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Construction on the African Continent: Opportunities, Risks and Trends

Physical infrastructure backlog in most of Africa is widely known and acknowledged. For example, road access rate is only 34%, compared with 50% in other parts of the developing world, and subsequently, transport costs are higher by up to 100% (PIDA, 2011). For many years there have been rumblings about Africa lacking adequate paved roads, reliable power grids, retail shopping malls, formal housing for all its peoples, modern office space, decent airports and efficient ports. Therefore, it was only a matter of time before investors began to realise that the massive infrastructure deficit on the African continent represents a significant and potentially lucrative investment opportunity.

The global financial crisis can in part be credited with changing perceptions of Africa as an investment destination. With the United States, Europe, the United Kingdom, Japan and other first world economies falling into recession, and many global markets consequently suffering losses, Africa's positioning changed from risky to a lucrative and relatively safe investment destination. Seven of the World's ten fastest growing economies are currently located in Africa.[1]

In a short space of time, the continent suddenly resembles a massive construction site with real estate markets faring well. By way of illustration, in the first quarter of 2012, the value of prime property in the world's key cities fell by 0.4% while that in Nairobi rose by 24% making it, globally, the strongest performer (Knight Frank, 2012). This is, however, not just due to perceptions of Africa as a better investment destination compared to the West in light of the global crisis. This performance is underpinned by good governance, institutional reforms and tightened monetary policy which has, amongst other things, kept inflation at bay. By the end of September 2012, Kenya had recorded 10 consecutive months of dropping inflation rates and, in parallel, a drop in lending rates too.

So, for those wanting to join the African construction boom, what are the opportunities, the risks and the overall trends?

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1 International Monetary Fund

What are the Opportunities and what are their Drivers?

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The case for investing in construction on the continent is strong, with the following factors contributing to this robust case: rapid urbanisation, strong current and projected economic growth, a rising middle class, regional integration and strengthened democracy, transparency, accountability and governance in many of Africa's 54 nations. Each of these factors is driving opportunities on the continent.

Urbanisation and Housing

In 2010 Africa had 51 cities with more than a million inhabitants, and only one city – Cairo – with more than 10 million. By 2040, it is expected to have more than 100 cities of more than one million inhabitants and 7 cities of more than 10 million.

The largest city is projected to be Kinshasa, where the population is expected to reach 24 million (PIDA, 2011) by 2040. These pressures are already being felt and in a bid to cope with this rising urbanisation, entire new cities are already being developed such as Tatu City in Kenya, the City of Light in Accra and King City in Takoradi, Ghana accommodating 178 000 residents between them and being built at the cost of US$300 million. In Nigeria, there is the Greater Port Harcourt City and the modern Eko Atlantic City being built on reclaimed sea.

These 'self-contained' new cities, based on the work-play-live concept, are intended to relieve the highly congested metropolises and minimise the need for inhabitants to go into the 'centre'. Indeed, demand for housing is growing across all price points. In Nairobi, for example, there is a demand for some 150 000 affordable new homes per annum at the lower end of the price spectrum, but with only some 30 000 units being built annually. Ghana, sits with a 1.6 million units housing deficit which is anticipated to grow to 3.6 million units by the year 2022 according to the Consumer Protection Agency of Ghana. While many countries in Africa have traditionally not had a developed mortgage market, this is changing as banks and specialised financial institutions are rolling out new programmes such as lower-income mortgages. Ghanaians, for example, are now able to more easily access 15-year mortgages for 18000 cedis (US$9245) and this is, in turn, creating opportunities for developers.

Strong Growth and resultant shortages of Office Space

As more businesses access African opportunities and set up local operations, the acute shortage of high quality, well priced office space is being exposed. Office rentals on many parts of the continent are high commensurate to the quality on offer. Business activity emanating from the oil and gas industry has further pushed rentals higher, making Luanda and Lagos some of the costliest cities in the World to live and operate in. In a 2012 cost of living survey, Luanda ranked as the second most expensive city in the world for expatriates. Lagos was ranked at number 39. To put this into context, Tokyo is the most expensive at number 1, just one place ahead of Luanda, while Paris ranked 37, Stockholm 46 and Vienna 48. Luanda rentals can be in the range of US$150 per square metre per month and Lagos US$70.

A Rising Middle Class and increased consumer spending power

The rise of the African middle class, as a percentage of the population, has been steady – in 1980, 111 million or 26% of the continent's population fell in this category rising to 151.4 million or 27% of the population in 1990 with a further surge to 196 million in 2000 and a dramatic increase to 313 million in 2010, equating to 34.3% of the population (African Development Bank, 2011). The rise in absolute numbers, compared to the percentage rise, has been more dramatic and this is best explained by the increase in population, with Africa having hit the 1billion population mark in 2010.

The prime beneficiaries of this socio-economic trend are consumer businesses and, primarily, retail – food and clothing. There is currently an explosion of such businesses moving into the continent and with that, a rise in the demand for formal retail infrastructure. To illustrate the scale of the opportunity, Nigeria is comprised of 36 states under its federal government system. With a population of 160 million, there are opportunities of scale across the country, beyond Lagos. The development of retail space is not happening fast enough and remains a key constraint to retailers' African growth plans. This, in turn, is hampered by insufficient FDI inflows into property. This has now created an opportunity for institutional investors, including African pension funds, which traditionally they have not invested in this asset class, but this is changing.

Regional Integration and Cross-Border Infrastructure projects

Many of Africa's 54 countries are small, with populations of fewer than 20 million and economies of less than $10 billion. Their infrastructure systems, like their borders, are reflections of the continent's colonial past, with roads, ports, and railroads built for resource extraction and political control, rather than to bind territories together economically or socially (PIDA, 2011). The essential benefit of regional infrastructure is to make possible the formation of large, competitive markets in place of the present collection of small, isolated, and inefficient ones.

As regional bodies and the African Union continue to drive the integration imperative, this is creating opportunities for an array of large infrastructure projects that span borders. Initiatives such as the North-South Corridor and the SADC Infrastructure Master Plan present massive opportunities for Public Private Partnerships (PPPs). There is recognition that such PPP arrangements could assist governments close material financial, managerial and technical gaps, while supporting further regional integration. For example, there is a US$100 billion funding gap for the SADC Infrastructure Plan.[2] The North-South Corridor project is equally ambitious and costly. It comprises 157 projects in the North-South Corridor, conceived as the area between Durban and Dar es Salaam, and includes 59 road projects; 38 rail projects and 6 bridge projects.

2 TradeMark Southern Africa

Risks and Challenges

The mortgage to GDP ratio for Ghana remains under 1% compared to 32% for South Africa (SARB, 2011) and 19.6% for Namibia (Bank of Namibia 2011).

While opportunities abound, what are the risks and challenges that need to be navigated in undertaking construction projects on the African continent?

- Challenges of accessing funding for property developments in many parts of sub-Saharan Africa. Although some developments in South Africa are funded with up to 100% debt, in the rest of the continent developers often need to put down around 50% in cash.

- For construction projects that cross borders, there is a lack of alignment between national and regional priorities and legislative frameworks. Where regional and continental infrastructure policies do appear in national legislation, too often they are not enforced.

- Construction costs (and professional fees) on the continent are high due to the non-availability of specialist building materials. Furthermore, is the high cost of land. An acre in a prime zone in Accra can cost up to US$2m. However, these need to be balanced against rental yields of over 10% for retail, residential and industrial properties.

- While there is a rising middle class in Africa, Africa remains a cash society and this places strain on household incomes. The mortgage market is underdeveloped or non-existent in the majority of the continent. The mortgage to GDP ratio for Ghana remains under 1% compared to 32% for South Africa (SARB, 2011) and 19.6% for Namibia (Bank of Namibia 2011). For most Africans wanting to own a home, the following approach is adopted: come up with the bulk of the money in one fell swoop or begin accumulating cement, tin sheeting and other housing components in order to start working in spurts as the cash comes in (Africa Report).

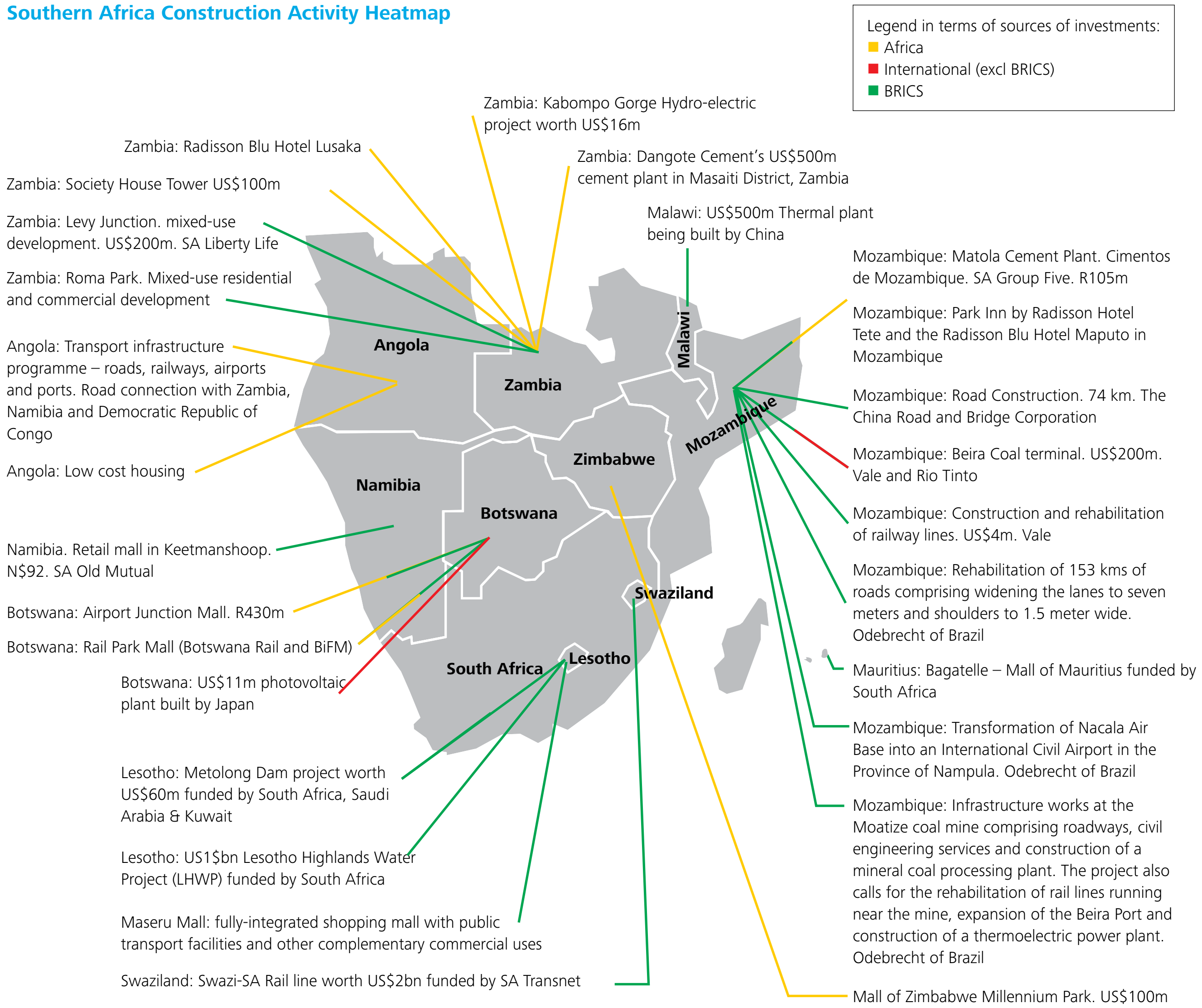
Trends

A number of trends are discernible based on Deloitte research on construction activities taking place in Sub-Saharan African excluding South Africa. The research mapped the following: what is being built; who is physically building it and who is funding the construction. The intelligence was collated from publicly available sources and may not be comprehensive. In terms of a process for filtering projects for inclusion, only selected projects commissioned or in progress as at the beginning of 2011 and are on-going (at the time of publication) were included. With regards to investment country sources the following categories are defined in an attempt to discern intra-Africa, BRICS, and other investments:

- BRICS – Companies from BRICS countries (Brazil, Russia, India, China, and South Africa)
- International – the rest of the world excluding the BRICs and other African countries
- Africa – African companies expanding beyond their home-base markets into other African countries. This captures the essence of intra-African trade.

Below are heatmaps showing some of the construction activity per region (based on the physical location of the project) of the continent:

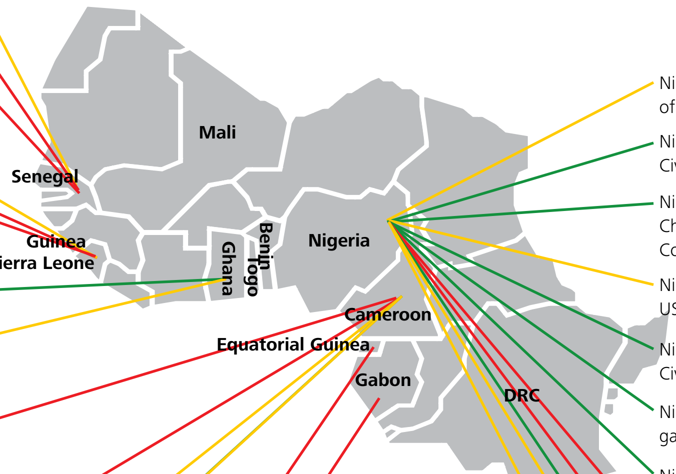
Southern Africa Construction Activity Heatmap



Source: Deloitte

Central and West Africa Construction Activity Heatmap

Legend in terms of sources of investments:
- Africa
- International (excl BRICS)
- BRICS



Senegal: Dangote Cement $500m

Senegal: Port development. DP World

Senegal: Radisson Blu Hotel, Dakar

Sierra Leone: Significant port and rail infrastructure to support the development of the Tonkolili iron ore project in Sierra Leone. African Minerals and Shandong Iron & Steel Group Co of China.

Sierra Leone: Radisson Blu Mammy Yoko Hotel, Freetown

Ghana: State Tower Bloc: US$63m. China State Hualong Construction of Ghana Limited

Ghana: First shorebase facility to support offshore oil and gas activities

Cameroon: Lom Pangar dam in the east of the country. World Bank and other international organizations. Planned capacity of 7.250 billion cubic meters for a reservoir that will cover 610 km².

Cameroon: World Trade Centre, hotel, Cardiac Centre in Shisong, Kumbo. Italy.

Cameroon: Dangote Cement's $115m plant in Douala

Cameroon: Memve'ele Hydroelectric Dam. Sinohydro Corporation Limited. Total FCFA 420bn of which Eximbank China through FCFA 243 billion loan; FCFA 112bn from the African Development Bank and the balance from the Government of Cameroon.

Gabon: Radisson Okoume Palace Libreville Hotel

Equatorial Guinea: Malabo City mixed use development: hotels, residential property and shopping malls. US$300m. Imotec.

Nigeria: Dangote Cement. Kogi State. Capacity of 10 million tonnes of cement per annum

Nigeria: Abuja Light Rail. US$102m. China Civil Engineering Construction Corporation

Nigeria: Abuja-Kaduna Railway. US$850m. China Civil Engineering Construction Corporation

Nigeria: Jebba-Kano rail line rehabilitation. US$79m. Costain Engineering

Nigeria: Lagos Light Rail US$1130m. China Civil Engineering Construction Corporation

Nigeria: Rehabilitation of existing narrow gauge from Lagos to Kano . US$110m.

Nigeria: Construction of 6 stations between Itakpe and Warri. US$480m

Nigeria: Park Inn by Radisson Hotel Abeokuta

Nigeria: Radisson Blu Anchorage Hotel, Lagos

Nigeria: 5 x Protea Hospitality Group hotels

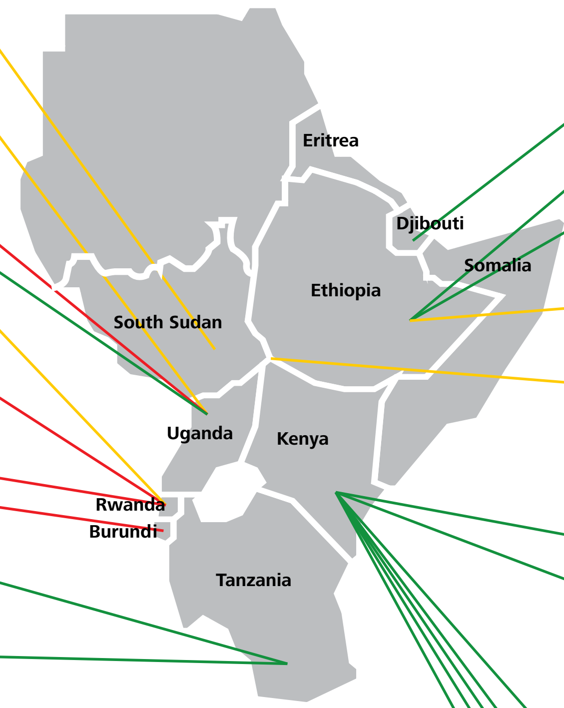
Nigeria: Dangote Cement. Single largest cement plant in Africa with a capacity of 5.2m MTpa

Nigeria: Dangote Cement. Ibese. 6 million metric tonnes of cement per annum (mtpa)

Source: Deloitte

East and Horn of Africa Construction Activity Heatmap

Legend in terms of sources of investments:
- Africa
- International (excl BRICS)
- BRICS



South Sudan: The US$5bn Lamu-Juba Oil pipeline funded by various countries including Kenya & Uganda

Uganda: Construction worth US$60m by Uganda private company to increase Tororo plant capacity from 20MW to 80MW

Uganda: The Nyagak hydro plant construction worth US$23m by German company

Uganda. Road networks. US$106m. Soft loan from China

Rwanda: manufacturing of US$15m facility at Kayonza district in Rwanda for edible oil and animal feeds funded by Tanzania

Rwanda: Construction of the one-stop border post worth US$56m at Rusumo on the Tanzania-Rwanda border funded by Japan

Rwanda: Radisson Blu Hotel Kigali

Burundi: 10MW hydro electric plant worth US$45m being built by China

Tanzania: 300-megawatt power plant, which includes a 1,100km power transmission line worth US$684m being built by China

Tanzania: US$1.2bn loan agreement with China. Construction of a 532-kilometre pipeline from the south of the country to Dar es Salaam

Djibouti: Doraleh Container Terminal. Odebrecht of Brazil

Ethiopia: ICT Park (Technopolis) worth US$45m being built by China

Ethiopia: Gibe III dam on the Omo river will be the highest in Africa. US$4.9bn. Industrial and Commercial Bank of China (ICBC) US500m. 1,870MW capacity. Italian Salini Group

Ethiopia: Dangote Cement plant. Capacity 1.5 MT/year. $400m. To start 2014

Kenya, South Sudan and Ethiopia: Sh2 trillion (US$23bn (£14.5bn) Lamu Port project. The project will integrate the economies of Kenya, South Sudan and Ethiopia while opening up the region to global trade opportunities with emerging economies.

Kenya: ICT Park. (Konza Technology City). US$9.6bn

Kenya: The Northern Bypass is one of Kenya government's major infrastructure projects aimed at making the country a regional business hub. The Northern Bypass together with the Eastern Bypass will cost Sh8.5bn. Kenya is financing 15 per cent of the project (Sh1.2bn) while the China is financing the remaining 85 per cent (Sh7.3bn).

Kenya: Thika Road. Sh2bn

Kenya: The Eastern Bypass. China Road and Bridge Corporation

Kenya: The Great Southern Bypass. China.

Kenya: Nairobi road networks. US$150 msoft loan from the Brazilian Development Bank.

Kenya: Ngong Road. Sh1.68 bn grant from the Japan International Cooperation Agency (JICA).

Source: Deloitte

So, what is happening?

- Southern Africa is characterised by a spate of retail malls and mixed-use development projects. The tenants of these malls tend to be South African retailers as they seek new markets north of their borders. Such construction is consistent with the rising African middle class on the continent coupled with the lack of formal retail infrastructure. The development of malls in West and East Africa has been largely funded by private equity funding while in Southern Africa, by South African insurance and pension fund players. In terms of occupancy in all regions, anchor tenants are largely South African retailers as they operationalise their Africa growth strategies.

- Kenya is characterised by significant road works programmes financed primarily by African Development Bank, China as well as Brazil and Japan. Construction of these roads is largely undertaken by the China Road and Bridge Corporation. Research shows that the country was losing close to Sh50 million a day due to traffic congestion in the city of Nairobi and its environs, primarily due to the time wasted on the road. Some of the infrastructure is designed to connect Kenya to its neighbouring countries and this will help operationalise the East African Community in 2014. The Lamu Port project connects Kenya, South Sudan and Ethiopia.

- There is significant construction activity in Mozambique and Sierra Leone relating to infrastructure development at the ports as well as rail and road in order to facilitate the movement of coal and iron ore, respectively, from the mines to the port for export. These developments are largely funded by large multinational commodity companies for their own specific use.

- The hospitality sector is marked by the construction of hotels, at different price points, in several countries. The Redizor Group (USA) (the Radisson) and the South African hotel group, Protea are leading those development efforts.

- There is significant railway construction and rehabilitation in Nigeria by the China Civil Engineering Construction Corporation.

- The Dangote Cement Group emerges as a significant African investor in the construction industry with a number of cement plants being built across the continent.

- In terms of the construction work, there is a trend toward non-African players such as, for example, the China Civil Engineering Construction Corporation, China Road and Bridge Corporation and the Odebrecht Group from Brazil.

- The regional integration mandate has introduced co-ordinated approaches to infrastructure planning and implementation. With this there is also a trend towards new financing mechanisms such as PPPs and raising national infrastructure bonds.

- A visible trend toward renewables with a number of hydro-dams being built in Cameroon, DRC, Ghana, Rwanda, Zambia, and Uganda. The largest is the Gibe III in Ethiopia at the cost of US$4.9bn. The Inga III hydroelectric power project is one of the largest proposed power projects in Africa and seen as crucial to providing sufficient power by 2020 and spurring Congo's economic growth.

Conclusion

Looking at the trends highlighted, construction will continue to drive economic activity on the continent for years to come given the continent's infrastructure needs which are far from being met. New thinking is also required. For example, PPPs could be seen as a vehicle that mitigates against risk by allowing private sector players to more positively influence government policy and thinking through interactions with government during the lifespan of a project, but as this continent develops rapidly, the solution may be one that does not exist today.

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