

Real Estate

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This policy brief is part of a series of nine sectoral studies developed by the Lebanese Center for Policy Studies (LCPS). The lead author of this series is Senior Economic Researcher Lina Maddah, with the contribution of Executive Magazine. The aim of this series of briefs is to examine the impact of Lebanon's economic crises on key economic sectors and present recommendations that can assist with private sector recovery. This series was developed with the support and contribution of the Lebanese Private Sector Network (LPSN) and in collaboration with Executive Magazine.

Sector Overview

The real estate sector has functioned as a reservoir of wealth and a motor of economic activity in the post-conflict re-construction and development period of the 1990s. It accounts for 13.7 percent of GDP on average between 2004 and 2016, and throughout the (by gross national product) wildly fluctuating 2000s and 2010s.¹ As such, construction and real estate development has attracted domestic and foreign investments as well as state and quasi-state support in form of housing loans and stimulus packages.

One can argue that the legal feat of initiating the listed Lebanese Company for the Development and Reconstruction of the Beirut Central District (Solidere) was integral to the post-conflict trajectory of Lebanon as a services-driven economy, although spikes of development and profitable speculation were counter-productively distorted by corruption and regulatory failure. The large private investments in the construction and real estate sectors over the years, aided by extensive involvement of banks and financial intermediary companies, contributed to rentier economy structures that ruled the country. Real estate management and development services, housing loan providers, and urban professional services from think tanks to consultants, lawyers, doctors and academia benefited from the intensification of an urban economy.

In the early phases of the post-conflict real estate boom of Lebanon, questions over the oblique funding of projects from cash converged with questions over the sustainability of projects concentrated at the high end of the property market. With the progression of social and economic trends in the 2000s and 2010s, the focus of real estate developers shifted to suburban projects and smaller-sized apartment units. As native demand of young families in the burgeoning Lebanese demographic shifted towards more affordable units, and at a time when adverse regional and geopolitical winds impacted the country's economy in the 2010s, real estate was the main focus of a quasi-state stimulus package administered by Banque du Liban (BDL), the central bank of Lebanon. According to BDL, the country's GDP growth rate, which was in the low single percentage points, was based to a substantial degree on the stimulus package, and thus attributable to the support for home financing. Cautionary voices warned at the time that while this subsidy strategy for real estate was propping up the economy, it carried a high risk.²

Notwithstanding the country's demographic needs, changing externalities and vacillating macroeconomic fortunes, the ills associated with the sector throughout the entire post-conflict period included an investment over-emphasis on non-productive real estate, absence of coordination, prevalence of corruption and weak supervision on municipal and larger levels, cyclical overproduction of units in periods such as the early 2010s, and failures to develop green urban spaces, efficient public transportation, and other urban

¹ Deutsche Gesellschaft für Internationale Zusammenarbeit (2019), 'Employment and Labour Market Analysis Lebanon', Available at: <https://bit.ly/3m23hzy>.

² June 2015, leader, Executive Magazine

infrastructures which are essential for making real estate investments useful for economic productivity gains and achievement of sustainable development. The real estate demand index of Byblos Bank reflects that interest of prospective buyers peaked more than 12 years ago, vacillated in the intervening years until 2018 with a slight downward bias, and fell to record lows by end of 2020.³

Real estate being a classic non-tradable good, the role of the sector in context of Lebanon's disingenuous balance of trade and balance of payments appeared limited to its ability to attract regional and expatriate Lebanese investment into high-end properties and stocks such as Solidere, with residential property and real estate receiving 70 percent of all foreign direct investment (FDI) as of 2010.⁴

At the cusp of the economic crisis in 2019, about 25 percent of loans were extended to the private sector; of this amount, about 40 percent were made for real estate investments (including 19 percent for mortgages, 16 percent for construction, and 5 percent for real estate and rent services). 'Non-housing' lending to households and industry activities accounted for only 12 percent of total loans. This translated into insufficient diversification of loans and investments, with the majority of the latter made in construction-related activities.⁵

The correlation between real estate and sustainable job creation in Lebanon has been very weak. Some analysts contend that investments into the real estate sector at the expense of more productive sectors contributed to a reduction of employment opportunities in the country. This is supported by the observation that the flow of foreign direct investment (FDI) was coupled with an intensification of real estate activity in Lebanon's main cities (Figure 1). Fiscally, the growth of this sector has been stimulated by a biased tax system (capital gains tax on real estate was only introduced in 2017).⁶

In 2015, real estate activities contributed 15 percent to Lebanon's GDP. However, this did not mean an equivalent creation of stable and dignified jobs in construction and real estate-related professions. High profits tended to be realized by developers in conjunction with low risks because of scarcity factors, alleged money laundering, and weak institutional control of building permits and property transactions. Use of technically obsolete and noise-polluting construction machinery, insufficient safety measures on project sites, corner cutting in many post-conflict developments, and reliance on informal labor involving non-Lebanese workers boosted profit margins further, at the expense of public and employee safety. The sector's share in employment generation remained extremely limited: 0.4 percent. Migrant workers form a significant percentage of this employment and most of their earnings are channeled to their home countries.⁷

³ <https://www.byblosbank.com/byblos-bank-news-room/byblos-bank-real-estate-demand-index-in-third-quarter-of-2020>

⁴ Investment Development Authority of Lebanon. (2010). Annual Report. Beirut: Investment Development Authority of Lebanon. <http://www.databank.com.lb/docs/Activity%20Report-2010-IDAL.pdf>

⁵ Awdeh, A. (2019). Monetary policy and economic growth in Lebanon. *Journal of Central Banking Theory and Practice*, 8(2), 147-171.

⁶ Abdo, N. (2018). *The Quest for Social Justice in Lebanon: The need for fair taxation*. Arab NGO Network for Development: Beirut. Available at: http://www.annd.org/data/file/files/01%20ANND-TAXJustice2017-Regional_Lebanon.pdf

⁷ Land Policy Dialogues May 2022 Report published by the Lebanese Association for Taxpayers Rights, *Land-Policy-Dialogues_Final-Synthesis-Re-port_English_May-2022-1.pdf* (aldic.net)

Challenges

Already in the years leading up to the crisis, and when subsidized housing loans from the central bank were suspended in 2018, the real estate market was slowing down. The income destruction of the past four years, in combination with the dis-appearance of housing loans by commercial banks, has moved even modest 'starter' apartment purchases far out of the reach of young families and public servants. Constructing a comparable advantage and competitive value proposition for Lebanese developments over international property markets could be a proposition only for upmarket apartments, villas, and mountain or seaside chalets as first or second residences that appeal to regional and international buyers.

However, while this market was significant as far as appealing to well-heeled regional buyers in the 1990s and to Lebanese expatriate buyers up to the 2010s, transaction data and political narratives suggest that much of the appeal to Arab buyers has broken away in the past 15 years. Moreover, competing with other property destinations around the Mediterranean is likely to be hindered not only by the country's political, social, and economic instability but also in terms of micro-economic detriments, by the degradation of environmental assets, trends to privatize public spaces, uneven anecdotal records of building quality, and the failure to apply cultural integrity or exclusivity to luxury properties as defining factors of high-end developments.

Overall, a resurgence of the property demand and price boom as seen between 2002 and 2011 cannot be expected for many years, probably until the currently unpredictable time when (and if) a new peak of pent-up housing demand coincides with a surge in economic productivity and nation-wide creation of livelihoods. Demand for real estate as a rentier investment proposition seems unpredictable, due to open questions about trust in the Lebanese financial market, future property taxation and regulation, perception issues, domestic political stability and regional security.

In the crisis years, there has been a further significant slowdown in new construction, according to recent data on construction permits. At the same time, and except for some distressed sellers, the market seems sticky in terms of property prices, in line with the belief of many local stakeholders that real estate prices will hold their ground and will at worst remain stagnant but never decline. This creates a self-reinforcing cycle where developers refuse to lower their prices in the hope that markets will rebound, which further reduces demand.

A lengthy hesitancy and downward trend in desire to seek ownership of an apartment or home is visible from the real estate index of Byblos Bank showing more than 90 percent reductions in real estate demand in the third quarter of 2020 when compared with demand at peak times (in the year 2010) and the average demand in the 2010s. Month by month survey results in Q3 of 2020

showed that less than one percent – exactly 0.6 percent – of polled Lebanese residents had plans to buy or build real estate in the coming six-month period, 4.1 percent-age points less than in the third quarter of 2019 and a fraction of peak demand seen in the third quarter of 2010.

Further along its downward spiral, the sector posted a yearly contraction of 18 percent during the first seven months of the year 2022, and the number of sales operations fell by 15 percent year-on-year for the same period. This was juxtaposed with a 34 per-cent increase in 2021, but according to analyst views, these temporary rises in real estate transactions have not been not organic.⁸

⁸ Raissa Batakji, March 2020, Real Estate: A Safe Haven During the Crisis? LAU News

Opportunities

Against these challenges stand unmet opportunities, even as, and partly perhaps because, cost inflation factors have been impacting international building material sup-ply chains and as urgent climate targets internationally mandate capital expenditure-heavy shifts to greener, energy-saving, and smarter urbanism in line with the SDGs, such as SDG 11.

In this regard, entirely new real estate development and property management opportunities can be developed from addressing such issues as, for example:

1. The large stock of unsafe and crumbled apartment buildings in Beirut (noting shocks of collapsed buildings which predate the August 20, 2020 port explosion)
2. The need for heritage preservation and cultural integrity in cities
3. The need for alignment of Lebanese municipalities and cities with UN Habitat targets, such as creation of urban green spaces
4. The need for improving urban economic productivity in the highly urbanized country of Lebanon
5. The need for pursuit of climate targets on the levels of energy preservation of housing and redesign of urban infrastructures

Policy Recommendations

1. Implement legislation that supports the recovery or upgrading of dilapidated housing units whether impacted by the Beirut blast or eroded due to age and heavy residential use
2. Update the rent law, enforce compliance with environ-mental regulations, and increase supervision of building codes in rental properties and all multi-party dwellings
3. Eliminate as much as possible corruption and per-verse incentives in public sector real estate administrations
4. Enforce and update heritage preservation laws, enforce land use regulations and restrictions on private development of seafront properties

LCPS

About the Policy Brief

A Policy Brief is a short piece regularly published by LCPS that analyzes key political, economic, and social issues and provides policy recommendations to a wide audience of decision makers and the public at large.

About LCPS

Founded in 1989, the Lebanese Center for Policy Studies is an independently managed, non-partisan, non-profit, non-governmental think tank whose mission is to produce and advocate for policies that improve governance in Lebanon and the Arab region. LCPS's current research agenda focuses on: enhancing governance, informing the process of economic growth and sustainable development, promoting inclusive and effective social policies, and informing the development of policies for a sustainable environment. Four themes cut across the above areas of focus, including gender, youth, conflict resolution, and technology.

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5. Update building codes, for example mandates for climate relevant damming and earthquake safeguard requirements for high and low rises
6. Update and enforce building, construction, and property insurance laws
7. Eliminate value and time gaps in assessments of properties and registration of property transactions, collect gains tax and property taxes in transparent and equitable manner
8. Incentivize investments, e.g. through tax breaks, in green construction machinery, green building technology and smart buildings
9. Strengthen, democratize and make more transparent associations such as the real estate association and the real estate developers' association
10. Establish clear quality certification standards and training for real estate and construction companies and professionals.
11. Improve working conditions on construction sites and communication with companies and sites on exemplary labor practices
12. Formalize hiring of construction workers and fulfill social safety network obligations
13. Invest in employee safety training and green certification
14. Invest in less polluting machinery