INVESTING IN ETHIOPIA

SECTOR REPORT—Real Estate

- **This Sector Report attempts to answer four questions concerning the real estate market in Addis Ababa:**
    - **What has been the scale and scope of recent real estate development?**
    - **What does the residential real estate market look like?**
    - **What has been happening in the commercial segment of the market?**
    - **What is the outlook for the real estate market in the coming years?**

- **The real estate sector has been one of the fastest growing segments of the Ethiopian economy. Indeed, our review of GDP statistics shows that had it not been for the expansion of this sector and the closely affiliated construction sector, Ethiopia would not have registered double-digit economic growth in the past five years.**

- **The residential real estate market in Addis Ababa is evolving into a varied mix of extensive government-built condominiums (ostensibly for lower-income groups), mid-market developments by housing cooperatives, and largely high-end homes built by real estate developers and/or homeowners themselves. Based on a survey conducted by Access Capital, we find that sale prices for even modest homes exceed Birr 1 million in many of Addis Ababa's residential neighborhoods, while average sale prices for large homes (with 1000 square meters and four-or-more bedrooms) are now routinely above Birr 6 million in the most expensive neighborhoods. In these same high-end neighborhoods, rental rates are in the range of Birr 30,000–40,000 per month for large homes. From a cross-country perspective, home prices and rents are beginning to match or exceed the levels seen in African countries with much higher incomes than Ethiopia.**

- **With respect to the commercial market, we find that rental rates for office space in Addis Ababa average around Birr 100 per square meter, though sometimes approach Birr 200 per square meter for prime, city-center locations. Based on the city-wide average, these square meter costs translate into rental rates of around Birr 5,000 per month for a small one-room office in a city-center location. For businesses seeking to rent half-a-floor or a full floor in a commercial building, average monthly rents are Birr 20,000 and 40,000 respectively.**

- **Regarding the outlook, we see both challenges and opportunities. On the former, key obstacles facing the sector include land policies, the scarcity and cost of construction material, infrastructure, and financing. With respect to the opportunities, we see much promise in four particular sub-segments of the real estate market: city-center commercial developments; residential developments—including apartments— focused on middle-income groups; new developments based on novel and cheaper construction materials; and commercial parking developments. Overall, though the likelihood of price declines in certain outlying areas is one notable near-term risk, the outlook for the real estate sector is otherwise broadly positive in our view, reflecting prospects for continued overall growth and particularly promising opportunities for developments that rely on higher densities, city center locations, and novel construction materials.**

May 2010
Access Capital Research

SECTOR REPORT—Real Estate

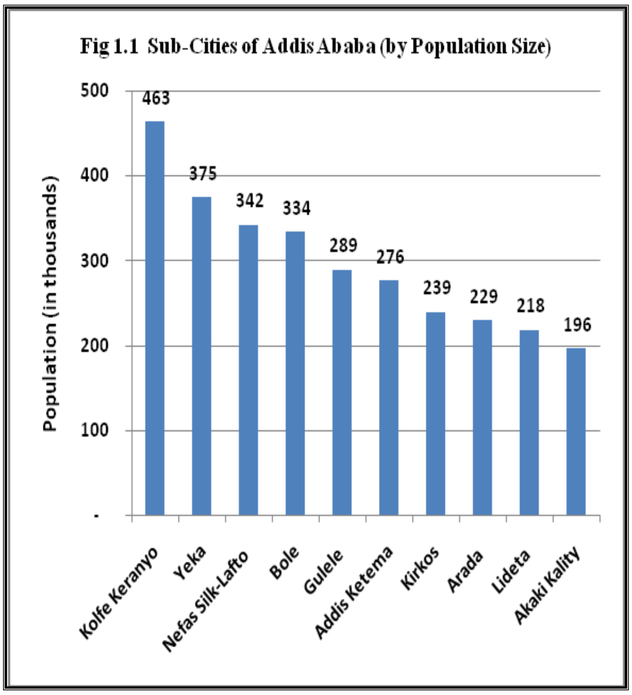
Introduction

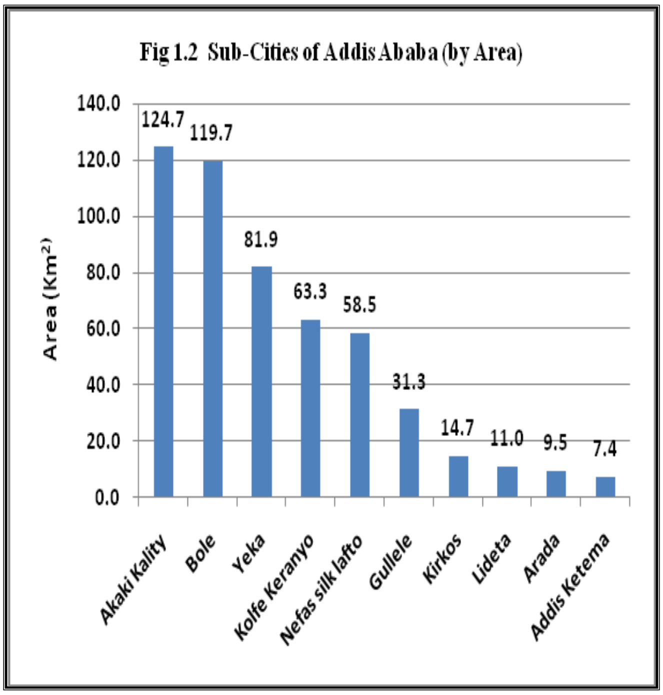
The rapidly changing real estate landscape in Addis Ababa is one of the more visible aspects of the extended period of growth recently experienced in Ethiopia. From large residential developments sprouting at the city outskirts to rising new office complexes and government-built condominiums being constructed in center city locations, there is no shortage of new facilities to demonstrate change in this area. Of course, despite all this new construction activity, Addis Ababa—like most developing country capitals—retains large swathes of informal and slum-like settlements scattered across the city. Still, over the past decade, the sub-set of city dwellers that are now part of the formal real estate market has expanded from a small base and is likely to do so for the foreseeable future.

To provide readers with a comprehensive overview of developments in this area, this Access Capital report attempts to address four key questions: (1) What has been the scope and scale of recent real estate developments? (2) What does the residential real estate market look like? (3) What has been happening in the commercial segment of the real estate market? (4) What is the outlook for the next one or two year period?

Overview

The City of Addis Ababa occupies an area of 522 square kilometers (0.05 percent of the Ethiopian landmass) and is comprised, according to official statistics, of an estimated 3 million inhabitants. The city is sub-divided into ten sub-cities, each of which has an average population of around 300,000 people (see below); the three largest sub-cities by population are Kolfe Keranio (with 463,417 inhabitants), Yeka (374,583) and Nefas Silk Lafto (341,743). In terms of land area, the largest sub-cities are Akaki Kality, Bole, and Yeka each of which covers an area exceeding 80 square kilometers. Population densities vary considerably among the sub-cities, with Addis Ketema and Arada showing the most densely populated neighborhoods while Bole and Akaki Kality are the least densely populated sections of the city.





Source: Addis Ababa City Administration (2009 estimates)

The recent scope of real estate developments in Addis Ababa can be reviewed from several perspectives and information sources, including from a macroeconomic perspective focused on the sector's growth record as measured in GDP statistics as well as from supplementary indicators such as the number of new real estate-related investment registrations, building permits issued by the city administration, and real estate tax revenues reported by the tax authorities. We review each of these indicators in turn below:

- **Macroeconomic statistics provide the broadest basis for tracking trends in the real estate sector.** Real Estate and Construction are two of the 18 sectors according to which Ethiopia's national income (GDP) statistics are reported. Taken together, these two sectors accounted for 14.9 percent of GDP in 2008/09, with real estate comprising 9.1 percent and construction comprising 5.8 percent. According to GDP sector data, real estate and construction sector grew—in real terms—by an annual average of 14.1 and 10.4 percent per year respectively in the past five years to 2008/09. This is somewhat above the average annual growth rate of real GDP during this period (11.4 percent), indicating a rise in the share of these activities within the overall economy. In fact, of the average 11.4 percent real GDP growth in the last five years, construction and real estate taken together provided 1.5 *percentage points* of the overall growth rate. Put differently, had it not been for growth in these two sectors, real GDP growth would not have reached the double-digit growth rates recorded over the past five years.

- **Investment Registrations at the Ethiopia Investment Authority (EIA):** Data on investment registrations at the EIA, which give a measure of *new investor intentions*, provide another metric of observing trends in the real estate sector. On this score, one observes that there was particularly rapid growth in real estate related investment plans in 2004 and 2005 following which investor interest declined during the years from 2006 until mid-2009. For the decade-long period, namely considering new investor intentions in 2001 versus that in 2009 (Birr 2.2 billion versus Birr 17.6 billion), the annual average growth amounted to 49 percent. Deflated by average inflation during this period, this amounts to real growth of around 37 percent per year.

- **Real Estate Development Licenses:** Somewhat parallel to the EIA data on investment registrations are data on real estate investor license certificates granted by the Addis Ababa Investment Agency (AAIA). Though there may be double-counting with EIA data, the trends in the Addis Ababa license data are still indicative. On this basis, we see sharp growth in licenses granted, from a level of 88 in the year 2005 to 160 in 2008, or an implied annual average growth rate of 22 percent.

- **Real Estate Tax Revenues:** Trends in rental income tax, to the extent that they capture the rising activity in the sector, can also serve as a proxy for measuring growth in the real estate sector. Such data suggest that real estate activity has (in nominal terms) risen by an annual average of 16 percent in the past five years.

On the basis of the above data sources, growth in real estate activity has likely been (in real terms) within the range of 14 to 22 per year, based on what we think are the two more reliable measurement sources**.**

The observed increase in the scope and scale of real estate activity has been driven by multiple factors. Foremost among these has been: (i) overall economic growth (as real GDP grew by an average of 11 percent per annum during the past five years); (ii) demographics (the urban population is rising by 240 ,000 per year, assuming the national population growth of 2.3 percent); (iii) a long-standing backlog of unmet housing demand (estimated at 456,000 housing units);[1] the provision—in limited quantities—of lease land for developers, cooperatives and individuals; (iv) the expansion of city roads and infrastructure (such as the construction of the Addis Ababa Ring Road and other major roadways, the improvement of numerous neighborhood roads, and the wider reach of electricity and water services to the edges of the city); and (v) tax and investment schemes, involving a broadening of investment areas, extended lease periods, and reduced income tax incentives.

Segments of the Residential Real Estate Market

With respect to residential developments, there are currently four categories of *new* developments taking place in the sector: (a) government-initiated condominium buildings; (b) residential neighborhoods initiated by developers; (c) owner-built housing dwellings; and (d) new home activity driven by housing cooperatives.[2]

a. **Government-built Condominiums:** In an effort to address the severe housing shortage evident in Addis Ababa, the government has constructed more than 78,000 condominium units throughout the city. About two-thirds of these units are currently completed and occupied by residents, with the remaining still in need various kinds of finishing

[1] One revealing indicator of the scale of unmet demand can be seen from the recent Government condominium lottery of April 2010. A total of 485,000 individuals (almost one-seventh of Addis residents) applied for condominium units though only 10,700 were made available (2.2 percent of total demand).

[2] In addition to these four categories of new developments, there are two other major categories of housing units in Addis Ababa: *kebele*-rented homes, mainly to those on low incomes, and informal housing settlements. Although these two categories comprise a large share of the existing stock of homes, they do not represent a significant source of *new* developments in the years ahead.

works. Launched extensively in 2005/06, this initiative is part of a grand Housing Development Program involving the eventual construction of 400,000 condominiums in Addis Ababa and other cities across the nation. Once completed, and assuming an average of four persons per unit, Addis Ababa's already constructed condominiums alone may house a total of around 315,000 inhabitants—more than 10 percent of the city population. On the conservative assumption that this figure will probably be doubled in the next couple of years, this segment of the residential real estate market alone may house as much as 15-20 percent of the population in a few years time.[3]

b. **Residential neighborhoods initiated by Real Estate Developers:** Residential homes and neighborhoods built by real estate developers are now becoming increasingly common ever since the first large-scale development was initiated by the pioneer in this sector, namely Ayat Real Estate. At present, the dominant real estate developers for residential villa homes include: Ayat Real Estate, Sunshine Real Estate, Habitat New Flower Homes, Ropack International, Ambassador Real Estate, Trancon Real Estate, Gift Real Estate, Enyi Real Estate, Country Club Developers, Akakas Real Estate, Boran Real Estate, Flintstones Homes, and Zenebe Frew Real Estate. Many more are also operational, though with more limited activities. For apartment developments, some of the most active developers include Ayat, Sunshine, Access Real Estate, and Flintstones Homes.[4] The developments of these private developers range from very luxurious, high-end communities that sell multi-million Birr homes (e.g. Country Club Developers and Akakas Real Estate) to sellers of more moderately priced homes (such as those of Enyi Real Estate, Sunshine, and Access Real Estate).

BOX 1: Land Allocations to Real Estate Developers

Over 2.7 million sq. meter of Addis Ababa's land (or less than 1 percent) was leased to developers between 2004 and 2007. Bole accounted for the highest allocation at 1,519,684 sq. meters, followed by Nefasilk-Lafto with 576,446 sq. meters, Yeka with 391,845 sq. meters and Kolfe-Keranyo with 108,841 sq. meters.

In terms of allocations to specific developers, a compilation of data from various press and industry reports suggest that **Sunshine Construction** was one of the front-runners in terms of land allotments, with 291,628 square meters of land in three different locations. **Berta Construction (Habitat-New Flower Homes)** was granted 120,000 square meters of land near CMC for the construction of 500 villas and the same number of condos. **Ambassador Real Estate** secured 75,000 sq. meters plot of land for the construction of villa houses and apartments. **Ayat Real Estate** also received 35,000 sq. meters of land in and around Kazanchis, separate from its large initial allocation in the neighborhood now known by its name. **Trancon Real Estate** acquired 50,000 square of land in Nifas-silk Lafto/Lebu area sufficient to build 46 villas and condominiums that could accommodate up to 539 households.

Modalities and payment terms: Most leases require developers to deliver their housing units within 24 months from the signing of the lease contract. In practice, this has been a difficult condition to meet for almost all developers. For the *bona fide* developers, the primary reason for the delays include unmet infrastructural work (roads, utilities) and a rapid and unexpected escalation in construction costs.

c. **Owner-built housing construction:** Housing units built by owners were by far the most common type of new residences before the advent of government-built condominiums and real estate developers within the past decade. Though relatively limited now, this portion of the real estate market is still active in older, more established residential neighborhoods such as Bole or Old Airport. Owner-built residences are also becoming increasingly common in some of the outlying neighborhoods that were initially popularized by real estate developers but have subsequently attracted individual home builders. Costs for owner-built construction are, of course, generally higher

[3] A potential doubling of Government-built Condominiums is not that unrealistic since this approach has become the authorities' primary instrument for addressing the city's severe housing shortages (in contrast to other more private-sector led initiatives that might have been entertained). Indications of active plans in this area include the already noted nation-wide target of 400,000 condominiums, already launched re-developments of old city neighborhoods (such as the large-scale *Lideta Redevelopment* project), and recent official plans to build 200 high-rise residential/commercial buildings via an Ethiopian Housing Corporation (EHC) which was recently established by the Ministry of Works and Urban Development for this purpose.

[4] By way of disclosure, Access Real Estate, currently engaged in the construction and sale of two apartment developments, is a sister company of Access Capital.

and this segment of the market thus tends to include the full range of housing units from modest homes constructed over extended periods to large and luxurious homes often built by razing or replacing older properties.

d. **Home construction by Housing Cooperatives**: Cooperative housing developments, organized by groups that share a common employer or membership, have been a long-standing feature of the residential real estate market going back to the days of the previous government. At present, the city administration has registered more than 500 housing cooperatives. The minimum membership in housing cooperative is 14 while the maximum number is 24. A good number of these cooperatives members are in the middle-income group, typically based on employer associations such as Ethiopian Airlines or other state-owned companies. Many cooperatives have already finalized the construction of their group homes, but many more are still on waiting lists for land allocations and this segment of the market will thus continue to be significant share of the overall real estate market in the years ahead.

A Survey of Residential Real Estate Prices

Access Capital conducted original survey work to provide a comprehensive picture of residential real estate prices throughout the different neighborhoods of Addis Ababa. We focused on both sale prices as well as monthly rental prices. Our survey involved contacting at least three prominent real estate brokers in each of ten residential neighborhoods of Addis Ababa. By focusing on residential neighborhoods, we have not surveyed some areas of the city that are known more for their industrial, commercial, or other elements (say Akaki-Kaliti, known more as an industrial area, or Mercato, known more as a market area). Moreover, we focused on what we consider three types of representative houses within the local market: a 250 sq-meter house with 2 to 3 bedrooms; a 500 sq-meter house with 3 bedrooms; and a 1000 sq-meter house with 4 or more bedrooms.

The survey revealed the following findings:

- **Sale prices**: Even at the low end of the residential housing market (homes of 250 square meters), we found that prices are generally above the Birr 1 million mark in the residential neighborhoods we surveyed. With respect to houses in the 500 square meter range, prices are generally in the range of Birr 2-4 million in most neighborhoods. At the high end, covering homes with 1000 square meters and four or more bedrooms, average prices rise to as much as Birr 6 million; in some sub-sections within these neighborhoods (such as "Bole Japan") average prices are as high as Birr 10 million. Across all three segments, prices are highest in Bole and Old Airport neighborhoods, roughly in the middle in areas such as CMC, Ayat, Summit, Imperial/Gergi and towards the lower end in neighborhoods such as Lafto, Lebu, Alem Bank, and Betel.

- **Rental rates**: Rental rates are highest in Bole and Old Airport with large homes in these areas commanding average rents of Birr 30,000 to 40,000. Even for much smaller sized homes, i.e. 500 sq meters homes with just 3 bedrooms, rents are near 10-20,000 in these same neighborhoods. As with home-sale prices, the mid-range of rents is seen in areas such as CMC, Ayat, Summit, and Imperial/Gergi (generally in the Birr 5,000-10,000 range), while the lowest rents are seen in neighborhoods such as Alem Bank and Betel (generally below Birr 3,000).

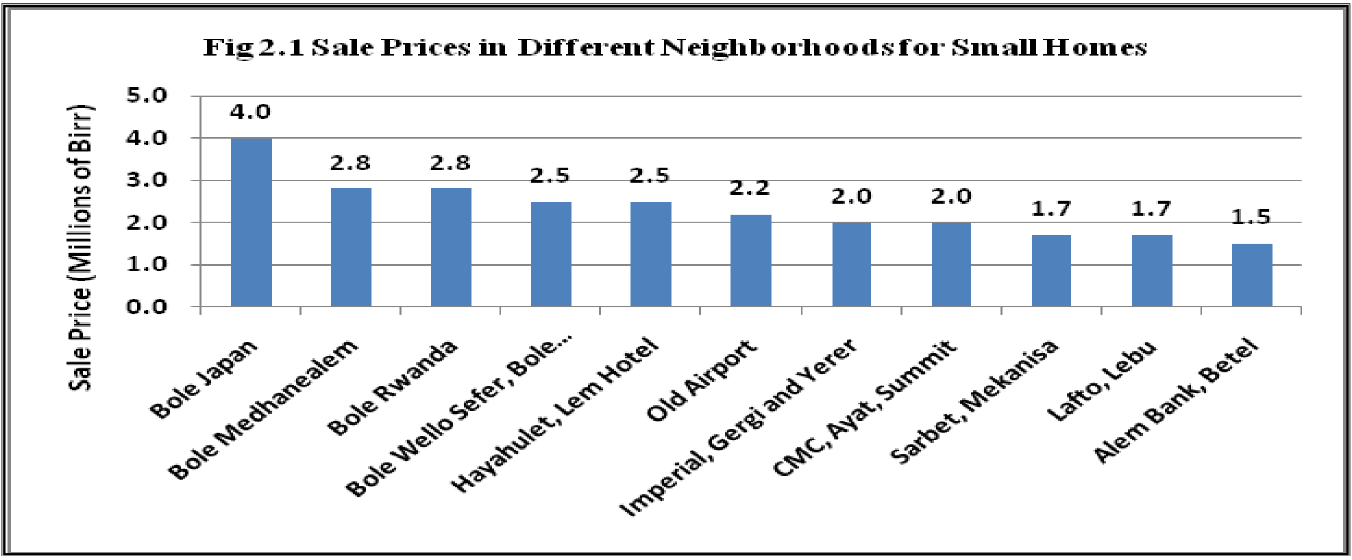
- **Yield on investment**: From an investment perspective, one important measure of the value and worth of a real estate investment is its yield, which measures the annual rental income derived from a property relative to its purchase price. This essentially gives an indication, in percent, of the rate of return an investor can expect by purchasing a property and subsequently renting it; this rate of return can be compared to other potential investment options (say deposits or bank shares) that might be considered as alternatives to real estate investment.[5] With this motivation, we compare rental yields across the city and find that they can vary considerably depending on neighborhood and size of homes. In general, rental yields tend to rise with the size of the homes. By neighborhood, we find that some of the lower-priced neighborhoods, such as Alem Bank and Betel, have rental yields that are only in the 4-5 percent range, which is essentially identical to what an investor can earn (without any risk) from keeping his/her funds in a local bank deposit. At the same time, returns are near 10 percent or more for higher-priced neighborhoods (Bole, Old Airport, and Hayahulet), more than double the return from holding bank deposits, showing the importance of location in the consideration of investment returns related to real estate rentals.[6] For owners whose purchases of properties were more than five years ago, we calculate that rental yields double to 20 percent as purchase prices were roughly half their current market rates in many residential neighborhoods.

[5] Thus, if a property is purchased for Birr 1,000,000 and earns an annual rent of Birr 120,000 (or Birr 10,000 per month), then the rental income is providing a yield of 12 percent to the investor.

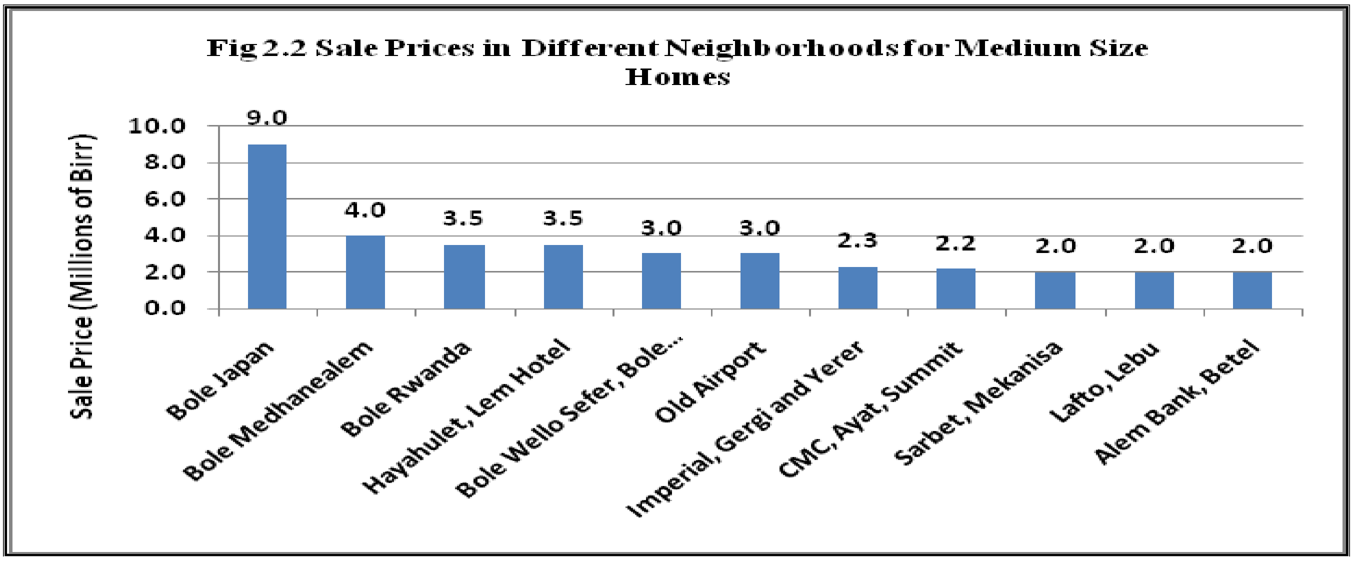
[6] These calculations ignore an investor's gains from future house price appreciation and thus *understate* the expected yield.

Our review of prices revealed some surprising findings when placed in a cross-country perspective. In particular, prices at the high end of the Addis Ababa real estate market are almost comparable to those seen in countries such as Nigeria, Botswana, and South Africa, where average sale prices are $ 1,000,000 in the main cities as compared to about $800,000 in Addis Ababa.[7] At the middle-range of the market, where prices in Addis Ababa average $250,000, we observe that local prices are comparable to those found in Nairobi, but far lower than those of homes in Accra, Dares Salaam, and Kampala. In comparing rental prices, we find that in the middle and lower-end of the market, rents in Addis Ababa are lower than nearly all of the above-mentioned cities. Interestingly, however, we find that Addis Ababa's rental prices for large homes actually match or exceed similar rental properties in other African cities such as Johannesburg, Abuja, Dares Salaam and Kampala. We believe this reflects the unusually high concentration of international organizations, foreign embassies, agencies, and NGOs that provides a high level of demand for higher-end properties.

SALE PRICES

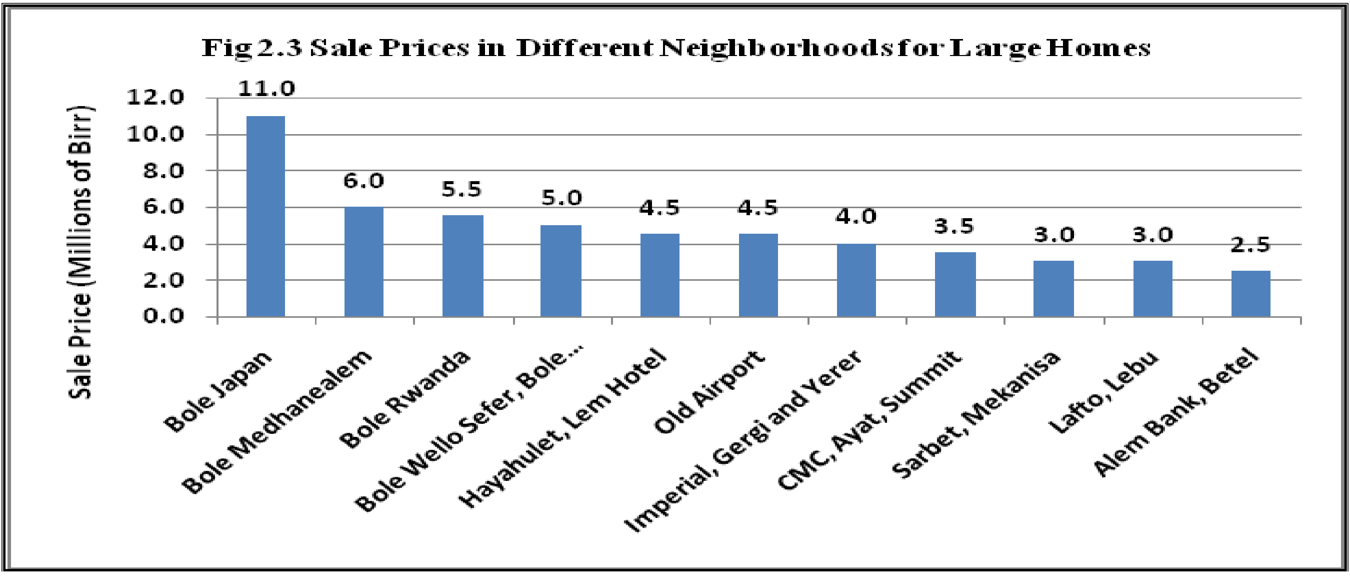


Source: Access Capital Survey



Source: Access Capital Survey

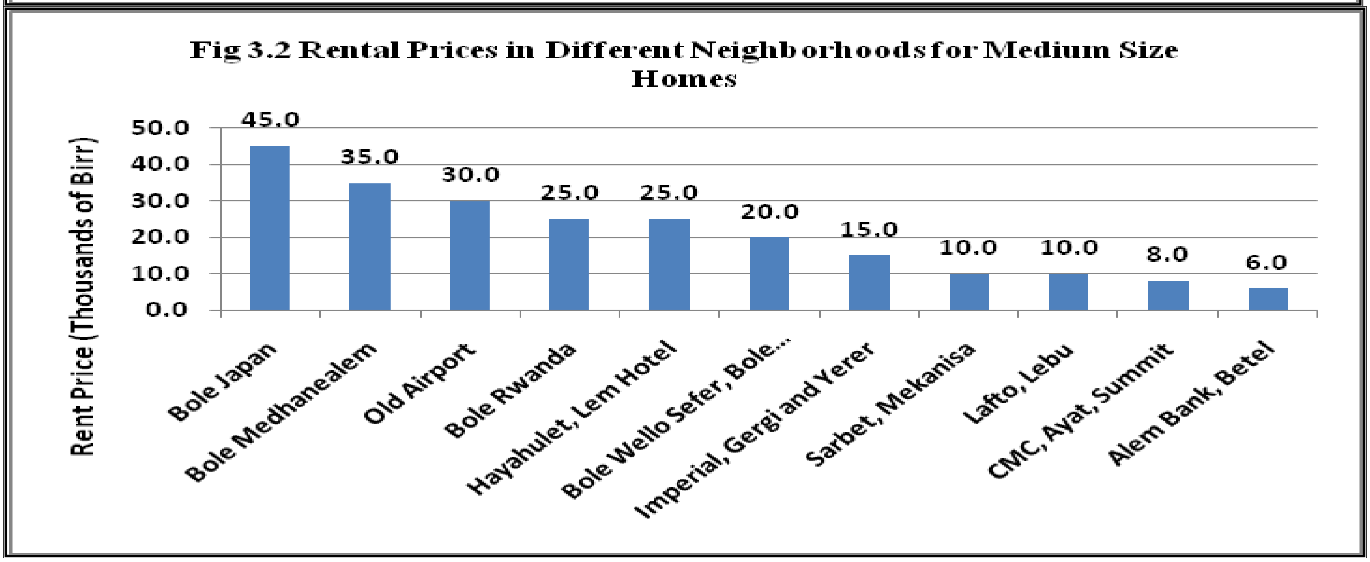
7 *Global Property Guide, 2009*

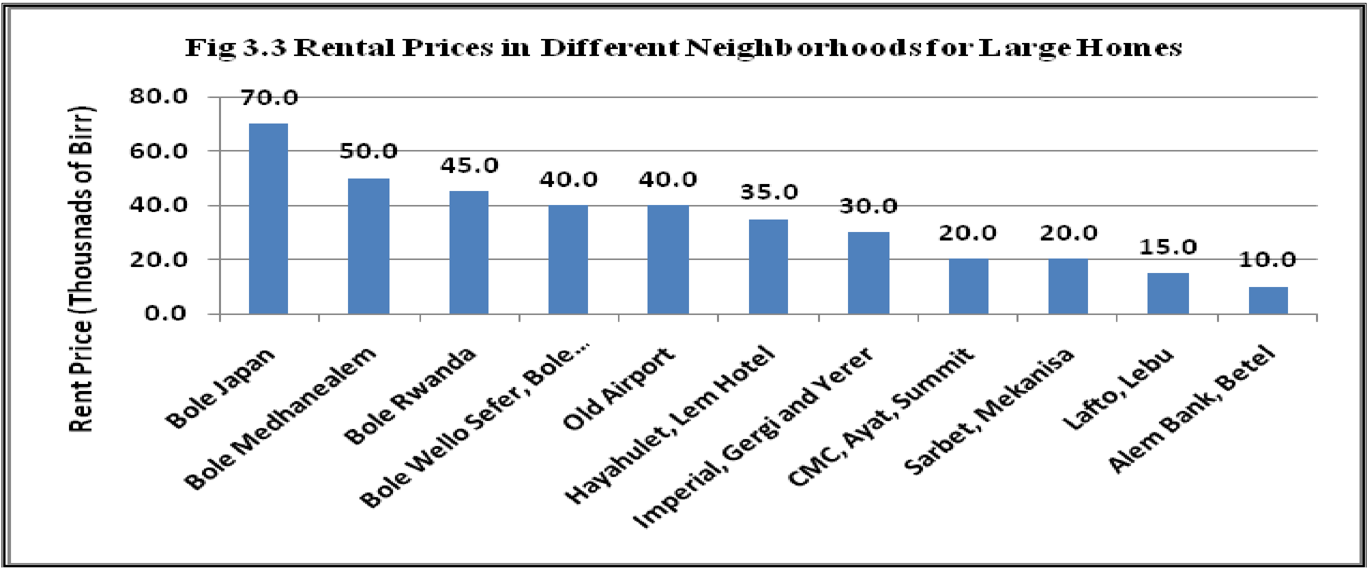


Source: Access Capital Survey

***Note: Large homes are defined as 1000 square meter plots with four or more bedrooms, medium-size homes are 500 square metere plots with at least 3 bedrooms, and small homes are 250 square meter plots with two or three bedrooms.**

RENTAL PRICES





Source: Access Capital Survey

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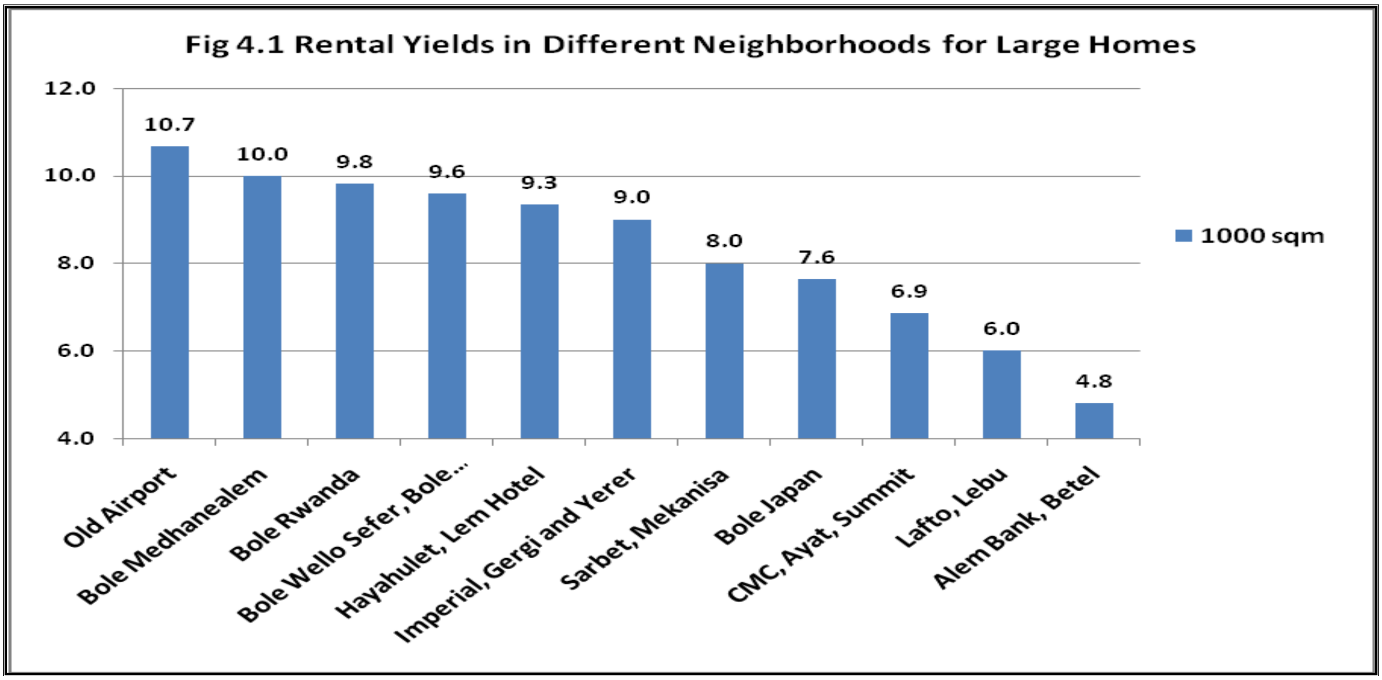

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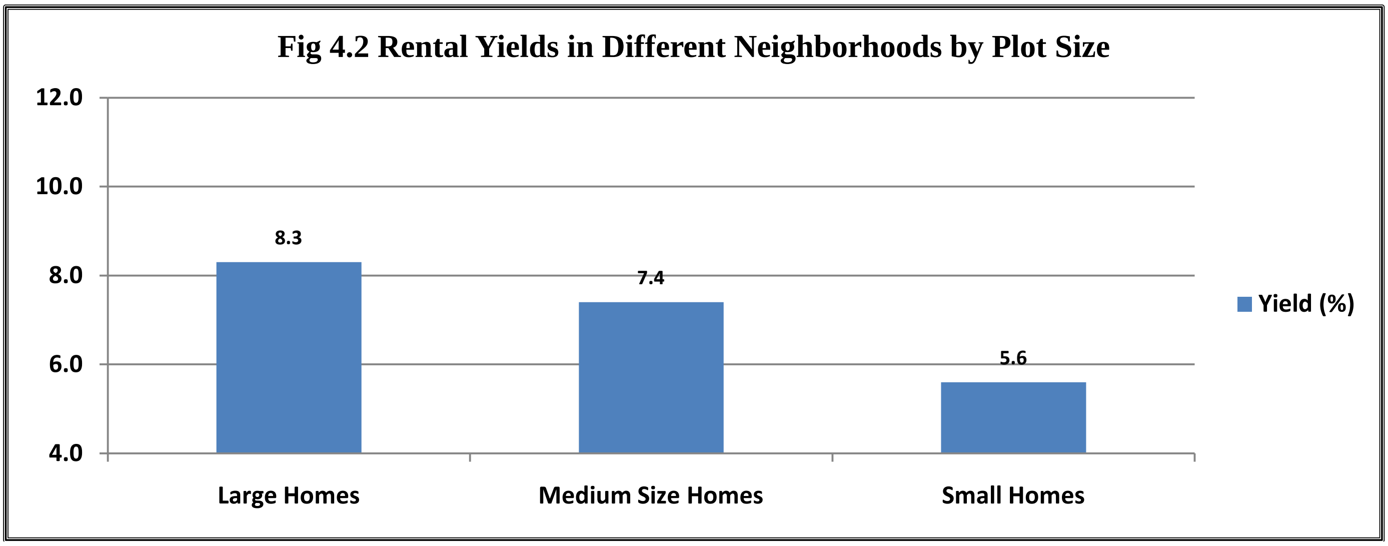


Source: Access Capital Survey

The Commercial Real Estate Market

Real estate activity in the commercial sector has been as dynamic as that observed in the residential sector over the past decade. Data on building permits granted by the City Administration between 2005 and early 2009 indicate that, out of the two major real estate categories, commercial buildings have been granted the largest share (40 percent) of building permits issued during this period; by comparison, residential building permits accounted for 30 percent of the total. In terms of the distribution of commercial building permits issued by the City Administration, Bole Sub-City held the leading position with 29 percent of the total, followed by Nefas Selk Lafto (21 percent), and Kirkos (19 percent).

The growth in the commercial market is being driven by many of the same factors propelling residential sector growth, including rapid economic growth and supporting public infrastructural development. Other factors relevant in the specific case of commercial buildings are the large increases in national and international businesses, particularly firms in the services sector. At the same time, government offices which used to operate in limited spaces all over the city are also concentrating on new and modern buildings, including renting properties from private landlords. Increasing numbers of embassies, international organizations, and NGOs which in the past had typically converted residences into office space are now moving towards renting whole floors or even multiple floors in modern city-center commercial buildings.

Access Capital conducted original survey work on price levels in the commercial sector, in line with our survey of residential prices. For commercial buildings, our methodology involved contacting 42 buildings located in all key areas of the city, including virtually all of the well-known commercial buildings found along the main roads and within key business districts. The 42 buildings we surveyed represent a total rental area of almost 107,400 square meters which we estimate covers a very sizeable portion of the modern commercial space in the city. Third floor price were taken in the comparisons between different buildings.

Our survey revealed that monthly rental rates for third-floor office space in commercial buildings vary from a low Birr 75 per m^2 in Arada Sub-City to a high of Birr 120 per m^2 in Yeka Sub-City.[8] Looking at the highest rental rates within a building (typically the ground floor), prices range from a low of Birr 125 per m^2 (in Arada Sub-City) to Birr 212 per m^2 (in Yeka Sub-City). City-wide, the average rental rate of modern commercial building space was found to be Birr 98 per m^2. With this average rental rate, the typical one-room shop or office in a modern commercial building (roughly 50 m^2)

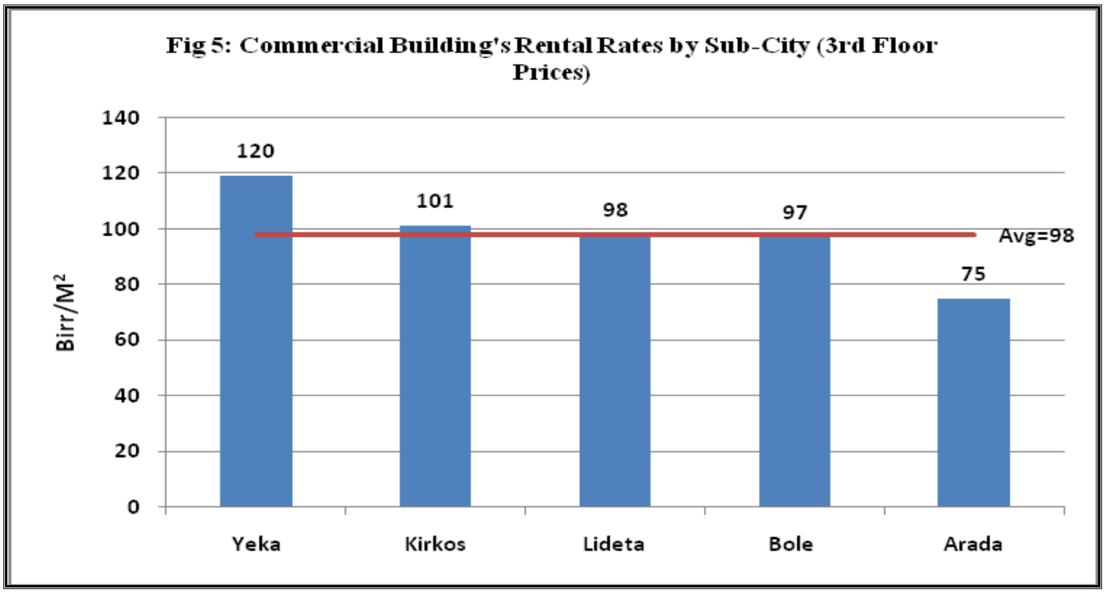
[8]We aggregate the survey results by neighborhood. The 42 buildings covered included the following: Dasset Building, Addis Fana PLC, Terfera Seyum Commercial, Kelifa Business Center, T.K International Building 1 & 2, Friendship, DH Geda, Dabi Complex, Saay building, Alem Building 1 & 2, Sevita Building, Salfaz Building, Mamitu Alamerw, Jambo Business Complex, Abyssinia Building, Daminaroff Building, TSBG International Trading, AHF International, Yoly building, Legesse Feleke, Aberus Complex, Dembel City Center, Menteweab, Mina, Tebaber Berta, Wongelawit Taddesse, Baleker Tower, Al Paulo Building, Alemu Woldetsadik Building, K-Kare Center, Adam's Pavilon, Yezelalem Building, Geo-Traco building, Nur Building, ITMA S.C, St.Ledeta Health science College, TG building, Rebecca Building, Lex Plaza and Comet Building.

commands a rental rate of near Birr 5,000 per month; for high-end neighborhoods such as Bole, this rises to around Birr 8,000 for the same one-room shop or office. Given the city-wide average rental of Birr 98 per m^2, large offices with multiple rooms that occupy an average of 200 square meters (typically half a floor) rent on average for around Birr 20,000 per month, while office rental space that corresponds to a whole floor (typically 400 square meters) amounts to an average of close to Birr 40,000 per month.

Table 1: Rental Rates for Commercial Buildings in Different Sub-Cities

	Highest Rent (Birr/M^2)	Lowest Rent (Birr/M^2)	3rd Floor Price (Birr/M^2)	One Room Office	Half Floor	Full Floor
Bole	158	75	97	4,853	19,414	38,828
Kirkos	167	69	101	5,060	20,240	40,480
Arada	125	50	75	3,750	15,000	30,000
Yeka	212	70	120	5,975	23,900	47,800
Lideta	167	82	98	4,917	19,667	39,333

Source: Access Capital Survey



Source: Access Capital Survey

Outlook

Future Challenges

The real estate sector faces a range of challenges in the coming years if the policy and regulatory environment remains broadly unchanged from its present form.

Supply and Price of Land: Land in Ethiopia is under current laws the property of the state and can generally be acquired only on the basis of lease. In many residential neighborhoods, there are 'free-hold' plots owned by private individuals outside of the lease system, but even for these plots of land the owners technically only own the buildings on the land and not the land itself (which remains state property). The prevailing land lease system practiced now for over a decade has allowed for many new real estate developments but has also been associated with various problems including: a high land lease price that is often beyond the reach of many potential buyers; the provision of large plots to developers who fail to commence or deliver promised projects on time; the allocation of the same plots of land repeatedly to different persons; the provision of land in remote areas where there is inadequate infrastructure development, and; administrative and bureaucratic delays in the actual release of already assigned land. Though there is a promising prospect of soon-to-be coming changes in the system of assigning and allocating leased land (see below), this remains to be tested and seen in practice in the coming years.

Availability and Cost of Construction Materials: The fact that the construction and related material production sectors are not well developed in the Ethiopia has created severe shortages of some key construction sector inputs in recent years. These, in turn, have raised the costs of building construction substantially: up by 125 percent since the mid-2000s according to CSA price data on "House Rent, Construction Materials, Water, Fuel & Power," and by even higher amounts (300 percent) for certain critical items such as cement. These challenges will persist until local production capacity in these critical areas is significantly expanded (as is occurring for items such as cement and steel) and/or until government quantitative import restrictions on commodities such as cement are removed.[9]

Infrastructure and Services: The provision of supporting infrastructure is a key component to the expansion of the real estate sector. However, the lack of provision of basic infrastructure and services has impeded progress in certain neighborhoods and held back the plans of developers who had acquired leased land. Problems are also aggravated by the lack of advanced planning and coordination between the city/sub-city administration and infrastructure providers (e.g. electricity/water suppliers), generating unnecessary costs and delays in the real estate sector.

Finance Availability: Lack of finance, particularly long-term finance, is a widespread constraint facing private business in Ethiopia and the real estate sector is no exception. The consequences of inadequate finance may be particularly more pronounced in the real estate sector, however, given the effects on both sellers (who find it difficult to start and complete their developments without adequate funding) and on buyers (who are often unable to secure sufficiently affordable mortgages). In the current financial environment, both project finance (for developers) and long-term mortgages (for buyers) remain scarce, implying that most real estate developers tend to self-finance a majority of their new constructions while most home buyers tend to pay in full for the purchase of their homes or apartments.[10] Unless the financial system can, over time, provide such long-term financing to both sellers and prospective buyers, affordability will remain difficult and the underdevelopment of the financial system will continue to act as a drag on what could otherwise be much faster and broader growth in the real estate sector.[11]

Opportunities

Despite the challenges identified above, there remain considerable opportunities from a business or real estate developer's perspective. From our review of the sector, we think the most promising prospects include:

Targeting Undeveloped and Under-developed City-Center Plots: One distinguishing feature of Addis Ababa is its historical pattern of unplanned growth which has led to modern commercial buildings being located (almost without exception) right next to informal, illegal, and/or completely undeveloped housing units. Thus, even in what would be considered prime city center neighborhoods—whether in Bole, Churchill Road, Meskel Square, Kazanchis, Mexico Square, Lideta, Piazza or many others—modern buildings and developments are typically surrounded by thousands of square meters of undeveloped (often empty) land just behind the main roads or "hidden" within close proximity to city center roadways. However, with the Addis Ababa Municipality now working to upgrade and revitalize many parts of the city-center and with the stricter enforcement of guidelines on the use of city center spaces (e.g. minimum floor requirements), we think the development of such undeveloped city center plots will be one of the most promising opportunities for both commercial and residential real estate developers. The main challenge in this respect is securing access to such plots through the City's lease allocation system. The experience so far has been discouraging given high initial lease prices demanded by the City (as a minimum floor) and even higher lease prices (of as much as Birr 10,000 – 15,000 per square meter) that are sometimes set at land

[9] Local cement prices, at Birr 250 per quintal, are still more than double the level of international cement prices, reflecting in part restrictions on cement imports (currently not allowed by the private sector and undertaken only by the government).

[10] Some limited assistance is offered by real estate companies who provide installment plans but these typically extend payments for a period of a year or two, in contrast to the long-term mortgages desired by most buyers; such financing is also often limited to only 50 percent of the total home price.

[11] Among other things, the development of local bond markets (which could allow banks to issue long-term debt to fund long maturity mortgages) as well an easing of conditions for accessing external finance could both alleviate the shortage of long-term funds in the private banking system.

lease auctions.[12] However, the outlook in this area may be changing, given the prospects for reduced lease rates and negotiated land lease allocations that have been signaled by the City Administration (see below for more).

Focusing on Under-served Market Segments such as Middle-Income Buyers: Real estate developments in the past decade have tended to focus on the high end of the market, which was only to be expected given strong demand from diaspora buyers, pent-up demand for larger homes (given restrictions on such homes under the previous government), and limited credit options that favored well-to-do buyers who could afford to purchase homes with full upfront financing. While demand from these groups of buyers sustained new developments for many years, our discussions with real estate developers indicate a situation where there is now much less buyer interest for this segment of the market following large scale developments of higher end homes and given much reduced demand from diaspora buyers (who represented as much as half or more of the demand in some higher-end developments). On the contrary, there is considerable unmet demand for less expensive homes that can be afforded by professionals and middle-income households more generally.[13] To the extent that supply can be expanded for homes in the price range of say Birr 400,000 to Birr 1,000,000, the unsatisfied demand is exceptionally high according to our review of the market, particularly if the financing to facilitate such purchases is also available.

Using cheaper and unconventional construction materials: Traditional construction techniques in Ethiopia—involving the heavy use of bricks, "blockets," and cement in virtually every stage of the construction process—are expensive, inefficient, and time consuming. Indeed, it is quite striking that low-cost building techniques and materials are so under-utilized in the local market given the country's income levels and the need to provide cost-effective housing at a substantially faster speed and larger scale. Given this state of affairs, developers with cheaper and unconventional construction materials are bound to have significant advantages over competitors with respect to cost, efficiency, and delivery times. Promising prospects in these regard include the use of pre-fabricated boards (such as drywall and gypsum), steel-based construction of high rise buildings, and locally available environmentally friendly building materials.

Introducing Commercial Parking Developments: The lack of parking space is emerging to be a pervasive problem in several of Addis Ababa's business and commercial districts, reflecting in part the very limited parking space that is built with the construction of new commercial buildings. This problem is only bound to get worse as the number of vehicles in the city continues its rapid growth (vehicle registrations have been rising by more than ten percent per annum in recent years). Key city center locations—including Bole, Kazanchis, Mercato, Piassa, Churchill Road and many more—could benefit from many well-placed and modern commercial parking garages that work to accommodate both daytime commercial users and night-time residential/recreational users. With the practice of paying for road-side parking spots now well established in Addis Ababa and with attractive rates already established for this service (around Birr 1 per hour or equivalent to Birr 10 per day per vehicle), the potential for the development of modern parking garages at key high-traffic locations is in our view very promising.

Predictions

Based on the range of data presented in this report and our overall review of the sector, we would venture to make the following predictions regarding the real estate sector. We would qualify our predictions by noting that comprehensive data in this sector remains scarce and that our assessment reflects judgments based on our surveys as well from a round-table discussion held with close to ten actively operating real estate companies in Addis Ababa.

A potentially pivotal change in the administration of land in Addis Ababa could soon alter the real estate sector in a very positive direction if the outcome is a more consistent system of leasing land at reasonable prices. Within the past year, the City Administration has clearly signaled its intention to simplify and improve procedures related to land lease issuance by both enacting new directives and by promising even further changes in the near future. Regarding the already issued directive, the City Administration has now allowed for the use of negotiations—rather than just auctions—in the allocation of leased land; lease rates under this allocation system are not to exceed Birr 4,500 per square meter. The City Administration has also now allowed for partially finished homes to be sold and transferred, canceling a prior directive that had prohibited sales and transfers of homes (even

[12] For example, with a lease price of Birr 10,000 per square meter, a typical 3,000 to 4,000 square meter plot that may interest a commercial building developer would be leased for Birr 30,000,000 to 40,000,000.

[13] Regarding affordability, a buyer with a Birr 10,000 monthly income can afford a home of around Birr 400,000 assuming a 15-year mortgage with a 20 percent down-payment, a 10 percent interest rate, and a cap of one-third of the borrower's income going towards the mortgage. For further illustration, the affordable home—as defined above— for a buyer with a Birr 5,000 monthly income falls to about Birr 200,000 while that for a buyer (or couple) with a Birr 20,000 monthly income reaches Birr 800,000.

by developers) unless 100 percent of the construction was completed. Looking ahead, the City Administration is signaling that it will speed up and streamline land allocations under the lease system, including the establishment of a Land Bank that is intended to become a central repository of all available spaces (i.e. residential, commercial, industrial and other uses) within the metropolitan area.

On the price outlook for residential homes, we think current prices are inflated for high-end residences in outlying neighborhoods (i.e. those at more than 20 kilometers from the city center) and that they could fall by at least as much as the price discounts—of 15 percent—currently being offered by some developers. Several real estate developments located in outlying neighborhoods were targeted to diaspora buyers, with as much as 50-60 percent of total buyers from this group. However, with the upheaval and financial distress encountered by large segments of the Ethiopian diaspora, several real estate companies have been faced with cancellations and a dramatic drop in new orders since early 2009. This has not improved to any significant extent in early 2010 and, for this reason; real estate developers have begun to offer discounts of between 5 and 15 percent on their previously posted prices. This, we think, indicates that there will continue to be a risk of price declines for similar homes in similar locations, i.e., high-end homes (above Birr 1.5 million) located at the very outskirts of the city.

For large residences in locations closer to the city center (most notably Bole and Old Airport), the current elevated price levels can be sustained in our view due to the unique demands for such properties arising from the city's large and ever-growing international community. With around one hundred embassies, several hundred NGOs and aid agencies, plus major international institutions like the AU, UNECA and others, the demand for high-end residences in close to city center locations is unlikely to face any shortfall in demand. If anything, as Addis Ababa's expatriate community expands to include the representatives of foreign companies and investors (in addition to the already large international organization/NGO sector), there might even be continued upward pressures on rents in the coming years to the extent that there is no significant expansion in the supply of city center homes. Thus, we see few risks for declines in either sale prices or rental rates for large homes in the established residential neighborhoods such as Bole and Old Airport.

With respect to commercial buildings, we think rental prices outside city-center locations may show modest declines in the coming years on account of the large amount of new construction in the pipeline. The supply of commercial buildings at the edges of the city has already increased sharply in recent years as it was often easier to secure more affordable plots of land in outlying areas rather than in the city center. At the same time, many unfinished commercial buildings are still in the pipeline, often delayed by shortages of key construction materials or of financing. As supply expands significantly, there is expected to be a decline in the current high rental rates (which largely reflected what was a scarcity of commercial buildings until very recently). For commercial space in city center locations, we think landlords can manage to keep rents high given the unique demand for such locations, but commercial buildings towards the outer edges of the city will not be able to do so and will thus likely show modest declines in rental rates (possibly on the order of 10-15 percent).

High-rise buildings will become increasingly common given their attractiveness from both a commercial and policy perspective. Addis Ababa's vast expansion in recent years and decades has largely been horizontal, but we see both policy and business interests converging to a new period of 'vertical expansion'. This vertical expansion will be promoted from a policy perspective by a City Administration eager to encourage mixed-use, high-density growth as part of its upgrading and revitalizing of under-developed city center locations. From a business perspective, developers will be eager to exploit the considerable cost savings (per square meter space of land area) offered by vertical expansion. With both policy and business interests lining up towards vertical expansion, an expedited pace of such developments can be expected in the coming years.

Apartment developments, both public and private, will become increasingly common. In line with the expectation of 'vertical expansion', the spread of apartment residential homes is in our view bound to become much more widespread in the coming years. The early initiative in this regard has already been taken by the government's large-scale condominium projects but we see much more active private sector involvement as well from here on. Private apartment developments are expected to be much more diverse in their targeted market segment than those of the government, which are likely to continue their original objective of addressing the housing needs of mainly lower income. That is, we see private developments targeting a market segment that starts with middle-income households but also caters to buyers seeking very high-end, exclusive, and luxurious apartment residences.

Overall, our predictions for the sector are broadly positive, but this is in part conditional on some key challenges (i.e., land allocation and financing) being addressed through policy and regulatory reform. Our outlook points to likely price declines for outlying residential homes and commercial office space, but even this risk to the outlook will be relatively modest in our view (at most a 10-15 percent price drop). In most other respects, the outlook points to promising prospects for developers prepared to seize emerging opportunities in several sub-segments of the real estate market.