2015) liquidity, risk could be defined as the difficulty of disposing a property faster and at a fair price. Real estate assets are said to be relatively illiquid when compared to other forms of investment, for example, stocks and bonds, (Scholz et al., 2015). This is as a result of the time and effort that is required to sell a property including the limited pool of potential buyers. During the period of downturns in the market or economic uncertainty, there can be increase liquidity risk as demand for real estate diminishes, (Dijk et al., 2020). This will in turn lead to longer holding periods and difficulty in exiting an investment.

Through the maintenance of a well-diversified portfolio, investors can manage liquidity risk, (Berk, 2017). Also, through same, they will maintain adequate cash reserves in cases of unforeseen circumstances as well invest in properties that have strong market demand and liquidity levels.

4.3 Operational Risk

Chernobai et al., (2012), explains, in real estate investments, operational risk could be seen as the risk of financial loss which arises from the day-to-day management and operation of a property. Operational risks may include cost of maintenance and repair, tenant turnover, vacancy rates and issues that deals on property management, (Chernobai et al., 2012). Cash flow, performance of the property and investor returns can be influenced by poor operational management.

In order to mitigate operational risk, Avis, (1990), opined that investors could conduct due diligence on potential investment properties. There is need for assessment of the quality of property management services, implementation of effective maintenance and tenant retention strategies. Utilizing professional property management surveyors and regular inspection of property can help investors in identifying and addressing operational risks proactively.

4.4 Legal and regulatory Risk

Legal and regulatory risk deals with the impact of changes in laws, regulations, zoning ordinances and government policies on investment returns and property rights, (Mbugua et al., 2020). Investors can be exposed to financial and legal liabilities due to non-compliance with legal requirements, disputes with tenants or third parties and unexpected regulatory, (Gyourko et al., 2008).

Prakash et al., (2017) recommended engagement of legal professionals that are experienced in real estate transactions to mitigate legal and regulatory risk. Conducting legal due diligence on properties that is thorough and being informed about relevant laws and regulations that affects real estate investments could help, Kingji & Dumi, (2016). Complying with local zoning laws, building codes and environmental regulations is crucial in minimizing legal and regulatory risk exposure.

5.0. Role of insurance in risk mitigation

Concept of Risk Transfer Insurance is a useful tool in the management of risk and this allows individuals and businesses to transfer the financial consequences of losses to insurance, (Pretorius et al., 2008). Through the payment of a premium, policyholders can obtain insurance coverage for specific risks, for instance; damage to the property, loss of income or liability, (Ferrentino and Vota, 2020). Furthermore, insurance plays a crucial role in protecting investors from unforeseen circumstances that could negatively impact real estate investments portfolios, (Shiller and Weiss, 1994). Risk transfer via insurance involves the insurer who assumes the financial responsibility for covered losses in an exchange for the payment of premiums by the policyholder, (Azende, 2012). The transfer of risk aids investors in mitigating the financial impact of risks that is associated with owning, operating or leasing real estate assets, (Neukirchen and Lange, 2005). Here, a safety net that could help investors in recovering from losses due to natural disasters, accidents, legal liabilities, or other unexpected events is made possible through an insurance coverage.

5.2 Insurance coverage types for real estate investments

Insurance companies offer a range of coverage options that is tailored to the specific risks which are faced by real estate investors. The types of insurance coverage for real estate investments include:

i. Property Insurance: This provides over for physical damages to real estate assets, buildings, structures and equipment from fire, theft, vandalism and natural disasters, (Glickman and Stein, 2005). Hence, ensures that property owners are protected against financial losses resulting from damage to real property.

ii. **Liability Insurance:** This type protects real estate investors from legal liabilities that arise from accidents or injuries that took place on their properties, (Vaynshtok, 2018). Liability insurance covers costs related to body injury, damage to the property, legal defence fees and settlements or judgments that results from liability claims.

iii. **Business Interruption Insurance: Boudreaux *et al.,* (2015)**, explains that business interruption insurance helps to compensate real estate investors for the loss of income and operational expenses during the periods when their properties are unable to generate revenue due to unforeseen circumstances or perils. This coverage helps investors maintain financial stability and continuation in the event of property damage or disruptions in business.

iv. Rent Loss Insurance: Rent loss insurance compensates real estate investors for loss of rental income in situations where tenants are unable to occupy or pay rent due to some events, such as damage to the property or defaults by the tenant, (Glickman and Stein, 2005). This coverage helps investors maintaining the cash flow and financial stability during periods of such vacancy or tenant turnover.

5.3 Indemnity and protection offered by insurance

Insurance provides indemnity and protection to real estate investors by compensating them for covered losses, damages or liabilities that were incurred during the policy period. In the time of a covered claim, the insurer is responsible for reimbursement of the policyholder up to the policy limits. This is subject to deductibles and exclusions outlined in the insurance contract. Indemnity ensures that investors are made whole financially after experiencing a covered loss thus, reducing the impact of unexpected events on their investments in real estate.

Also, insurance provides protection against financial risks that can jeopardize an investor's assets, reputation or long-term financial viability, Berk, (2016). Real estate investors can safeguard their properties, mitigate potential liabilities and protect their investment portfolios from unforeseen risks by securing insurance coverage. Insurance serves as a risk management tool which enables investors to manage proactively uncertainties and minimize the financial impact of adverse events in the real estate market.

6.0 An overview of real property insurance in Nigeria and some advanced economies

Real property insurance in Nigeria, like some other developed countries like the United States, United Kingdom, and Germany is intended to safeguard property owners against damage or loss, (Ndalu, 2016). Nonetheless, there exist some key differences regarding coverage, legislation, and market dynamics. In terms of coverage, Daniel, (2024), explains that Nigeria, real property insurance often covers risks such as fire, flooding, and theft. Nonetheless, the coverage is always restricted in comparison to developed countries where insurance policies tend to be more extensive, covering a broader spectrum of risks, including natural disasters, vandalism, and liability protection.

Olayingbo and Akinlo, (2016), observed that insurance in developed eonomies frequently provide supplementary coverage options, including business interruption insurance, loss of rental income protection, and liability insurance for landlords which are not obtainable in Nigeria.

Also, differences exist in the regulatory aspect of insurance as discovered by Akpan and Joseph, (2017), observed that insurance regulation in developed economies is typically more stringent and well-defined compared to Nigeria. Regulatory authorities in developed countries, including the National Association of Insurance Commissioners (NAIC) in the United States and the Prudential Regulation Authority (PRA) in the United Kingdom, regulate the insurance sector to guarantee solvency, consumer protection, and equitable practices.

However, the Nigerian regulatory environment for insurance is evolving, with the National Insurance Commission (NAICOM) supervising the sector. Efforts have been made to fortify regulation in Nigeria to improve consumer protection and industry stability. Another aspect of comparison is the market dynamics which Ikpeme *et al*., (2021), observed was very low. According to the study, the market penetration of real property insurance was negligible compared to the number of real properties in Nigeria. This is not, however, the situation in developed countries.

For instance, insurance penetration in Germany, is 5.77%, United Kindom 14%, Japan 8.6% (Statista, 2022 and Atlas Magazine, 2024) while in Nigeria it is 0.5% (Leadway Assurance, 2023). As seen above, real property insurance in Nigeria is rather low when juxtaposed with developed countriess, where insurance is more extensively used as a risk management instrument. This is partially attributable to insufficient awareness, affordability challenges, and restricted access to insurance products in Nigeria, (Ikpeme *et al*., 2021).

In developed nations, real property insurance is a well-established enterprise characterized by intense competition among insurers, resulting in a diverse array of products and coverage alternatives for property owners. The market dynamics in advanced economies are more developed and complex than those in the growing market of Nigeria. Nevertheless, Both Nigeria and other developed nations impose compulsory insurance for certain classes of real property, possess comprehensive regulatory structures overseeing insurance activities, etc.

7.0 Conclusion

Securing real estate investments through insurance is very important for mitigating risks and protecting stakeholders' interests. The comparative analysis between Nigeria and developed countries shows significant disparities in the adoption and effectiveness of insurance approaches. Developed countries appear to have well-established insurance frameworks that provide comprehensive coverage for real estate investments thus, ensuring financial security and stability. In contrast, Nigeria's insurance sector is fraught with challenges such as low penetration, inadequate regulatory frameworks and limited product offerings. In an attempt to bridge this gap,

8.0 Recommendation

Nigeria government should take a cue from developed countries via: the strengthening regulatory frameworks in order to ensure compliance and enforcement. Stakeholders should increase awareness and education on real estate insurance, develop an innovative insurance products that is tailored to the local market and encourage public-private partnerships which will enhance infrastructure and investment. Through the adoption of a robust insurance approach, Nigeria can: attract foreign investment as well as boost economic growth, enhance the transparency and confidence in the real estate sector, protect stakeholders from unexpected risks and losses as well as align with global best practices including standards. Conclusively, securing real estate investments via insurance is necessary for Nigeria's economic development and global competitiveness. Embracing a comprehensive insurance approach can unlock the hidden potential of Nigeria real estate sector and this can possibly provide a secure environment for investment and growth.

Investors should review their policies to ensure adequate protection for their real estate assets. Investors can mitigate the risk of substantial financial losses resulting from unforeseen events that could damage to their properties by obtaining property insurance

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