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REAL ESTATE

The Lebanese real estate sector has witnessed a number of variations in its market trends in the period following the civil war. This issue aims to analytically trace recent developments in the Lebanese real estate sector along with their economic reasoning while assessing the factors involved. These include the massive post war reconstruction era, favorable property laws directed towards foreign investors, the rise in tourism, occasional drops in confidence regarding the political and security situation, geo-political shifts in investments of Arab capital and the availability of long-term mortgages. A comparative analysis against markets in the region, namely the Syrian republic and Gulf countries, is then made.

I. Evolution of Lebanese Real Estate

Research and statistics appear to indicate that Lebanon had witnessed fluctuations in real estate activity at four critical points since the end of the 15 year civil war:

a) Post War Reconstruction Era (1992-2000)

Following the end of the 15 year civil war in Lebanon in the early 1990s, the real estate sector was in poor condition. This once booming segment of the economy, especially following the oil boom and subsequent gulf investment in the sector in the early seventies, was now stagnating at the back of massive post war destruction, a liquidity squeeze and a lack in Foreign Direct Investment (FDI).

The government however came to play an important role in the immediate restoration of real estate in the aftermath of the war. In collaboration with the Council for Reconstruction and Development (CDR), it led what was to be become known as the massive post war reconstruction plan, which pushed the economy forward.

Data on real estate during this period is limited to supply side statistics, namely the surface area covered by the new construction permits compiled by the Order and Architects and Engineers of Beirut and Tripoli. As Figure1 illustrates, the annual surface area covered by new construction permits moved sharply upwards between 1993 and 1995, a rise of 129.4% in two years[1].

Figure 1 then points to a decline in construction activities thereafter. This was in part due to the economic recession at the local level as well as the loss in investor confidence following the Israeli aggression in1996, but also, the result of an excess supply of buildings being addressed to the upper class and to wealthy gulf investors rather than to middle class citizens, who in reality, were driving demand for small and medium sized apartments. This slump in the real estate market continued up until the turn of the century.

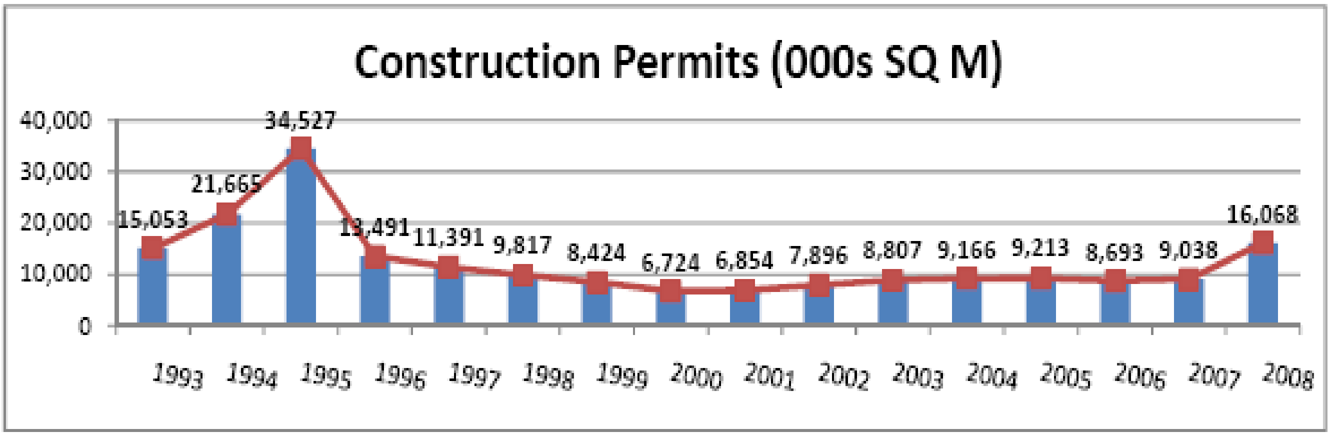
b) Boom at the Turn of the Century (2000-2006)

At the turn of the century, Lebanon's construction sector began to show signs of a recovery following the previous 5 year economic slowdown. As Figure1 shows, the area covered by new construction permits began to slowly rise. In 2002, they grew by 15.2% relative to the previous year, followed by 11.5% in 2003, 4.1% in 2004 and 0.5% in 2005. A number of developments transpired that led to this revival in the real estate market:

First, the end of the Israeli occupation in the South in the year 2000 stimulated reconstruction work in that area, thus contributing to a small scale construction boom. According to figures published by the Order of Architects and Engineers in Beirut and Tripoli, together, the area covered by new construction permits in the

[1] It would have been interesting to study the demand for real estate during this period but limited data in this field plays a impeding role in this. The Real Estate Directorate however, began compiling and publishing this category of data in 2006.

Figure One: Area covered by New Construction Permits



Source: Order of Architects and Engineers in Beirut and Tripoli

Southern Casas of Nabatieh and South Governates witnessed the largest increase in real estate supply in the country, as they rose by 37% and 10% respectively between 2000 and 2001.

Second, the Investment Development Authority in Lebanon (IDAL) highlights how major developments and changes in property ownership laws have also played a role in spurring the Lebanese real estate market. In 2001, Law N296— which amended a 1969 law (N11614) governing foreign acquisition of property— eased legal limits on foreign ownership of property and thus, encouraged investment in a variety of sectors, most notably industry and tourism. Law N296 essentially abolished discrimination between Arab and foreign nationals with regard to property ownership, and lowered real estate registration fees from 6% for Lebanese and 16% for foreigners to 5% percent for both Lebanese and foreign investors. The law also permitted foreigners for the first time to acquire up to 3,000 square meters of real estate without a permit and more than 3,000 square meters with Cabinet approval. Until this day, cumulative real estate acquisition by foreigners is not to exceed 3% of total land in each district and is not to exceed 10% of total land area in the Beirut district. As a result of this amendment, the real estate sector witnessed a second wave of growth since the end of the civil war. This change in the law not only spurred the expansion of real estate projects that catered to the tourism and service sectors, such as hotels, commercial and leisure centers, but also, in the number of foreign owned projects aimed at addressing the growing demand for— and hence supply of— residential developments.

The loosening of Lebanese foreign property laws also collided at a time when geopolitical investment, income and tourism patterns were shifting. For one, the September 11th 2001 attacks on the US economy together with the onset of the oil boom in 2003 had huge repercussions on the real estate sector within the whole of the MENA region, especially Lebanon. The attacks reshaped the primary tourist destinations for wealthy Gulf Arab investors, who saw Lebanon as a welcome chance to mix business with pleasure. This also encouraged a relocation of their excess petrodollars and business investments in countries closer to home. The Lebanese real estate market thus benefited from a sustained upturn in the tourism industry, which led to a sharp rise in investment in new hotels and commercial centers and expenditures on new villas and apartments. Nevertheless, the success that Lebanon has observed is not surprising: its geographic situation makes it a privileged gateway to all residents of Arab countries, and the Lebanese way of life is more attractive in terms of its closeness to European society relative to other neighboring countries in the region. In addition to this, the relatively advanced banking laws can be considered as a plus for foreign companies willing to expand their activities in the region.

c) Real Estate following the July 2006 War (2006-2007)

The third phase in the evolution of the real estate

Figure Two: Total Number of Property Sale Transactions (local and foreigners only)

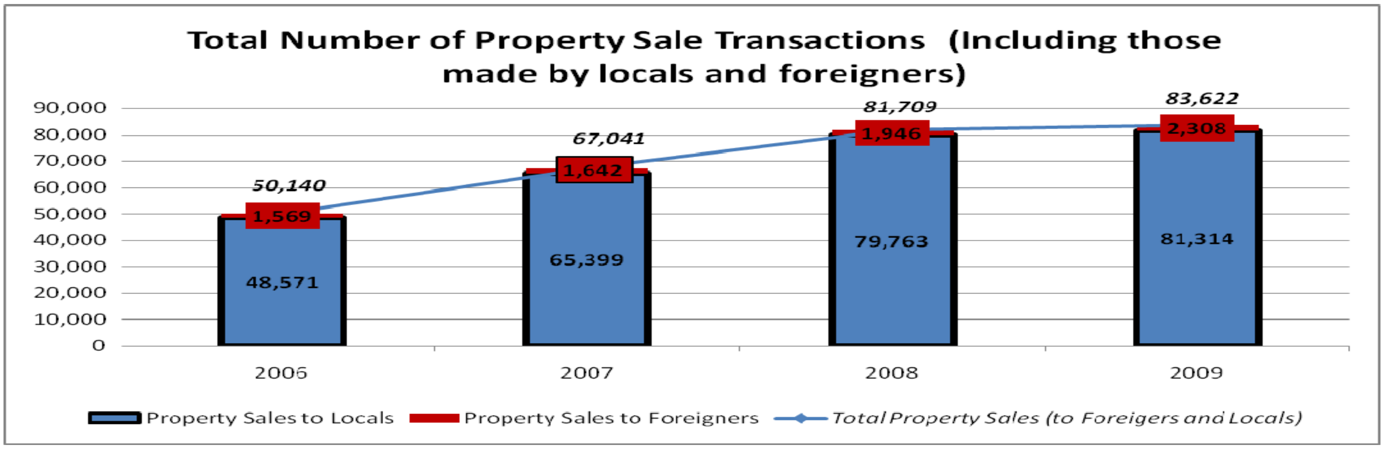
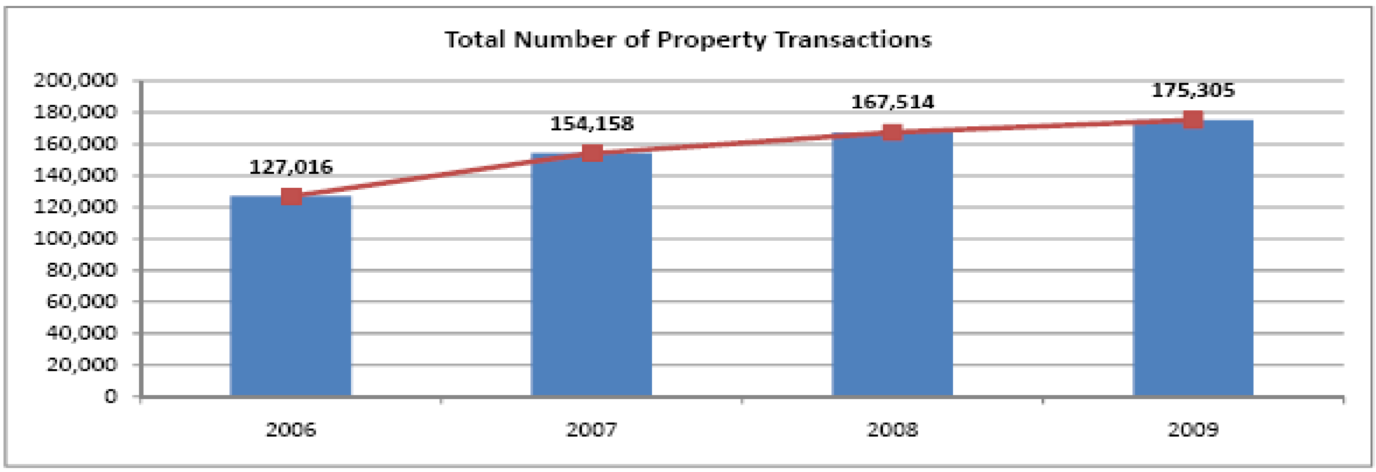


Figure Three: Total Number of Property Transactions



sector coincides with new developments in the type of data available regarding real estate activity in Lebanon. The real estate directorate began to record and publish figures on the number of property transactions taking place regarding re-contracted real estate— that is, old properties and not only those related to new construction permits. This data is interesting since it provides us with another characterization of real estate activity, especially since the reconstruction of war prone areas does not necessarily require the construction of new real estate projects per say (i.e.: an increase in the area covered by new construction permits), but rather, a simple rehabilitation of the damaged structures.

In this context, the July 2006 war had two effects on the Lebanese real estate sector. First, figure one depicts how growth in the area covered by new construction permits slowed down by 5.98% relative to the previous year, as the war put a temporary halt to a number of construction projects. In addition, the number of new transactions registered at the order of architects and engineers fell during this period, from 14,068 transactions registered in 2005 to 10,461 and 10,358 transactions in 2006 and 2007 respectively. The 34.5% and less significant 0.9% drop in real estate operations also capture the effects of the July 2006 war. Although the war had a negative slow down effect on the Lebanese economy and on this aspect of real estate, it did not alter the long term plans made by a number of foreign companies to continue investing in big construction projects. For example, in early 2006, the privately owned "Abu Dhabi Investment House (ADIH)" launched a real estate project in central Beirut called "Beirut Gate" at a cost of around USD$600 Million. In November 2006, ADIH announced that the project would go ahead and the final design master plans of the project were submitted to "Solidere", the company responsible for developing Beirut city centre. The company also stated that the political disputes following the July 2006 war did not affected its investment plans in Lebanon. As a result, supply of real estate did not plummet in the long term.

Second, the number of real estate operations that represent property sales (sales to locals and foreigners and hence, investment in real estate) as well as the total number of property transactions– which include property sales to locals and foreigners together with other transactions related to property such as insurance, ownership and removal of property restrictions— increased between 2006 and 2007, as shown in figures two and three respectively. This illustrates an increase in the number properties being sold in the former and in the number of property operations taking place in the latter, and hence a general rise in real estate activity.

Despite the rise in re-contracted real estate transactions illustrated by the increase in the number of property sales, the average value of property remained consistent in 2006 and 2007, but followed sharp rise in values thereafter. This price appreciation despite the war and political turmoil prevalent in 2006 indicates: a) a commitment made by investors to maintain business in Lebanon and b) the rising costs in global construction materials together with the scarce availability of land and resources in major cities such as Beirut.

d) Era following the Financial Crisis

The final and most recent trend directing the Lebanese real estate sector came about in the period of the financial crisis. During this time, and in contrast to the circumstances prevalent in the global real estate market, the Lebanese real estate sector experienced remarkable expansion, as areas covered by new construction permits grew by 77.8%, reaching 16.2 million square meters in 2008 relative to the 9.04 Million square meters attained in 2007. Furthermore, the total number of property sales during this period also rose dramatically despite the financial crisis. Between 2007 and 2008, their average number jumped from 67,041 sales to 81,709 sales as their average value increased from LBP 94 Million or US$141,705 in 2007 to LBP 120 Million or US$ 180,900 in 2008, that is, a 27.7% increase. This increase in the value of sales was due to a sharp rise in the volume of property sales, which rose 21.9% over the same period coupled with the average increase in property prices due to the inflation in construction materials.

It is worth noting that a study carried out by the "Global Property Guide" found that the rise in price of Lebanese real estate over the past five years has been phenomenal. A 50 square meter apartment in Beirut for instance, which in 2004 would have cost US$60,000 costs an outstanding US$400,000 by 2009. An article in "Al Bayan" also states that real estate prices in Lebanon grew 30% in the last three years alone.

In addition, the rise in the volume of sales has been immense given the current global climate. This demonstrates the magnitude of investment being channeled to the Lebanese real estate sector since the financial crisis. For instance, Lebanon's level of FDI inflows reached record highs of US$ 3.6 Billion in 2008, 56% of which was directed towards real estate. With the global banking and financial sector plummeting following the financial crisis, many Arab investors and Lebanese expatriates began to redirect their capital from traditional stock market investments towards projects with lower risk, such as those in the real estate sector.

Another reason for the rise in the value of real estate in Lebanon comes about due to the sharp drop in inflation rates and hence, interest rates over the last decade, especially during the period marked by the financial crisis. Inflation rates have fallen from an average of 17.9% in 2000 to 9.95% in 2008, thus slowly allowing interest rates to follow suit and hence, relieving the pressures associated with obtaining a mortgage. Together with the burst of liquidity in the Lebanese banking sector following the financial crisis in 2007-8 — evident from the fact that total deposits rose by

10.23%,15.6% and 23.1% in 2007, 2008 and 2009 respectively—as well as Lebanon's stance as an eminent tourist destination and safe haven following its remarkable resilience to the financial crisis, local banks have been encouraged to lend out even more capital to support the real estate sector with what are now the lowest market rates available in Lebanon since the end of the 15 year war. This has effectively boosted demand in a country where land is already in short supply and hence, inflated the value of real estate.

II. Comparison with Regional Countries

How do the factors that have shaped the Lebanese real estate sector differ from those experienced in neighboring countries. In this respect, Syria and countries in the Gulf Cooperation Council (GCC) are analyzed. Syria is chosen due to its close proximity to Lebanon whereas the GCC countries are selected as a result of the area's booming nature over the last decade.

Syria

In a 2009 report by Cushman and Wakefield—the global property consultancy firm based in London — Syria was ranked as the 8th most expensive city for office rents in the world. As Muwaffaq Khudhur, of Mazen Al Assadi Estate Agency in Syria contests, supply and demand have been essential to such an occurrence.

Demand in the Syrian real estate market has been influenced by a number of factors. First, the flood of one million Iraqi refugees following the Iraqi invasion in 2003 and the significant number of Lebanese who escaped Israeli attacks in the summer of 2006, have all increased purchasing interests in Syria, thus adding to the growth in demand. This portrays a differing trend to how real estate can be effected by conflict. Unlike Lebanon, whereby the war had an adverse effect on real estate, real estate in Syria benefited from its surrounding conflicts.

Second, demand for luxury villas and office space rose following the influx of business executives who settled in the country following the10th 5 year reform plan initiated by the Syrian government, which aims to develop the financial system and enhance the business sector and investment environment over the 2006-2010 period.

Third, changes in Syrian Laws and Decrees also played a part in attracting investors to the country and raising the demand for more office and commercial space. These include:

1. Replacing Investment Law #10 (1991) with a new Investment Law issued in January 2007 that is more flexible in terms of ownership rights, renting lands and real estate for investment projects with no limits, and limiting government intervention in annulling these rights except for specific cases.
2. Modifying the Legislative Decree # 51 (2006) and hence, reshaping the rate of income tax in favor of investors. The tax rate for income between 1,000,000-2,000,000 SYP and 2,000,000 to 3,000,000 SYP fell from 26% and 29% respectively to 24% for the entire range.

Coupled with the global rise in price of construction materials, the increase in demand for residential, commercial and office space brought about a shortage in supply and price hikes of up to 20% in real estate sales and 40% in rental prices by 2006, when up until 2003, the sector was had witnessed stable demand. This upward trend has continued up until now, where very few dedicated office blocks exist in what is traditionally considered 'downtown' Damascus. But with the number of shortages in the supply of houses continuing to exist in the Syrian market relative to the vast increase in demand, prices in the real estate sector continue to soar. In the meantime, new real estate projects are trying to meet the rising demands.

GCC

In the case of the GCC countries, the property market since the beginning of the 21st century has been influenced by two main events. First, developments and changes in property ownership have played a major role in spurring the property market and boosting the economy of the GCC region. However, the financial crisis then reversed this process in a number of countries in the region.

The liberalization of property ownership over the last decade has created an organized and transparent environment for the real estate sector, adding credibility and confidence to the market, a point emphasized on by an article in Real Magazine. For instance, all countries in the GCC region that eased restrictions on foreign property ownership to some extent, witnessed a boom in the real estate sector. Oman for instance issued a decree in 2006 that allowed all nationalities to own freehold properties in tourism designated areas. Dubai however, was the leader in creating modernized property ownership laws in the region when in May 2002, a decree was similarly issued to allow the freehold ownership of pre-designated properties to foreign investors.

Although the availability of liquidity and hence, mortgages has been vital to the long term well-being of the real estate market, this has not been the case in the UAE in recent times, where lending troubles, due in part to the current drying up of liquidity following the financial crisis, have restricted mortgage and lending facilities that were once easy to obtain. This means that property prices could continue to deteriorate and hurt the real estate market in the UAE even further. The Lebanese economy, on the other hand, was sheltered to the financial crisis since it has maintained confidence in these facilities and hence, prevented a large drop in real estate values, as witnessed in the UAE market.

Like Lebanon, Bahrain witnessed little damage to its property sector following the crisis as its sound economy in terms of diversity and sustainability and its solid financial discipline have all helped offset the negative effects of the crisis on the property market. Although Bahrain was behind some of the other GCC countries in terms of growth of real estate development, many projects are appearing as a large number of residential developments was launched in the last quarter of 2008 at a time when most GCC countries saw massive increases in the number of cancelled projects or of those being put on hold.

Conclusion

The real estate sector in Lebanon has been influenced by a number of factors over the years and according to the events depicted in this article, the underlying features that determine the growth in real estate are both similar and different in several countries. Laws governing foreign investments for instance have generally boosted growth in real estate in Lebanon as well as in the rest of the region. Similarly, developments which also aim at protecting the local economy from external turmoil, such as the conservative banking policies adopted by the Lebanese Central Bank, are essential matters that intend to directly or indirectly safeguard and boost the real estate sector.

However, upon examining the situation of other countries in the MENA region, one may also highlight how the misfortunes of one economy sometimes work in favor of another. Unlike the negative effects of the conflicts in Lebanon on the real estate sector, the ongoing conflict in Iraq for example, has essentially been an important factor in boosting the real estate sector in neighboring countries, such as Syria. Additional global and regional calamities observed since the financial crisis have also affected real estate investment by transferring capital and investments from one country to another or from risky sector to a relatively risk averse one.

The MOET Newsletter hopes to keep its readers up-to-date on topics important to the Ministry as well as on the current economic climate.

For more information or assistance, please do not hesitate to contact the Economic Research Unit at the Ministry of Economy and Trade:

Tel: +961 1 982 294 (Ext. 1609 -1610)
Fax: +961 1 982 297
hanouti@economy.gov.lb
cbitar@economy.gov.lb
www.economy.gov.lb

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