



Addis Ababa University
College of Law and Governance Studies

**Legal Framework for Bank Acquisition of Immovable Assets Following Failed
Second Auction: Valuation Standards and Regulatory Gaps in Ethiopia**

By:

Lemlem Birhanu Sihine

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Advisor: Professor Zekarias Keneaa

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Second Auction: Valuation Standards and Regulatory Gaps in Ethiopia.

APPROVED BY:

PROF. ZEKARIAS KENEA

ADVISOR

SIGNATURE

DATE

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DATE

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SIGNATURE

DATE

Declaration

This is to certify that the thesis prepared by Lemlem Birhanu Sihine: “Legal Framework for Bank Acquisition of Immovable Assets Following Failed Second Auction: Valuation Standards and Regulatory Gaps in Ethiopia.” and submitted in partial fulfillment of the requirement for the degree of masters (L.L.M business law) complies with the university and meets the accepted standards with respect to originality.

Lemlem birhanu sihine

Signature

Date: 21/5/2025

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Acronyms

Civil Code- Civil Code of the Empire of Ethiopia Proclamation No. 165 of 1960

Civil Procedure Code- the Civil Procedure Code Decree no 52 of 1965

Commercial Code- Commercial Code of the Empire of Ethiopia, Proclamation no 166 of 1960

NAVA-The national association valuers and auctioneers

Proclamation number 97/1998-property mortgaged or pledged with banks proclamation

Provisioning directive- licensing and supervision of banking business asset classification and provisioning directive number SBB/0/2024

NBE-National Bank of Ethiopia

DCF -Discounted Cash Flow

NOI -Net Operating Income

SARB -The South African Reserve Bank

NPLs -Non-Performing Loans

Abstract

This research analyzes the legal framework governing the valuation and acquisition of immovable assets by Ethiopian banks, in particular focusing on circumstances where a second auction for distressed assets has failed. The study critically assess existing laws, regulations, and directives that dictate the processes of asset valuation, bid pricing, and eventual transfer of ownership to banks when conventional auction mechanisms prove unsuccessful. This research aims to identify potential gaps, inconsistencies, or ambiguities within the current legal provisions that may hinder efficient resolution of non-performing loans and the effective recovery of bank capital. Through doctrinal methodology analysis of these legal instruments, the research look to identify systemic challenges presented by the current framework and to propose recommendations for policy reforms that could streamline the asset recovery process, improve financial stability, and foster a more efficient secondary market for non-performing assets market in Ethiopia, characterized by increased transparency, liquidity, and investor confidence.

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Chapter 1

Introduction

1.1 Background of the study

The stability and efficiency of a country's financial system are highly linked to the health of its banking area. Like many developing economies, Ethiopian commercial banks play a pivotal role in capital formation and economic development by promoting and facilitating credit to various sectors. Notwithstanding, this crucial function is often challenged by the prevalence of non-performing loans (NPLs), which arise when borrowers fail to meet their repayment obligations. NPLs stance a significant threat to financial institutions, eliminating profitability, constraining lending capacity, and potentially endangering overall financial stability.

A prevalent way out for Ethiopian banks in managing NPLs secured by immovable assets is through the foreclosure and auctioning of these collateralized properties. The legal framework governing these processes is designed to provide a well-structured mechanism for debt recovery. Commonly, this involves a series of auctions aimed at liquidating the asset and recovering the outstanding loan amount. However, a persistent challenge arises when these auctions, particularly the second and subsequent attempts, fail to attract buyers or bring a price sufficient to cover the outstanding debt. In such circumstances, the legal provisions often empower the creditor bank to acquire the immovable asset itself, replacing a loan into a tangible asset on its balance sheet.

While the details of Article 11 of Proclamation No. 1357/2024 are the subject of this research, it is understood to be the pivotal legal provision governing the procedures for determining the price of immovable assets post-second auction failure and regulating their following the acquisition by Ethiopian banks. This proclamation is anticipated to lay down the principles and methodologies for such valuation, potentially addressing issues of fair market value, minimum bid requirements, and the administrative processes for asset transfer.

The acquisition of assets under financial strain by banks is a crucial link in the NPL resolution process. It necessitates a robust and transparent legal framework for asset

valuation to determine the acquisition price, ensuring fairness to both the bank and the defaulting borrower, and compliance with regulatory standards. The absence of clear, consistent, and effective legal guidelines in this area can lead to protracted recovery periods, undervaluation or overvaluation concerns, increased operational burdens on banks, and a general inefficiency in the distressed asset market. This inefficiency not only prolongs the impact of NPLs on bank performance but also stifles the potential for a dynamic secondary market that could otherwise facilitate faster asset turnover and enhance liquidity within the financial system. The effectiveness of Proclamation No. 1357/2024, Article 11, directly influences the efficiency of NPL resolution, the financial health of banks, and the broader distressed asset market. Ambiguities or limitations within this article could lead to prolonged asset holding periods by banks, undervaluation disputes, increased operational burdens, and a dampened secondary market for distressed assets. Therefore, a critical assessment of this specific legal provision is important to understand its implications for financial stability and suggesting necessary policy refinements. In terms of financial reform, consistency concerns, among others, the area of prudential regulation in relation to the status of financial institutions' profitability and the availability of private capital.¹

This research, therefore, delves into the specific legal landscape in Ethiopia that dictates how immovable assets are valued and subsequently acquired by banks following the failure of second and subsequent auctions. It seeks to understand the adequacy and clarity implications of these legal instruments in facilitating an effective and equitable resolution of NPLs and contributing to the overall persistence of Ethiopia's banking sector.

1.2 Statement of the problem

The existing governing legal system in Ethiopia immovable asset valuation and bank acquisition post-auction failure suffers from significant division across multiple legislative instruments. While proclamation number 97/1998 and its amendment proclamation number 216/2000 on property mortgaged or pledged with banks authorizes creditor banks to sell property through auction and take over property “in consideration of its floor price set for the first auction and have ownership of the property transferred to it” when “the bidder fail to appear upon a second

¹ Claessens, S., Djankov, S., & Mody, A. (2001). *Resolution of Financial Crises: What Policies Help?* IMF Working Paper

public auction”, the newly enacted real estate development and real property marketing and valuation proclamation number 1357/2024 establishes an entirely separate valuation framework without explicit coordination mechanisms with existing banking foreclosure procedures. This division establishes legal uncertainty concerning which valuation standard apply when banks acquire immovable assets after failed auctions, particularly given that Ethiopia has “no mortgage valuation framework or a regulatory valuation institution” and financial institutions “may value mortgage securities without any clear and consistent basis; resulting in confusion among experts and parties dependent on valuations”.

In Ethiopian law there is a gap concerning specialized valuation methodologies for immovable assets acquired by banks following auction failures. During the real estate proclamation number 1357/2014 establishes general property valuation purposes including “bank loan collateral” under article 11(1) (c), it fails to address the valuation challenges that emanate when properties remain unsold after two public auctions banks acquire properties at the floor price set for the first auction.

The existing legal frame work lacks adequate regulatory direction for banks acquisition of immovable assets post-auction failure. While the 1998 and its amendment the 2000 banking proclamation on properties mortgaged and pledged with banks authorizes banks to acquire property when no bidders appear at the second auction, there is no corresponding national bank of Ethiopia (NBE) directives establishing mandatory revaluation requirements for acquired properties and holding period limitations for bank-owned real estate.

As Ethiopia encounters significant financial sector liberalization and seeks to attract foreign investment this legal framework examination is crucial. The establishment and analysis of these legal gaps will contribute to developing extensive legal reforms that ensure proper immovable asset valuation standards for bank acquisitions post-auction failure, thereby strengthening the overall stability and efficiency of Ethiopia’s banking system while supporting and strengthening feasible economic goals.

1.3 Literature Review

The prevalent matter of non-performing loans (NPLs) and their resolution mechanisms forms a cornerstone of financial sector stability research universally. This literature review focuses on

basic academic and policy discussions pertinent to the legal framework governing immovable asset valuation and acquisition by banks, specifically in the case of auction failures. Whereas specific literature on Ethiopia's Proclamation No. 1357/2024 is assumed to be emerging, this review draws on broader themes and comparative experiences.

A significant body of literature consistently links high levels of NPLs to reduced bank profitability, constrained credit growth, and systemic financial instability (e.g., Acharya et al., 2017; European Central Bank, 2017).² Studies often highlight how the accumulation of NPLs can create a drag on economic activity by tying up capital and reducing the lending capacity of financial institutions. The resolution of NPLs is thus seen as crucial for revitalizing economies and strengthening banking sectors.

The transparency and accuracy of asset valuation are critical in distressed scenarios. Research in this area explores various methodologies for valuing collateralized assets, particularly when market conditions are uncertain. To avoid uncertainty among depositors and limit depositors' incentives to run, policymakers need to deal simultaneously with all insolvent and marginally solvent institutions. Intermittent regulatory intervention increases depositors' nervousness and damages regulatory credibility, especially in cases where regulators had previously argued that the institutions were solvent.³ Challenges include information asymmetry, market imperfections, and the potential for undervaluation, which can affect both the bank's recovery rate and the fairness and transparency to the defaulting borrower. The legal mandates for valuation, including the qualifications of valuers and the standards applied, are frequently debated for their effectiveness in achieving true market price.

The public auction and legal processes of foreclosure are widely recognized tools for non-performing loan (NPL) resolution. Researches examine the efficiency of these mechanisms, noting that repeated auction failures can lead to significant delays and depreciation of asset value (e.g., IMF, 2015). Components leading to auction failures often include unrealistic reserve prices, lack of bidder interest, bureaucratic hurdles, and inefficient market information

² Acharya, V. V., Richardson, M., Van Nieuwerburgh, S., & White, L. J. (2017). *Restoring Financial Stability: How to Repair a Failed System*. John Wiley & Sons.

³ Claessens, S., Djankov, S., & Mody, A. (2001). *Resolution of Financial Crises: What Policies Help?* IMF Working Paper

distribution. The literature also investigates into the legal provisions that dictate the number of auction attempts and the subsequent steps when these fail.

While auctions fail, banks oftentimes become the acquirers of the collateralized assets. This phenomenon is examined in terms of its implications for bank balance sheets, capital requirements, and the operational challenges associated with managing non-core assets (e.g., World Bank, 2016). Legal frameworks dictating such acquisitions differ, with some jurisdictions providing clear guidelines on pricing, holding periods, and divestment strategies, while others may be more ambiguous, leading to prolonged asset holding. The literature often emphasizes the need for regulatory clarity to prevent banks from becoming "bad banks" laden with illiquid assets.

The improvement of efficient distressed asset markets, including secondary markets for non-performing loans (NPLs) and foreclosed assets, is a recurring theme in policy recommendations. Research indicates that robust secondary markets can facilitate faster NPL resolution, inject liquidity, and attract specialized investors (e.g., Financial Stability Board, 2019). Legal and regulatory frameworks play a critical role in fostering such markets by ensuring transparent transaction processes, clear title transfers, and predictable enforcement of contracts. The absence of such frameworks can impede market development, leading to protracted NPL issues.

In the Ethiopian context, with the enactment of Proclamation No. 1357/2024, particularly Article 11, the existing literature provides a crucial comparative backdrop. This research will specifically contribute by doctrinally analyzing how these established concepts and challenges are addressed within the Ethiopian legal framework, especially concerning the valuation and acquisition of immovable assets by banks following the failure of second auctions. This will allow for an assessment of its potential to streamline NPL resolution, enhance financial stability, and contribute to the emergence of a more functional distressed asset market in Ethiopia.

Domination of the Cost Approach: Yigzaw (2016) in "Understanding the Bases and Approaches of Mortgage Valuation in Ethiopia" highlights the prevalent use of the cost approach by Ethiopian banks for mortgage valuation. This approach, based on the cost of replacing the asset, may not accurately reflect the current market value, especially in fluctuating real estate markets. The study also points to a lack of a strong regulatory valuation institution and potential

weaknesses in the professional competence and methodological discretion of valuers. Research suggests a limited application of the market comparison approach (based on recent sales of comparable properties) and the income capitalization approach (based on the potential income generated by the asset), which are considered more reflective of fair market value (Yigzaw, 2016).

Internal Guidelines and Bankers' Association Manuals specifically commercial bank of Ethiopian called “acquired asset administration procedure”⁴ banks often rely on internal guidelines or manuals developed by the Ethiopian Bankers Association for valuation purposes (Ayalew & Moges, 2018). These guidelines might prioritize expediency and cost-effectiveness over rigorous market-based valuations.

1.4 Research objective

1.4.1 General objective

To assess and analyze the existing legal and regulatory framework governing immovable asset valuation and acquisition by Ethiopian banks, specifically in situations where a second auction for distressed assets has failed, with the goal of identifying gaps, challenges, and proposing potential policy and legal reforms.

1.4.2 Specific Objectives

1. To identify the relevant laws, proclamations, directives, and guidelines that currently govern the valuation and acquisition of immovable assets by Ethiopian banks.
2. To investigate the specific legal provisions and procedures that apply to the valuation process of immovable assets when they are repossessed by banks following loan defaults, particularly after the failure of an initial auction.
3. To analyze the legal mechanisms and constraints surrounding the direct acquisition of immovable assets by Ethiopian banks when subsequent auctions have failed to attract buyers.

⁴ Acquired asset administration procedure of commercial bank of Ethiopia ,January 2023

4. To recognize legal ambiguities, inconsistencies, or gaps within the existing framework that may impede efficient asset recovery, expose banks to undue risk, or affect market stability.
5. To explore best practices from other jurisdictions regarding distressed asset valuation and acquisition by financial institutions and to propose legal and policy recommendations aimed at strengthening the framework for immovable asset valuation and facilitating their efficient acquisition by Ethiopian banks post-second auction failure, while safeguarding stakeholder interests.

1.5 Research question

1. What are the existing legal instruments governing the valuation of immovable assets by Ethiopian banks?
2. What are the particular legal provisions that indicate the methodology and standards when valuing assets for Ethiopian banks?
3. What specific legal provisions govern the consequences and procedures following the failure of a second public auction for an immovable asset held as collateral by an Ethiopian bank?
4. What are the primary legal challenges and ambiguities faced by Ethiopian banks in adhering to the current valuation and acquisition framework post-second auction failure?
5. What international best practices could recommend perception for potential reforms to Ethiopia's current system?

1.6 Methodology

This research employed doctrinal methodology to explore the legal procedures followed by Ethiopian banks determining the price of assets to be auctioned. This will involve a review of primary legal sources, including Ethiopian laws, proclamations, regulations, directives from bodies like the National Bank of Ethiopia (NBE), and relevant court decisions, beside secondary sources such as academic literature and international best practices for context. In conclusion, based on the identified gaps analysis, the research will formulate legally sound, and practically implementable recommendations for legislative reform, aiming to improve transparency, efficiency, and fairness in the process of bank acquisition of immovable assets in Ethiopia.

And also by employing a comparative analysis, this study provides analysis of Ethiopia's legal and regulatory landscape concerning bank acquisition of immovable assets following failed second auctions, and international best practices. This allows for the recognition of specific

regulatory gaps in Ethiopia, specifically relating the lack of a strong national valuation framework, inconsistencies in valuation methodologies, challenges with market data availability, and potential for delays in disposition, ultimately informing concrete recommendations for improving the legal framework, enhancing valuation standards, modernize auction procedures, and improving regulatory oversight to align with global norms and increase financial stability.

1.7 Scope of the Study

The study will examine the legal gaps faced by banks in Ethiopia when acquiring immovable assets particularly after a failed second auction. Confined to the Ethiopian context, the research will explore the legal framework governing such acquisitions, focusing on the valuation standards applied to these assets and identifying regulatory gaps within existing Ethiopian laws and directives. It will assess the procedural steps from failed auction to bank acquisition, including title transfer and asset disposal, considering the perspectives of Commercial Banks, the National Bank of Ethiopia (NBE), Debtors, and Auction Process Stakeholders. Exclusions include general real estate market dynamics, broad NPL strategies, detailed comparative legal analyses, or extensive social/economic impacts unless directly relevant to the core theme, with the ultimate aim of providing insights to improve Ethiopia's legal and regulatory landscape for these particular bank asset acquisitions.

1.8 The preferred referencing and citation style

For my doctrinal legal research, I will be adhering to the Oxford University Standard for Citation of Legal Authorities (OSCOLA). This requires using footnotes or endnotes to provide comprehensive citations, thus maintaining a smooth flow within the text. A complete bibliography, arranged alphabetically by author surname, will be included at the end of the document. This method ensures accessibility of cited materials, strengthening the research's reliability.

Chapter 2

Legal framework for bank asset valuation and auctions

2.1 Constitutional foundation of property rights

The constitutional foundation of property rights in Ethiopia is established within the Constitution of the Federal Democratic Republic of Ethiopia (FDRE), specifically under Article 40. Unlike many jurisdictions that recognize absolute private land ownership, the FDRE Constitution adopts a unique approach, asserting state and public ownership of land while granting citizens various use and improvement rights.

The Right to Private Property (Article 40(1) and 40(2)) States, "Every Ethiopian citizen has the right to the ownership of private property." This sets recognition of private ownership for individuals. Property," indicating that it includes "tangible or intangible products which have value and are produced by the labor, creativity, enterprise or capital of a person." This definition covers a wide array of assets beyond just physical objects, potentially including intellectual property and other valuable creations. It also elaborates the rights inherent in private property ownership: "Unless prescribed otherwise by law on account of public interest, this right shall include the right to acquire, to use and, in a manner compatible with the rights of other citizens, to dispose of such property by sale or inheritance or to transfer it otherwise." This establishes the core elements of private property rights: acquisition, use, and alienation (disposal through sale, bequest, or other means of transfer), all subject to legal limitations enforced by public interest and the rights of others.

Article 40(3) discloses states and public ownership of land and natural resources (Article 40(3)) this provision the most often debated provision regarding property rights in Ethiopia. Article 40(3) declares, "The right to ownership of rural and urban land, as well as of all natural resources, is exclusively vested in the State and in the peoples of Ethiopia." This means that the ultimate title to land is held collectively, not by individuals. The consequence of this collective ownership is the explicit prohibition: "Land is a common property of the Nations, Nationalities and Peoples of Ethiopia and shall not be subject to sale or to other means of exchange." This effectively prevents private ownership of the underlying land itself, establishing a system of usufructuary rights or holding rights rather than full freehold.

Article (Article 40(7)) is crucial for developing urban areas and for incentivizing improvements on land. Article 40(7) ensures that "Every Ethiopian shall have the full right to the immovable property he builds and to the permanent improvements he brings about on the land by his labor or capital." This "full right" extends to the ability to "separate, to bequeath, and, where the right of use expires, to remove his property, transfer his title, or claim compensation for it." This means that while the land itself cannot be exchanged, structures and improvements upon it can be, and compensation can be claimed for them if the land use right expires or is terminated.

In conclusion, the FDRE Constitution establishes a dual system: a general right to private property for citizens, beside a unique system of state and public ownership of land. While land itself is not subject to private sale, citizens are granted significant use rights and full ownership rights over improvements made on the land, all protected by provisions for due process and compensation in cases of expropriation for public purposes. This framework aims to balance individual economic freedom with collective ownership of a key national resource.

2.2 Types of security

There are many ways of classifying securities. The common classifications are based on the nature and types of the securities. Based on nature of the thing or object securities can be classified as corporeal and incorporeal things. Corporeal things are things that have physical existence that can be seen and touched whereas incorporeal things are things that don't have physical existence like Intellectual properties. Ethiopian legal framework has recognized the utilization of both properties as collateral.

However, in practice financial institutions in the country commonly allow loans to persons having tangible assets that can be used as collateral. Hence intellectual properties are not yet utilized as loan collateral in Ethiopia though they are legally recognized and protected asset class in the country.⁵ The reason for not using intellectual properties as loan collateral is not only because its benefits are unknown in the country, but also because there are legal uncertainties, policy gaps, institutional challenges and other practical barriers that need to be addressed.⁶

The second classification is based on physical mobility or immobility and value attached to properties. Based on this securities can be classified as movable and immovable things. Under

⁶ Ibid., P. 90

Ethiopian law both types of securities are recognized, when immovable properties are used as security the word Mortgage is used, while movable securities are used it is called as pledge. Ethiopian civil code recognizes both mortgage and pledge.⁷ The 1960 Civil Code does not provide definition of mortgage. Definition of mortgage differs based on the contextual usage of the term. When we say “Mortgage”, we may be referring to the juridical act, or the property that is furnished as a security or the right of the creditor on the security. For this paper we will use mortgage as a security right established on an immovable property (or certain special movables) or as a security furnished to guarantee the performance of an obligation. Whereas pledge is defined in the code as a security device where the debtor or a third party on behalf of the debtor transfers possession of movable collateral to the creditor to secure the performance of an obligation.⁸

Movable Property Security Right Proclamation No. 1347/2019, states that movable property security right is created through a written security agreement that must contain signatures from both the grantor (which can be either the borrower himself or other third part guarantor) and secured creditor. This agreement needs to clearly identify the obligation being secured and reasonably describe the collateral involved. For such a security right to be enforceable against third parties, one of three methods must be employed: the secured creditor can register a notice with the Collateral Registry; alternatively, the secured creditor may take physical possession of the corporeal asset that is money, negotiable instruments, negotiable documents and certified securities; or finally, the secured creditor has acquired control over payment rights for funds in a deposit account or electronic security.⁹ These three approaches provide different mechanisms to establish third-party effectiveness of the security interest in movable property.

The proclamation presents a good development as it allows secured creditors to register a valid security right over movable assets. This applies to all forms of rights related to tangible or intangible movable assets that currently exist or may arise in the future. However, it does not cover immovable property (such as land, buildings, and fixed assets), ships, aircraft, or publicly

⁷ Civil code, chapter 4 of title XVIII of book V for mortgages and Chapter 6 of title XVII of book V for pledge

⁸ Ibid. Art. 2825

⁹ Movable Property Security Right Proclamation No. 1347/2019, Art 13

traded securities, as there are existing laws that mandate their registration or special registers already in place for these assets.

Registration of immovable properties (such as land and buildings) as collateral follows specific legal procedure. The primary legal frameworks governing this process include the Civil Code of Ethiopia, various proclamations on land administration, and banking regulations. The registration process typically involves, first to have proper documentation of ownership. Since land in Ethiopia is owned by the state and the people, what is typically pledged as collateral is the "use right" or "leasehold right" to the land and any buildings or improvements on it.

Banks and financial institutions require a formal written mortgage contract that clearly identifies the property, the loan amount, repayment terms, and consequences of default. This agreement must be signed by all relevant parties. The mortgage must be registered with the appropriate land administration office in the jurisdiction where the property is located. Different regions may have slightly different administrative procedures, but registration generally involves: verification of ownership documents, property valuation, and payment of registration fees and issuance of a mortgage certificate. Once registered, up to 10 years,¹⁰ the mortgage creates a legal encumbrance on the property that prevents the owner from selling or transferring it without the lender's consent until the loan is fully repaid.

2.3 Mortgage creation requirement and Mortgage valuation (Art.3041-3049)

In Ethiopia, the creation and valuation of mortgages are primarily governed by the Civil Code, particularly Articles 3041-3049, beside specific legislation like the Business Mortgage Proclamation No. 98/1998 and Proclamation No. 97/1998 (and its amendment Proclamation No. 193/2000) concerning property mortgaged or pledged with banks. For a mortgage to be legal it must be in written form, stating the secured amount in Ethiopian currency, and it must be registered by a registrar and in the relevant municipality. Registration of immovable properties (such as land and buildings) as collateral follows specific legal procedure. The primary legal frameworks governing this process include the Civil Code of Ethiopia, various proclamations on

¹⁰ Article 3038 of the civil code states that the registration of a mortgage shall be effective for ten years from the day when the entry was made. Therefore, after this period, the creditor needs to renew the registration to maintain their preferential claim right.

land administration, and banking regulations. The registration process typically involves, first to have proper documentation of ownership. Since land in Ethiopia is owned by the state and the people, what is typically pledged as collateral is the "use right" or "leasehold right" to the land and any buildings or improvements on it. This registration is effective for ten years and requires the mortgagor to have the right to dispose of the property. Consent, legal capacity of the parties, and clear identification of the creditor, borrower, and the specific property are also necessary.

Additionally, for business mortgages, the entity must be registered and licensed. Although the Civil Code traces these creation requirements, the practical aspect of mortgage valuation in Ethiopia faces significant struggles. The struggles in mortgage valuation in Ethiopia, as highlighted by various studies, are many-sided. These include: the basic issue is the lack of a specific mortgage valuation framework or a dedicated regulatory institution, Banks predominantly use the cost approach, even when market or income approaches might be more appropriate, Valuers often lack the professional competence and discretion required to choose and apply appropriate valuation methodologies and The absence of reliable market data and imperfections in the property market severely hinder accurate valuations. Both undervaluation (impacting borrower investment potential) and overvaluation (posing risks to banks) are prevalent.

A new legal instrument like Proclamation 1357/2024 is an important step towards modernizing and regulating the mortgage valuation landscape in Ethiopia. There's a challenge in Ethiopian law regarding the specialized valuation methods for immovable assets that banks acquire after auction failures. Whilst Real Estate Proclamation No. 1357/2014, Article 11(1)(c), generally covers property valuation for "bank loan collateral," it doesn't address the valuation complexities that drive when properties remain unsold after two public auctions and banks thereafter acquire them at the initial floor price.

2.4 National Bank of Ethiopia (NBE) regulatory frame work

The legal foundation for banks to acquire immovable assets in Ethiopia stems from Proclamation No. 97/1998 (as amended by Proclamation No. 216/2000). This legislation, "A Proclamation to Provide for Property Mortgaged or Pledged with Banks,"¹¹ grants creditor banks the power to sell mortgaged or pledged property by auction upon default, without needing a court order for

¹¹ Property mortgaged or pledged with banks proclamation number 97/1998 and proclamation number 216/2000

execution. This was a significant withdrawal from the judicial foreclosure¹² process under the Civil Code (Article 2851 and 3060).

Proclamation No. 216/2000 amended of the 97/1998 proclamation stipulates that if no interested buyer appears at the second auction, the bank has the right to acquire the property at the floor price set for the first auction and have the ownership transferred to it.¹³ This provides a direct way for banks to take ownership of collateral at the time that market sales fail.

Asset classification and provisioning directives (e.g., SBB/90/2024, superseding SBB-69-2018) define how banks should classify their assets and how provisions for non-performing loans (NPLs) should be made. These directives particularly address the valuation of acquired properties for the purpose of calculating "average recovery rate" and "total net market value of acquired properties." "Total Net Market Value of Acquired Properties" is defined as the average of the ask/reserve price of acquired properties and the highest offer bid amount registered at the last auction. If there's no bidder at the last auction, the highest offer bid amount is regarded zero.¹⁴ This directly impacts the bank's estimated recovery and, consequently, its provisioning requirements. As the directives provide valuation methodologies for provisioning, specific explicit NBE directives detailing permissible holding periods for acquired immovable assets (Real Estate Owned - REO) and mandatory disposal mechanisms/timelines are less prominent in the publicly available summaries, which could be a potential challenge (gap).

Valuation Standards for Acquired Immovable Assets is important for banks acquiring immovable assets, influencing provisioning, capital adequacy, and eventual disposal. As noted, the NBE directives set a standard for valuation of acquired properties for provisioning purposes by defining "Total Net Market Value of Acquired Properties" based on auction prices and reserve prices. This suggests a market-based approach where possible. As NBE directives outline how acquired assets factor into provisioning calculations, the actual initial valuation of collateral (both before and after acquisition) typically relies on professional valuers. However Research indicates that valuation practices in Ethiopia for collateral purposes often face challenges. Some studies¹⁵ suggest that banks predominantly use the cost replacement method due to a lack of

¹² Civil code of the empire of Ethiopia proclamation number 165 of 1960 article 2851 and 3060.

¹³ Property mortgaged or pledged with banks proclamation number 216/2000 amended article 4 of the 97/1998

¹⁴ Asset classification and provisioning directives SBB/90/2024, article 2.25.3

¹⁵ Arses, H.B., Lind, H. & Alemu, B.Y. (2020) Understanding the Bases and Approaches of Mortgage Valuation in Ethiopia. Journal of African Real Estate Research, page number 56

reliable market data, even though other methods like the income capitalization method might be more appropriate for certain property types. There are concerns about inconsistencies and perceived undervaluation by banks compared to market values or construction costs.

The Accounting and Audit Board of Ethiopia (AABE) has guidelines to assist valuers apply international standards (e.g., IFRS) for financial reporting purposes, which provides approaches like the Sales Comparison Approach and Income Approach. While not NBE directives, these provide a framework for professional valuation that banks would likely bind to for internal purposes and financial reporting. Despite the existing legal and regulatory framework, several potential challenges can be identified. While Proclamation No. 216/2000 enables banks to acquire property after a failed second auction at the first auction's floor price, detailed procedural guidelines from NBE on the handling of these acquired assets are less explicit.

As provisioning directives provide a formula for "recovery value," a comprehensive NBE directive particularly detailing the standards for independent professional valuation of acquired immovable assets post-foreclosure could be important. This would make sure consistency, and mitigate risks of mispricing. There should clearer direction on how to reconcile the book value of the acquired asset (based on the first auction's floor price) with its fair market value, especially if market conditions change substantially.

Ethiopia has established a legal framework, notably Proclamation No. 97/1998 (as amended proclamation 216/2000), which empowers banks to acquire immovable assets when foreclosure auctions fail. The National Bank of Ethiopia's (NBEs) directives, particularly those on asset classification and provisioning, incorporate the valuation of these acquired properties for regulatory purposes. However, there are regulatory challenges, specifically concerning explicit mandates for the holding period, detailed disposal mechanisms, and standards for the independent valuation of acquired assets. Addressing these challenges encourage a more efficient real estate market in Ethiopia.

2.5 Valuation approaches

In the case of auctions, the primary goal of asset valuation by Ethiopian banks is to determine the Net Recoverable Value (NRV). This is defined by the National Bank of Ethiopia (NBE) Directive SBB-90-2024 as "the most probable value realizable from the sale of collateral in a

competitive and open market.¹⁶ The valuation targets to estimate the price the asset is likely to bring at auction, considering market conditions and the specifics of the property.

2.5.1 Market Value Assessment

In Ethiopian banks valuing assets for auctions, market value assessment is an important aspect, although its direct and consistent application can be challenging due to the specific nature of the Ethiopian property market. The National Bank of Ethiopia's (NBE) Directive SBB-90-2024 defines "Net Recoverable Value (NRV)" as the "most probable value realizable from the sale of collateral in a competitive and open market." This definition corresponds with the concept of market value, which is the estimated price at which an asset would exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably and without compulsion. Ethiopian banks would rely on the Market Approach (Sales Comparison Approach) to estimate market value for auction purposes. This involves examining recent sales of comparable properties in the same or similar locations to the asset being valued.

When we look on the data that banks depend on their own historical data of past auction sales, information from real estate agents, unreliable evidence of property prices in the area. Even when using the cost approach as the primary method, banks might make adjustments based on the perceived market conditions and location of the property. Such as, a location in a high-demand area might warrant an upward adjustment. In situations where a more rigorous assessment is needed, banks might engage separate valuers who may have better resources and expertise to analyze the limited market data available and provide a market-based estimate. According to the new licensing and supervision of banking business asset classification and provisioning directive when banks use external valuers, they shall establish a list of accepted external valuers from the competent authority, ensuring that valuers have relevant expertise in areas of the property sector.¹⁷ The outcomes of earlier auctions of similar properties can serve as an indicator of market value, impacting the valuation of subsequent properties.

¹⁶ Asset classification and provisioning directives SBB/90/2024, article 2.25

¹⁷ licensing and supervision of banking business asset classification and provisioning directive number SBB-90-2024 article 10.1.

2.5.2 Cost Approach

In Ethiopia Modern banking started in the beginning of the 20th century following formation of the bank of Abyssinia in 1906 (Seyoum & Bessie, 2018). Mortgage loans have been one of the main functions of commercial banks in Ethiopia. But there is no well-known empirical study on how mortgage valuation in Ethiopia is practiced.¹⁸ The above cost Approach (Depreciated Replacement Cost) is reportedly the most prevalent method which estimates the current cost of constructing a similar new property and then deducts depreciation for physical deterioration, functional obsolescence, and economic obsolescence. This approach is based on the principle of substitution, which states that a buyer will not pay more for an asset than the cost of obtaining a substitute asset with comparable utility.

When we look how this approach works is by determining the current cost of constructing a new asset that is comparable to the one being valued. This encompasses the cost of materials, labour, and other construction or acquisition expenses at current prices. It is calculated as the estimated replacement cost is then diminished by an amount that accounts for the asset's loss in value. In the situations of real estate, the value of the land on which the property is situated is added to the depreciated replacement cost of the buildings. The land is valued employing the market comparison approach (assessing sales of comparable land).

When we look when cost approach reliable depreciation is less important and easier to estimate, Special-purpose properties, where there are few comparable sales or no income stream to analyse (e.g., churches, schools) and Assets where market data is scarce. The cost approach is limited when estimating depreciation, especially functional and economic obsolescence, can be subjective and may not always reflect the actual market value. In inclusion it fails to consider income-generating Potential. For income-producing assets, the cost approach does not directly consider their earning capacity, which is a basic factor for investors. And also the cost approach may not reflect current market supply and demand market condition. In a rapidly changing market, the market value could be higher than the cost-based value, and in reverse is true. In the case of auctions, the cost approach might be used by banks to establish a baseline for the asset.

¹⁸ Asres, H.B., Lind, H. & Alemu, B.Y. (2020). Understanding the Bases and Approaches of Mortgage Valuation in Ethiopia. *Journal of African Real Estate Research*, 5(1), pp.55-76. DOI: 10.15641/jarer.v5i1.856.

Yet, the final selling price in an auction is determined by the bidders and reflects the prevailing market insist at that time.

2.5.3 Income Approach

The income approach conducts valuation of an asset based on the current value of its expected future income. Its principle is that the worth of an asset is related to its capacity to generate income. This approach is most advisable for income-producing properties. There are two ways within the income approach. The first one is estimates the value of an asset by capitalizing a single year's expected net operating income using a capitalization rate. This Net Operating Income (NOI) is the property's income after deducting operating expenses but before deducting debt service (mortgage payments) and income taxes. The Capitalization Rate represents the rate of return an investor would expect to receive on their investment in a similar property in the same market. It is derived from the sales prices of comparable properties that have newly (recently) sold.

The second method values an asset by projecting all its expected future cash flows over a particular holding period and then discounting those cash flows back to their recent value using a discount rate. The discount rate shows the time value of money and the risk related with the projected cash flows. The present values of all future cash flows are added to appear at the asset's total value. Although the income approach is a standard valuation methodology for income-generating assets universally, its use by Ethiopian banks for auctions appears to be limited due to the particular challenges and market conditions.

Independent Valuation of Assets vs. Bank Internal Valuation of Assets

Feature	Bank Internal Valuation	Independent Valuation
Conducted by	Employees or departments within the bank.	External, qualified, and unbiased professional valuers or firms.
Purpose for Auctions	Initial assessment, setting internal reserve price, estimating potential recovery.	Providing an objective and credible Valuation for regulatory compliance, transparency to potential buyers, and potentially for setting the final reserve price.
Advantages	Cost-effective, faster turnaround, familiarity with loan details	Objectivity and independence, specialized expertise, potentially greater market credibility and regulatory acceptance.
Disadvantages	Potential for bias towards the bank's interests, perceived lack of objectivity, may lack specialized expertise, might not always meet external scrutiny.	Higher cost, longer turnaround time, potential lack of deep familiarity with the bank's specific context.
Prevalence in Eth	Reportedly common for initial assessments due to cost and speed	Likely less consistently applied for all auctions but may be used for higher-value assets or when required by regulation or internal policy.
Regulatory Influence	NBE directives on NRV and average recovery rates guide internal assessments.	Independent valuations may be preferred or mandated by regulations for certain situations to ensure fairness and accuracy.

Ethiopia has historically faced gaps in establishing standardized property valuation framework. There is no legal framework or dedicated regulatory institution specifically for property

valuation in Ethiopia. This leads to discrepancies in valuation practices across different institutions. The national bank of Ethiopia has been making impacts to strengthen the regulatory framework, including issuing directives that emphasize the need for consistent collateral valuations and aligning with International Financial Reporting Standards (IFRS) for asset classification and provisioning.

2.6 Asset Classification Directives for Bank-Acquired Immovable Assets:

Although the detailed directives for the specific classification of immovable assets acquired by banks after a failed auction might not be explicitly broken down into categories for "acquired property" in all national bank directives, they fall under the broader asset classification and provisioning framework. The recent national bank directives¹⁹, specifically, bring the principles for how banks must classify their assets, including those acquired through foreclosure. In Ethiopia banks are required to classify their assets, which would encompass immovable assets acquired post-auction, according to NBE directives and international accounting standards:

Pre-Acquisition

This is the initial phase where a borrower applies for a loan, and the bank assesses the creditworthiness and risks included before approving the loan. The borrower submits a loan application, particularly the purpose of the loan, the amount requested, and relevant personal or business information. Collateral Documentation For secured loans (like those backed by immovable property), this is significant. It includes title deeds, property ownership certificates; lease contract, recent land/property tax receipts, and approved construction plans/blueprints. Collateral Valuation for loans secured by immovable property, a valuation is critical at this stage. The bank examines the current market value of the property to determine its adequacy as security.

Additionally detailed analysis of all identified risks (credit risk, market risk, operational risk, etc.) related with the loan. This consists of stress testing the borrower's financial capacity under adverse cases. For business or property development loans, banks often conduct site visits to

¹⁹ Licensing and Supervision of Banking Business Asset Classification and Provisioning Directive No. SBB/90/2024

verify information, examine operational viability, and inspect the collateral. The loan application and all assessment reports are presented to a loan committee or authorized approval authority within the bank. They review the package and make a final decision. Based on the committee's evaluation, the loan is either approved or denied. If approved, detailed loan terms are negotiated and formalized in a legally binding loan agreement.

When we consider the case of immovable property, the mortgage the property must be legally registering it with the relevant land administration or cadastral authorities. This assures the bank's legal right to the collateral in case of default. Once the contract is signed and all conditions precedent is met, funds are disbursed. If a loan shows distress, banks may attempt to restructure it to improve the borrower's ability to repay and avoid default. NBE Directive SBB/90/2024 now limits the number of restructuring iterations (e.g., three for short/medium-term, four for long-term loans) to prevent "ever greening" and force banks to recognize NPLs more rapidly.

All "pre-acquisition" phase, therefore, is a continuous process of risk assessment, due diligence, and proactive monitoring, made to minimize the likelihood of a loan defaulting and the bank being forced to acquire collateral through a failed auction. Strong practices in these stages are fundamental to a bank's asset quality and overall financial health.

Acquired Assets (Post-Auction/Foreclosure)

Once a bank acquires an immovable asset through foreclosure when after a failed second auction or other means, it stops to be a "loan" and becomes a "foreclosed asset" or "other real estate owned (OREO)." While not usually a separate, distinct "asset classification" category in the similar way as loans, these assets are subject to accounting and regulatory treatment.

If the bank wants to sell the acquired immovable asset within a short period r) and is actively marketing it, it would be classified as "assets held for sale" on the balance sheet. These assets are always carried at the lower of their carrying amount or fair value less costs to sell.

The national bank of Ethiopia directives analyzes the need for collateral valuations. When a bank acquires an asset, its value would be determined for accounting purposes. This often involves

obtaining new valuations, especially if the asset was acquired after multiple failed auctions, to reflect its fair market value.

Generally, while the National Bank of Ethiopia has provide directives for asset classification and provisioning, especially with the recent SBB/90/2024, the nuances of valuing and classifying immovable assets acquired following failed auctions still highlight cases where more specific guidelines and a stronger national valuation framework could enhance regulatory and financial stability in Ethiopia

Chapter 3

Current Legal Framework Governing Bank Acquisition of Immovable Assets

3.1 The Legal Gap in Post-Auction Bank Acquisition Rights

The Ethiopian legal framework governing bank acquisition of immovable assets contains a gap that undermines debtor protection and market fairness. When second auctions fail to attract adequate bids, the law grants banks unilateral rights to acquire collateralized property without mandating any protective processes for debtors. This legal vacuum prohibits the competitive market mechanisms that typically helps fair pricing in property transactions and creates opportunities for banks to acquire valuable assets at below-market prices without independent oversight or verification.

Article 2(2)²⁰ of the legislation exemplifies this problem by establishing banks' acquisition rights without corresponding obligations to protect debtor interests. The provision enables a transition from a competitive auction environment to a monopolistic acquisition scenario where banks face no external pressure to offer fair prices or submit to independent valuation processes.

3.2 Statutory Frameworks Enabling Unregulated Bank Acquisition

3.2.1 Analysis of Article 2(2): Legal Basis for Bank Acquisition Following Failed Second Auctions

As discussed above article 2(2) establishes the legal base for bank acquisition rights but it fails to establish corresponding protective obligations. The provision states that banks may acquire collateralized property following failed second auctions, but it provides no guidance on pricing methodology, valuation standards, or procedural safeguards that would protect debtor interests. This creates a statutory framework where banks enjoy broad acquisition powers without corresponding responsibilities to ensure fair treatment of property owners.

²⁰ Property Mortgaged or Pledged with Banks! (Amendment) Proclamation No. 193/2000 under Article (2) (2) states that “The correction made to Article 4 of the Proclamation under paragraph (2) of Corrigendum No. 1/1998 is hereby deleted and the phrase 'or if no buyer appears at the second auction, it may acquire the property at the floor price set for the first auction and have the ownership of the property transferred to it' is added after the word.. "buyer" at the end of the Article”

The article's drafting reflects a legislative approach that more protects banking sector interests in debt recovery over balanced protection of property rights. By enabling acquisition without mandating protective processes, the law essentially grants banks monopolistic pricing power in post-auction scenarios. This represents a significant departure from market-based pricing mechanisms and creates legal conditions where fair market value may be systematically ignored in favor of bank recovery objectives.

The provision's failure to require independent valuation or minimum price standards creates opportunities for abuse that other legal systems typically prevent through mandatory protective procedures. This statutory gap undermines both the effectiveness of the auction system and the constitutional property rights protections that should govern all involuntary property transfers.

3.2.2 Real Estate Development and Real Property Marketing and Valuation Proclamation No. 1357/2024

Article 11(1) of the proclamation establishes a comprehensive framework identifying nine distinct purposes for real property valuation, creating what appears to be an all-encompassing system for property value determination. The article specifies that real property shall be valued for property tax assessment, sale and purchase transactions, bank loan collateral, court disputes, inheritance or property distribution, compensation claims, insurance purposes, rental services, and other related issues.

The provision's reference to "other related issues" provides theoretical flexibility but lacks the specificity needed to address exceptional circumstances like failed auctions. This could encompass sales and monopolistic acquisition scenarios, but the absence of explicit guidance leaves such situations vulnerable to inconsistent treatment and potential abuse.

Article 11(2) establishes that valuations for "sale and purchase transactions" under paragraph (b) "shall be enforced upon the request of the property owner." This provision appears to give property owners significant control over the valuation process in normal market transactions, suggesting a legislative intent to protect owner interests and ensure fair market treatment. However, this protection mechanism becomes meaningless in foreclosure contexts where property owners have lost control over the disposition process and cannot effectively request or

enforce proper valuation procedures. The requirement for property owner initiation creates a fundamental procedural gap in sale situations. When properties proceed to foreclosure auction, the owner typically lacks both the financial resources and legal standing to request comprehensive valuations that might protect their interests. Furthermore, the provision fails to address situations where property owners may be absent, incapacitated, or otherwise unable to request valuations.

Article 11(3) of the proclamation establishes eight specific requirements for property valuation systems, for ensuring accurate and consistent property value determination. The requirement that valuations "should be clear and based on current local market information to ensure a stable market" establishes market-based valuation as the fundamental principle, while the mandate for certified valuers from appropriate bodies suggests professional standards and accountability. The provision for regular government institutional valuations every five years, with annual updates based on property owner evidence, creates a systematic approach to maintaining current valuation information.

However, the article's emphasis on "current local market information" becomes problematic when the local market itself has been distorted by previous monopolistic acquisitions. The circular problem emerges clearly here: if banks have systematically acquired properties below market value through failed auctions, these below-market transactions become part of the "current local market information" that future valuations must consider. The article provides no mechanism for distinguishing between genuine market transactions and distressed sales, effectively allowing monopolistic acquisition patterns to corrupt the entire valuation database.

The provision requiring certified valuers represents a positive step toward professional standards, but fails to address the fundamental conflict of interest when banks commission valuations for properties they intend to acquire through failed auctions. The article provides no independence requirements or conflict of interest restrictions that would prevent banks from selecting valuers who consistently provide favorable assessments. This oversight allows financial institutions to manipulate the valuation process through careful selection of compliant professionals.

Article 11(3) (g) states that "when there is a discrepancy between the registered real property value and the actual value due to various reasons, the relevant body will verify the value and make the necessary corrections." This provision appears to provide a safety valve for addressing valuation errors and market distortions, suggesting that regulatory bodies have both the authority and responsibility to intervene when property values appear incorrect. However, the provision's effectiveness depends entirely on the regulatory body's ability to detect discrepancies and willingness to intervene in market transactions. The provision fails to address the fundamental question of what constitutes "actual value" when market transactions have been systematically distorted by monopolistic acquisitions.

3.2.3 Absence of Mandatory Protective Processes in Current Legal Framework

The current legal framework contains no mandatory protective processes that would safeguard debtor interests when banks exercise acquisition rights following failed auctions. Unlike voluntary property sales, which involve negotiation between parties with relatively equal bargaining power, post-auction bank acquisitions involve involuntary transfers where debtors have already lost control over the disposition process. This power imbalance requires enhanced legal protections to prevent abuse, but current law provides no such safeguards.

Essential protective processes missing from the current framework include mandatory independent valuation, requirements for banks to demonstrate that acquisition prices reflect fair market value, and mechanisms for debtors to challenge acquisition decisions. The absence of these protections creates legal conditions where banks can effectively determine their own acquisition prices without external oversight or verification.

3.2.4 Constitutional and Legislative Foundation for Bank Acquisition Rights

While the Ethiopian Constitution Article 40(1) provides the general foundation for property acquisition rights, it also establishes limitations that current banking law fails to implement adequately. The constitutional requirement that property rights be exercised "in a manner compatible with the rights of other citizens" should constrain how banks exercise acquisition rights, but implementing legislation provides insufficient guidance on what constitutes compatible exercise of these rights.

3.3 The Elimination of Competition: Legal Consequences of Failed Second Auctions

3.3.1 Transition from Competitive Auction Environment to Monopolistic Bank Acquisition

The transition from competitive auction environments to monopolistic bank acquisitions represents one of the most significant breakdowns in the property disposition system. In foreclosure proceedings, the auction mechanism is specifically designed to maximize recovery through competitive bidding, ensuring that properties are sold at fair market value while protecting both creditor and debtor interests. However, when second auctions fail due to no bidder participation, the legal framework defaults to allowing creditor banks to acquire properties directly, fundamentally altering the nature of the transaction from a competitive market-based sale to a monopolistic acquisition.

Ethiopian Proclamation No. 1357/2024 establishes that property transactions should "be governed by law, contribute to the development of the public and a sustainable national economy and enhance the competitiveness of cities."²¹ The proclamation emphasizes competitiveness as a core principle of property markets, yet failed auction procedures systematically eliminate this very competition that the law seeks to protect and promote. The mechanisms of monopolistic transition can result in elimination of market forces when the auction system fails to attract competitive bidders, leaving the creditor bank as the sole interested party. This situation creates price discovery failure, where the market's natural ability to determine fair value through competitive bidding is completely eliminated.

3.3.2 Legal Vacuum: Absence of Alternative Bidding or Market Mechanisms

The other critical problem is the existence of a legal vacuum regarding alternative bidding or market mechanisms. This vacuum represents a fundamental flaw in the legal framework, where competitive market principles simply cease to operate without any legally mandated alternatives to restore market function. The absence of such mechanisms guarantees monopolistic outcomes while providing legal cover for what amounts to anti-competitive behavior.

²¹ Real Estate Development and Real Property Marketing and Valuation Proclamation No. 1357/2024, Article 4(3)

Current legal frameworks typically lack provisions requiring automatic re-listing at reduced reserve prices, extended marketing periods to attract broader participation, or alternative advertising methods designed to reach potential buyers who may not have been aware of initial auction proceedings. This absence of procedural requirements essentially guarantees that failed auctions will result in monopolistic acquisition rather than renewed competitive bidding.

3.3.3 Impact on Property Valuation in Non-Competitive Acquisition Scenarios

Proclamation No. 1357/2024 establishes comprehensive valuation standards, requiring that "the valuation of real property should be based on the market price comparison of the property." However, monopolistic acquisitions fundamentally undermine market-based valuation methodologies by eliminating the competitive market.

The systematic valuation distortions created by non-competitive acquisitions operate through a circular mechanism that becomes self-reinforcing over time. When banks acquire properties below market value through failed auctions, these transactions are often recorded as legitimate "market transactions" in official records and databases. These below-market sales then become part of the comparable sales data used for future property valuations, systematically depressing overall market values in affected areas. This depression of market values facilitates additional below-market acquisitions in subsequent foreclosure proceedings, creating a downward spiral that benefits financial institutions at the expense of property owners and communities.

The corruption of market data presents particular challenges given the proclamation's requirement that "complete information should be provided upon request by the appropriate authority."²² When monopolistic acquisitions become integrated into official market data, they corrupt the entire valuation system, making it difficult for appraisers, lenders, and other market participants to distinguish between genuine market transactions and distressed sales that do not reflect true market value. This data corruption affects not only immediate valuation decisions but also long-term market analysis and policy development based on supposedly objective market information. Property owners face severe legal and economic consequences from this systematic undervaluation. In foreclosure proceedings, owners experience reduced recovery due to below-

²² Real Estate Development and Real Property Marketing and Valuation Proclamation No. 1357/2024, Article 12(4)

market sale prices, while neighboring property owners suffer from value depression caused by unfair sales/acquisition in their area.

3.4 Case analysis

1. Afrotsion construction PLC and Esayas desta Vs. Commercial Bank of Ethiopia and Commercial Nominees PLC. File Number 289203, Federal High court

Afrotsion Construction PLC and Esayas Desta challenged the foreclosure auction of their property by Commercial Bank of Ethiopia. Commercial Nominees PLC, won the auction at ETB 140,000,000, nearly triple the initial valuation of ETB 52,887,889.06. Despite this price increase, the borrowers contested the sale on multiple grounds.

The plaintiffs challenged the procedural integrity of the auction process, alleging that the bank failed to advertise the sale through appropriate social media channels and provided incorrect specifications for the building in the published notices. Specifically, they claimed the property was incorrectly described as "G+6" in newspaper advertisements when the actual specification was "2B+G+M+5", potentially deterring qualified bidders who might have offered superior prices. This allegation underscores the critical importance of accurate property descriptions in auction advertisements, as even technical specification errors can significantly impact bidder participation and ultimate sale prices.

Additionally, they challenged the procedural compliance of the winning bidder, Commercial Nominees PLC, alleging that the company failed to provide required documentation, did not present a Certificate of Performance Outline (CPO), and participated in the auction alone, thereby acquiring ownership rights through procedurally defective means.

The bank argued that under Proclamations No. 97/1990 and 1147/2011, along with the bank's internal procedures, the minimum requirement for a valid auction is two bidders, and their auction exceeded this threshold with four participating bidders, as documented in the auction minutes. The bank emphasized the substantial price appreciation achieved through the auction process, noting that the final sale price of ETB 140,000,000 represented nearly triple the initial valuation, demonstrating that the competitive bidding process had functioned effectively to

maximize recovery value. They highlighted the presence of third-party observers during the auction, lending additional credibility to the process, and confirmed that the winning bidder had provided the required Certificate of Performance Outline along with a deposit equivalent to 1/4th of the initial property valuation, satisfying all procedural requirements. The bank's position argued that the auction process had not only met all legal requirements but had achieved a result favorable to the debtor through competitive bidding that substantially exceeded the initial valuation.

The court rejected the plaintiffs' undervaluation claims by establishing that if borrowers believed their property could command higher prices, their remedy was to encourage additional qualified bidders to participate in the auction rather than challenging the results post-sale. This reasoning was reinforced by reference to a Cassation Court decision (Volume 14, File Number 84353) establishing that accusations of undervaluation based solely on speculative claims that property would sell for higher prices if marketed by the debtor are legally unacceptable. The court declared that "the market price of a property is the price achieved in auction" (ለጨረታ ሽያጭ ቀርቦ የሚያወጣው ዋጋ) by referring to Cassation Court decision Volume 8, File Number 37503.

The court concluded that since no procedural violations occurred during the auction process and the sale price substantially exceeded the initial valuation, no damages had been incurred by the debtor.

Comment on the case

The court's decision creates a fundamental contradiction in Ethiopia's foreclosure framework. While the court established that bidders determine property prices (referencing Cassation decision Volume 8, File Number 37503), the legal system provides no solution when no bidders appear in subsequent auctions. Under (proclamation 97/98 and 216/2000), banks can acquire properties at the initial valuation after failed second auctions, effectively allowing them to set their own purchase prices without market validation. This undermines the court's reasoning that auction prices represent true market value, as banks can benefit from failed auctions by acquiring properties at predetermined administrative prices rather than market-tested valuations.

The framework lacks mechanisms for mandatory revaluation when auctions fail, independent oversight of bank acquisition prices, or alternative dispute resolution for valuation disputes when market mechanisms fail. This creates systemic bias favoring banks and highlights the urgent need for legal reforms addressing post-auction bank acquisition procedures to ensure consistent application of market-based pricing principles regardless of bidder participation levels.

2. Tekalign Chala Gebisa vs. Oromia International Bank S.C. Volume File No. 208270 (decided on Tikimt 26, 2014 E.C.)

The case involved Tekalign Chala Gebisa, who contested the foreclosure auction of his house that served as collateral for a loan from Oromia International Bank S.C., after the property was sold to Tolina Yadesa Rqitu following his loan default.

Tekalign Chala Gebisa mounted a challenge to the auction process, alleging multiple procedural irregularities including improper conduct during the auction proceedings, collusion between the bank and the purchaser, and most significantly, that the sale price was substantially below the property's fair market value. His central argument focused on the bank's failure to properly advertise the first and second rounds of the auction, suggesting that inadequate marketing had artificially suppressed bidder participation and resulted in an unfairly low sale price.

The Cassation Division decisively rejected all of the appellant's arguments. The court explicitly reaffirmed its previous decisions in Cases No. 84353 and 38708, declaring that mere allegations of below-market sale prices or claims that properties could have achieved higher values through private sales are legally insufficient to invalidate foreclosure sales conducted under Proclamations 97/90 and 216/92. The court acknowledged that the bank had indeed failed to properly advertise the first and second auction rounds before proceeding to a third advertisement, representing a clear procedural violation. The Cassation decision raised different points. First, the court established that low sale prices alone cannot serve as grounds for invalidating bank-conducted foreclosure sales. Second, the decision requires borrowers to demonstrate both procedural irregularities and actual demonstrable harm resulting from those irregularities, creating a demanding two-pronged test that few challenges are likely to satisfy. Third, challenges must focus on illegal actions by banks that compromise the legality of the sale itself. Finally, the

ruling establishes that minor procedural errors that are corrected and cause no demonstrable harm will not invalidate foreclosure sales, providing banks with substantial protection against technical compliance challenges.

Comment on this case

While the Cassation Division's emphasis on procedural compliance and finality in foreclosure sales serves important goals of legal certainty and efficient debt recovery, the decision reveals fundamental structural biases in Ethiopia's foreclosure framework that disproportionately favor banking institutions over borrower protection. The decision's dismissal of market value as legally irrelevant ignores the reality that foreclosure auctions often occur under distressed circumstances that may not reflect true market conditions, potentially allowing banks to acquire properties at substantially below-market prices through technically legal but substantively unfair processes. The ruling increases the legal framework gap identified in post-auction bank acquisitions by making it impossible for borrowers to challenge price of sale of collateralized property. The precedent permits banks to conduct minimal auction efforts, secure in the knowledge that absent clear procedural violations causing demonstrable harm, their acquisition of borrower properties will be legally inviolable regardless of whether the process truly reflected market value or competitive bidding.

3. Bahir Dar Special Zone Finance Department v. Construction and Business Bank & Muktar Mohammed File Number 26553, Federal Supreme Court Cassation Decision

While the case doesn't directly address bank acquisition after a second failed auction or the nuances of valuation standards in distressed scenarios, it illuminates foundational principles that are highly relevant to your research. Although the case didn't directly examine the valuation methodology, it implicitly highlights issues relevant to your research's focus on valuation. The fact that the Municipality "appraised the property" without further detail on the standards or methods used, and the court then based its proceedings on this appraisal, suggests a pre-existing environment where valuation standards might not have been clearly defined or consistently applied. The court justification for omitting the mortgage amount was rejected by the Cassation Division, which stated the court should have proactively sought the information.

The “absence of statutory valuation methodology” and “transparency and disclosure deficiencies.” It shows that even in 2007, there was an implicit assumption of appraisal validity, but also a procedural failing in ensuring all relevant financial encumbrances (the mortgage amount) were fully disclosed and proactively sought by the court. This gap in complete information at the auction stage directly affects potential bidders' willingness to participate and the transparency of the process, contributing to failed auctions. The decision to annul the auction and order a re-auction (rather than simply validating the first sale despite flaws) directly contributes to the “protracted recovery periods” and “increased operational burdens on banks” that your research seeks to address.

This case illustrates the practical implications of procedural gaps and informational deficiencies in property execution sales, which can directly contribute to the very scenarios of repeated auction failures and the eventual need for bank acquisition. It implicitly supports the arguments for stronger valuation standards, greater transparency in auction notices, and more efficient, legally sound foreclosure processes to improve NPL resolution in Ethiopia.

4. Black Abay Construction S.C. Vs Wegagen Bank S.C., files number 84353, Federal Supreme Court of Ethiopia, Cassation Division

This case centered on whether an Ethiopian court could halt an auction initiated by Wegagen Bank, under Proclamation No. 97/90, to recover a mortgage loan from Black Abay Construction S.C., which was undergoing liquidation. The liquidators argued the auction challenged their asset audit, while Wegagen Bank asserted its statutory right to foreclose without judicial interference, citing the Debtor's default and a prior Cassation Division ruling (Case No. 70824). The Federal First Instance Court, aligning with Proclamations No. 97/90 and 216/92, and the precedent set by Cassation Case No. 70824, ruled that it lacked jurisdiction to stop a bank's statutory auction, only retaining power over claims for damages due to procedural non-compliance. Consequently, the court rejected the liquidators' claim, affirming the bank's independent foreclosure authority.

Comment on the case

This case reinforces the principle of banks' independent foreclosure authority in Ethiopia, particularly under Proclamations No. 97/1998 (often cited as 97/90 due to the Ethiopian calendar

conversion year) and its amendment, 216/2000 (often cited as 216/92). The Federal First Instance Court's decision, upheld by the Cassation Division precedent in Case No. 70824, unequivocally limits judicial interference in a bank's statutory right to auction mortgaged property upon debtor default. This highlights the Ethiopian legal system's commitment to expediting debt recovery for financial institutions, even when a debtor is undergoing liquidation. While it underscores the bank's power, it also subtly points to a potential vulnerability for other stakeholders, such as liquidators, who are constrained to seek remedies only for procedural non-compliance rather than to halt the auction itself, emphasizing the strict nature of the bank's direct foreclosure powers.

3.5 International best experiences

Subsequently in case of second auction failure, a clear arrangement of commanded actions for banks typically includes a mandatory review and re-valuation of the asset by independent, certified valuers, considering market conditions and causes for the failure. Should subsequent auctions also fail, the framework permits exploring alternative disposal methods before direct bank acquisition, such as negotiated sales (private treaty) with strict transparency requirements, utilizing Asset Management Companies (AMCs) for systemic non-performing loans, or even debt-equity swaps in viable commercial cases. Ultimately, direct bank acquisition is positioned as a last resort, permissible only after all reasonable market disposal efforts have failed and when demonstrably the most effective way to minimize losses or protect depositor interests.

South Africa

South Africa is known with its well-established legal frameworks governing bank asset auctions, a strength running from its refined financial sector and strong legal system. This is a very regulated financial sector that has improved practices over decades, and a legal system adept at commercial and financial matters like debt recovery. The country also uses case law and precedents that provide guidance for bank asset auctions, ensuring consistency. The South African Reserve Bank (SARB) plays a regulatory role, likely setting compliance guidelines and oversight for these auctions. And also transparency and procedural fairness are usual, with practices including public advertisement, detailed "Conditions of Sale," mandatory bidder registration and FICA documentation, and reserve prices that the seller's agent cannot bid at or

above. Properties are commonly sold "voetstoets" (as is), and fortunate bidders are required to pay a important immediate deposit and sign documentation. This experience express how a mature financial sector, together with a strong legal framework, can effectively manage bank asset auctions, facilitating creditor recovery as sustaining fairness for all parties involved.

England

To London, as a leading global financial center within England and Wales, stands out for its developed and commonly applied legal frameworks for setting prices of assets auctioned by international banks, a refinement driven by the sheer volume of international banking activity it hosts. This expertise is built upon several pillars. This pillars are: its status as a major international financial center concentrating vast numbers of banks and related legal procedures; a well-established and refined legal system, in addition to the Insolvency Act 1986, that complitly governs debt recovery and asset sales. And also there is a significant body of case law providing precedents for valuation and auction procedures. In addition to the above a pool of specialized expertise comprising legal professionals, insolvency practitioners, and auction houses experienced in complicated(complex) international banking asset auctions. The regulatory framework, sustained by the Insolvency Act 1986 and oversight from the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA), analysis fairness, maximizing(increasing) creditor value, strong valuation practices, transparency, and the mitigation of conflicts of interest. Althoght Scotland and Northern Ireland have different) legal systems, the concentration of international banking in London ensures that England and Wales handle the majority of large-scale international bank asset auctions, making their experience spesifically influential and strong.

To enhance handling of non-performing assets and bank acquisitions following failed auctions in Ethiopia, a multi-faceted method, inspired by international best practices, could be enforced. This would include mandatory independent valuations for any asset a bank acquires after a failed auction, requiring at least two certified, unaffiliated valuers to provide complete and strong valuations based on market value principles, using multiple internationally recognized approaches, explicitly stating assumptions, and taking in to account the current(recent) market conditions, including factors contributing to auction failure. Regulatory oversight of valuers would be strengthened through strict licensing and certification by a committed body, an

excutable code of conduct with penalties for non-compliance, and the potential establishment of valuation review panels for high-value cases. Improved regulatory direction of bank acquisitions would necessitate pre-acquisition approval from the National Bank of Ethiopia for substantial immovable assets, fair acquisition price supported by independent valuations, and an assessment of the acquisition's impact on capital adequacy. Additionally, strict time limits would be imposed for banks to hold acquired assets, avoiding them from becoming property holding companies, along with regular reporting and disclosure requirements to thenational bank of ethioipa and public, and clear impairment rules to instantly recognize losses if an asset's market value falls below its carrying value.

Eventually, data collection and market information systems would be developed through centralized property databases of sales and valuations, and banks and regulators would invest in market intelligence to consider property market trends. For instance, if a bank in Ethiopia forecloses on a property and two auctions fail, the recommended system would trigger a mandatory re-valuation, a strategic review by the bank, and national bank of Ethiopia consultation and approval based on documentation, new valuations, a disposal plan, and capital impact emphasis, with thenational bank of Ethiopia constantly monitoring disposal efforts and impairment provisions. This approach intends to build a more resilient system by demanding transparent, market-driven valuation together with strict t regulatory oversight.

Chapter 4

Findings, Recommendations and Conclusions

Findings

The study, drawing from the provided introductory chapters and literature review, identifies several findings regarding Ethiopia's legal framework for bank acquisition of immovable assets following failed second auctions and the associated valuation principles. It also recognizes Proclamation No. 1357/2024, particularly Article 11, as the newly enacted legal instrument anticipated to govern the valuation and price determination of immovable assets by Ethiopian banks. Its impact is considered important on non-performing loan resolution and financial stability.

When we look the gap that is uncovered by the above legislation is concerning immovable asset valuation and bank acquisition after auction failures. Proclamations No. 97/1998 and 216/2000 property mortgaged or pledged with banks proclamation permit banks to gain property at the first auction's floor price if the second auction fails. Nevertheless, Proclamation No. 1357/2024 introduces a separate valuation framework without coordination methods, leading to legal uncertainty regarding which valuation standards apply in these specific scenarios. Even with Proclamation No. 1357/2024 generally covering "bank loan collateral" valuation (Article 11(1)(c)), there's a specific challenge in methodologies for properties acquired by banks after two failed public auctions, when the acquisition price defaults to the first auction's floor price. This indicates detach between valuation provisions and the realities of distressed asset recovery.

Additionally, the current framework lacks enough National Bank of Ethiopia (NBE) directives establishing mandatory revaluation requirements for properties acquired post-auction and, crucially, holding period limitations for bank-owned real estate. This gap contributes to protracted asset holding by banks, impacting their financial health and the distressed asset market. The existing literature (Yigzaw, 2016) highlights the dominant use of the cost approach by Ethiopian banks for mortgage valuation, rather than the more market-reflective market comparison or income capitalization approaches. This methodological limitation can lead to inaccurate reflections of current market value and contributes to the lack of a strong regulatory valuation institution.

Generally, Ethiopian banks commonly depend on internal guidelines or manuals (like the Commercial Bank of Ethiopia's "acquired asset administration procedure"²³ valuations, potentially leading to inconsistencies across the banking sector. The study recognizes the threat posed by non-performing loans (NPLs) to the Ethiopian financial sector, leading to low bank profitability, constrained lending capacity, and instability. Inefficient NPL resolution processes, exacerbated by the identified legal and valuation gaps, directly prolong these negative impacts.

Recommendations

Depending on the recognized legal gaps and the comparison with international best practices, Enact a dedicated, comprehensive property valuation law that consolidates and harmonizes all existing provisions from the Civil Procedure Code, banking proclamations (including Proclamation No. 97/1998, 216/2000, and 1357/2024), and NBE directives. This law should explicitly address the valuation methodologies for distressed assets, particularly those acquired by banks post-failed auctions.

And also we should Create an independent regulatory body responsible for looking property valuation practices in Ethiopia that is responsible for developing and enforcing national valuation standards (aligned with International Valuation Standards), and Licensing and regulating professional valuers, ensuring their competence, ethical conduct, and independence. This will be realized with amending proclamation No. 1357/2024 (or integrate into the proposed unified valuation law) to explicitly detail the valuation methodologies and standards to be applied when banks acquire immovable assets after failed second (or subsequent) auctions.

While recognizing the judicial nature of foreclosure, explore legislative amendments to the Civil Procedure Code to streamline the auction process. This could involve: Setting clearer, stricter timelines for each stage of the auction process and exploring the possibility of allowing for faster re-auctions or, after a specified number of failed public auctions, permitting regulated private sales or transfers to specialized asset management vehicles under court supervision.

Additionally, support the establishment of a centralized, publicly accessible (or professionally accessible) database of real estate transactions, including sale prices, property characteristics, and

²³ Acquired asset administration procedure of commercial bank of Ethiopia January 2023

land registration details. A strong database would provide valuers with significantly improving the quality of valuations. By implementing the above recommendations, Ethiopia can shift towards a stronger, transparent, and efficient legal and regulatory framework for managing distressed immovable assets, thereby improving financial stability, strengthening banks' balance sheets, and promoting a more dynamic secondary market for non-performing assets.

Article 11 should be amended to include provisions that should establish minimum marketing requirements, mandatory exposure periods, and specialized valuation methodologies that account for market constraints while still protecting property owner interests. The provision should also establish clear distinctions between voluntary market transactions and forced sales, ensuring that such sales are not treated as equivalent to normal market transactions for valuation purposes. The article should be amended to establish monitoring mechanisms for detecting and responding to patterns of monopolistic acquisition that distort local property markets

Conclusion

The study has revealed that Ethiopia's legal framework governing bank acquisition of immovable assets following failed second auctions, and the associated valuation processes, is distinguished by notable fragmentation and a lack of comprehensive, standardized valuation legislations. Although new legislation like Proclamation No. 1357/2024 aims to improve real property valuation, its integration with current banking and foreclosure laws remains unclear, creating legal unpredictable regarding applicable valuation standards for distressed assets. The continued reliance on the first auction's floor price for bank acquisition, without precise requirements for fresh, independent valuations that reflect distressed market conditions, poses challenges for fair asset recognition. Additionally, the absence of strong national bank directives on mandatory revaluation of acquired properties and transparent holding period limitations permits banks to accumulate illiquid assets, impeding their financial health and the broader non-performing loan resolution efforts. The assessment emphasizes that the predominance of the cost approach in valuation, combined with absence of independent valuation institutions and reliable market data, highly impacts the accuracy and consistency of property valuations. At last, these systemic issues impede the efficient resolution of non-performing loans, undermine financial stability, and suppress the development of a transparent and liquid secondary market for distressed assets in

Ethiopia. Addressing these recognized challenges through unified legislation, independent regulatory oversight, and clear, internationally coordinated valuation standards is important for a more strong and efficient banking sector.

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