The Emerging East Africa Construction Market 2015

Focus on Uganda, Ethiopia, Tanzania, Mozambique and Kenya

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EAST AFRICA IN NUMBERS: THE ECONOMIC POTENTIAL

Country	Popu-lation	GDP (US$ Mn)	Annual Growth (2015 (F) (%)	Inflation (%)	Budget balance (% of GDP)	Current account balance(% of GDP)	Share of Construction in GDP (%)
Kenya	42.93	62.72	5.9	7.2	-3.8	-8.2	4.7
Ethiopia	90.98	49.86	7.2	7.7	-0.4	-9.4	5
Tanzania	47.67	36.62	7	5.8	-5.2	-15	7.3
Uganda	38.04	26.08	7	5.5	-4.6	-4.4	14.6
Mozambique	26.49	16.59	8.2	4.6	-10.8	-43	3.3

Source: World Bank and African Economic Outlook, African Development Bank, UNDP and OECD 2014

According to the United Nations, East Africa comprises the following countries: Burundi, Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Mayotte, Mozambique, Réunion, Rwanda, Seychelles, Somalia, Uganda, United Republic of Tanzania, Zambia, and Zimbabwe. Of these, Burundi, Kenya, Rwanda, Tanzania and Uganda are part of an Economic Union called the Eastern African Community (EAC), an inter-governmental organization aimed at regional cooperation that is working toward a common monetary and trade union with a common currency. Mozambique, a former Portuguese colony is the southern-most country in East Africa and often considered as part of South Africa for most economic computations and economic unions.

Most countries in East Africa are likely to continue to grow at a healthy pace of 6 percent and above during 2015 and beyond driven by improved performances in the agricultural, mining, tourism and industrial sectors. Notably, Mozambique, Ethiopia, Tanzania, Uganda and Kenya.

Inflation in most of the countries receded in 2013 and 2014 as compared to earlier years, mainly owing to lower food prices, prudent fiscal and monetary policies, most notably in Ethiopia where inflation fell from 20.5% in 2012 to a single-digit level of 7.7% in 2014), with prudent debt and expenditure management, and exchange rate stability.

Role of Government and Developmental Planning for Construction

Kenya's long-term development blueprint is called Vision 2030 and it aims to transform the country into a newly industrializing, middle-income country that provides a high quality of life to all citizens by 2030. The vision rests on three pillars: an economic pillar which aims at economic growth of 10% per annum; a social pillar which seeks just, cohesive and equitable social development in a clean and secured environment; and a political pillar which aims to install an issue-based, people-centred, result-oriented and accountable political system that respects rule of law and protects the rights and freedoms of every Kenyan. The foundation of these pillars are infrastructure development, public sector reform and macroeconomic stability.

The Vision is to be translated into action with the help of Medium Term Plans or MTPs that constitute medium range five year plans spread over a five year period. The Vision is to be implemented through successive five-year Medium Term Plans. The first Medium Term Plan (MTP I) 2008-12 performed moderately with mixed results an average growth rate of 3.7% was achieved during the plan, though positive results were witnessed in the social and political pillars.

The MTP II 2013-17 is more ambitious, aiming for a growth rate of 10% to be achieved by 2017-18. It prioritizes infrastructure development to enhance competitiveness; investing in irrigation and mechanized agriculture to enhance food security; support to value addition; poverty reduction and social protection; skills development; governance and public financial management reforms; transparency and accountability in the EI; promoting national unity and identity; and improving security.

Under MTP II, the Kenyan government has planned a complete revamp of road, rail and port transport infrastructure is planned including expansion, development, and modernization of roads, rail, ports and other transport infrastructure. The cost of infrastructure projects under the MTP II is estimated at Ksh 245.63 trillion (US$ 2.89 trillion). The government has also prepared associated policies for roads and transport, energy, agriculture and skills development to support the implementation of the MTP II

Similar to Kenya's MTP, Ethiopian government has embarked on an ambitious Growth and Transformation plan for the period 2010 to 2015. The Construction industry in Ethiopia has been the largest beneficiary of this plan. According to report by Access Capital, the GTP is likely to provide opportunities to contractors worth US$ 20 billion annually based on the projects it has laid out for implementation over the next few years. Ethiopia now sports the highest capital expenditure in the region, spearheaded by the GTP, with its infrastructure stock growing by an annual 15 percent between 2002 and 2012 to become the sixth largest in terms of capital stock of infrastructure in Africa.

Construction Industry in East Africa

For long considered underdeveloped and frontier countries and also laggards among their northern and southern neighbours in terms of foreign investment, by the developed nations of the World in contrast to the developing emerging markets or the BRIC nations, the discovery of oil and gas reserves in the East African belt in the past decade have spurred rapid interest of Foreign Direct Investments (FDI) in this region. According to an Ernst and Young Africa Attractiveness Survey in 2014, the East African region witnessed a growth in FDI by 23 per cent between 2007 and 2013, accounting for a share of 17 per cent of the African continent's FDI as of 2013. Oil discoveries in Juba, South Sudan, Uganda and Kenya as well as gas deposits found off the coasts of Tanzania and Mozambique have turned East Africa into a focal point for exploration and investment. The region is abundant in many commodities including oil, gas, gold and niobium as well as rare earth metals.

These countries are largely infrastructure deficient and present huge potential in terms of infrastructure development as they have begun major transport and logistics expansion programmes with strong government support. Within the oil and gas sector alone it is estimated that between US$60 billion to US$70 billion needs to be invested in infrastructure in the East African region, according to analysts. According to a report by investment house KPMG, it is estimated that four out of every ten mega construction projects in the East African region are related to transport and dominated by Chinese and European construction firms, strongly encouraged by the individual and regional government support of the EA nations.

Tourism is yet another strong driver to growth of construction and the requirements for rapid expansion of infrastructure with countries such as Kenya and Tanzania leading the trend followed by Uganda, attracting an increasing number of global tourists in recent years. Another attractive trend is the growth of the middle class in East African markets, stronger than emerging markets such as India, according to a McKinsey report, East Africa presents a growing potential for retailers and retail development, with Kenya and Tanzania beginning to attract retailers from the region and abroad. The trend is however so fast paced that the retail real estate is unable to keep pace and the slow growth of retail space is beginning to act as a hindrance to investment for retailers.

While studies by global construction firms such as AECOM point out that construction costs in East Africa are amongst the cheapest in the World, for sectors such as infrastructure and high rise buildings, large retail and commercial constructions are often hindered by costs of importing and transporting them to remote areas, and in installing water and sewage networks where the essentials are not available, apart from importing specialist labour and know how to man these projects.

While both governments and the private sector have been investing heavily in the East African construction market, the focus of these investments have been mainly on development of rail and roads, power plants, retail developments such as large malls, skyscrapers and hospitals. 59 percent of the projects in the region were dominated by the government as of 2014, according to a Deloitte report on the Africa, mostly in the rail and road sectors. Key cities such as Nairobi in Kenya, Dar e Salam in Tanzania and Maputo in Mozambique are quickly emerging as hotspots for investment activity with transport corridors and trade routes being forged to connect these cities with the world while transforming them into sizeable urban clusters for consumer facing companies across the globe to target for further investment.

Mega Projects in East African Construction

Construction activity in East Africa, which according to analysts has been sporting growth of over 13 per cent compound annual growth rate between 2009 and 2013, is showing good diversification, evidencing a mature and competitive industry. The broad sectoral shares of projects, include the largest share of infrastructure projects (59 per cent as of 2014) followed by energy and power accounting for 37 per cent of the total. Activity in the transportation sector construction also grew by 17 per cent as compared to 2013, according to a Deloitte study.

The study estimated the number of mega construction projects in East Africa excluding Mozambique at US$ 67,688 million from US$ 60,671 million in 2013. According to the report, transport projects grew by 17% in 2014 as compared to 2013, while Energy and Power remained static at 37% in terms of the total number of projects under construction in the region. Kenya held the most projects followed by Uganda and Ethiopia. Tanzania had just 7% and Rwanda 4% of the total East African projects. Government financed nearly 59 per cent of the mega projects in East Africa during 2014, followed by private domestic firms, while intra African funding was restricted to 8 percent and international financial institutions to 2 percent. As regards country shares, Kenya held the most projects followed by Uganda and Ethiopia. Tanzania had just 7% and Rwanda 4% of the total East African projects as of 2014.

Also in East Africa, significant Retail development is underway, particularly projects such as the Two Rivers and Garden City. Kenya's Garden City project, when it was announced last year was expected to be a game changer in the country's real estate space, paving the way for mixed use developments across the region. The project promises 50,000 square metres of rentable retail space, 421 residential units for sale and 3.4 acres of serviced land for sale. Garden City had been touted to be East Africa's biggest retail project so far, though in October 2014, yet another mega project Two Rivers, Kenya's largest retail development, was announced, a 58,000 square meter mixed use development that will include medium range residential homes, a five star hotel, office blocks and a shopping complex to be executed in phases with a total floor area of 830,000 square meters on completion in October 2015.

Many local and multinational consumer companies are already thriving in Africa and reaping handsome returns and it is now attracting international and regional retailers such as Carrefour and South Africa's Shop Rite and Massmart among others. Retail developers such as Majid Al Futtaim have stepped into the lucrative East African retail development space. Despite numerous challenges such as finding the correct local skills and establishing the right supply and logistic chains, Kenya represents one of the most affluent retail markets in the continent which is virtually untapped as well. Retail projects in Africa attracted nearly 17 percent of the FDI into the region in 2013. Global credit card players such as Visa, MasterCard and American Express too have found its attractive growing middle class a major draw apart from its sophisticated non-cash payment infrastructure as compared to other emerging and frontier economies, also boosting the attractiveness of retail and real estate development in the region.

Tanzania's Bagamoyo Port is receiving the largest investment in the region. The second largest project (Mombasa to Mabala Standard Gauge Railway Line) is significantly smaller from this perspective. Other significant projects include the Ethiopian Renaissance Dam (US$ 4.2 billion), Addis Ababa-Djibouti Railway (US$ 3.3 billion), LAPSSET (Lamu Port-South Sudan-Ethiopia Transport Corridor) Project (US$ 3.3 billion) and Ugandan Farm-down Geothermal Plant (USD 2.9 billion). Milestones reached in key transportation projects included breaking ground on the Nairobi to Mombasa rail project; Tanzania refurbishing the Dar e Salaam to Issaka rail link; airport expansion projects across the region; and port expansion planning.

In Uganda, the country's first oil refinery, a US$ 2.5 billion project is underway to produce 60,000 barrels a day, for which the government has received detailed proposals from four international companies as at June. Supporting transportation projects include a US$ 255 million North Eastern Road Corridor, and construction of hydropower projects in Karuma and Isimba. Road development is an intensive focus in the region, with significant projects underway to address inter- city highways and a number of PPP projects planned to come to market over the next 18 months, such as the 2nd Nyali Bridge PPP project. Kenya is also in the process of developing an annuity finance project for a 10,000 kilometers road development and maintenance programme. In Uganda, capital raising of US$ 8 billion for a standard gauge railway is in process within the Nairobi Mombasa Railway.

In 2013, the government in Kenya had announced its intent to add 5 000MW to the energy grid, which has resulted in three mega projects being put out to tender in 2014. Of these, the 960MW Lamu coal fired power station was cleared through the court cases on 15th January 2015. It also plans to add 9 solar power plants through PPP over the next few years. Kenya also commissioned the largest geothermal plant in the world in 2014 and Ethiopia, too, has put in place ambitious power sector expansion plans including a large hydro power plant, and a gas power plant that aims to add 12,000 MW to the national power grid.

Ethiopia which according to analysts constituted the largest share of capital investments, which were predominantly funded by governments, included mega projects such as a US$ 4 billion geothermal farm, set to be the largest geothermal plant in Africa and the Grand Ethiopian Renaissance Dam, expected to generate 6000 MW of electricity on completion.

Taking the south eastern country Mozambique as a separate entity as it is considered often a part of South Africa, it offers its own growing investment market for construction. It was mentioned in 2014 by Deutsche Bank as “one of three of the main foreign investment destinations in Africa” a report by the investment bank stated that over the next few years, the country is expected to be home to infrastructure projects worth an estimated US$32 billion. According to this report data, Mozambique has 18 large infrastructure development projects valued at more than US$24 billion under construction. Of these, only 5.5% fall within the country’s current economic backbone of Agriculture. 50% are in Energy and Power and 45% are Transport projects. All of these are underway with the medium to long-term vision to better integrate infrastructure to create an economically viable commercial system. As Mozambique operates as the gateway to and from the ocean for a number of landlocked African countries (Zimbabwe, Zambia and Malawi), its infrastructure development plays an important role in the developmental plans of landlocked Southern and East African countries, which increasingly rely on its development. According to the IMF, the huge energy investments in the country would require nearly US$ 24 billion of supporting infrastructure investments for which around US$ 4 billion could be annually invested by international companies between 2014-19, with all contents assumed to be imported., which could translate into a net FDI flow of US$ 24 billion during 2014-18, of which 80% will go towards the development of the gas industry.

Future Outlook: East African Construction

Largely sustained by individual and regional economic investment across the infrastructure and energy sectors, spilling over into real estate developments in the fast urbanizing East African economies, strong economic fundamentals backed by ample government support are likely to help the East Africa become a rapidly growing market for construction over the next few years. While Tanzania and Mozambique are the fastest growing economies, Kenya is likely to be a dominant player in the market given its region driven by a well-diversified economy and a vibrant private sector, despite its lower growth rates in 2014.