Survival of the fittest for Lebanese real estate developers

The ice age

Coming into 2018, Lebanon’s real estate market was already sputtering. For several years, real estate developers have complained of worrying market conditions—always hoping that the next year will be better, that the political situation in Lebanon will change, and that buyers will come clamoring back.

The first wave of concerns was voiced by developers of luxury units. Property sales in this uppermost segment began slowing down around 2011, creating a glut of luxury-grade apartments that industry insiders estimated at a value of no less than $3 billion. The mid-segment of the market came next, with a drop in the sale of $300,000 to $500,000 apartments, which mostly cater to Lebanese expats. Sales performance of that portion of the market began dipping in 2015, when the pocketbooks of those working in oil-producing states took a hit with the fall of oil prices. What still remained vibrant was demand for entry-level units that were affordable for young families, thanks in no small part to the subsidy schemes promoted under the annual economic incentive packages of Banque du Liban, Lebanon’s central bank.

The cancellation of a central bank-administered financing mechanism at the end of 2017, however, has changed the outlook. While developers are not quite saying the apocalypse is nigh, they are increasingly concerned. The central bank's decision to close the spigot financing home loan subsidies—a near $2 billion market segment—has brought the market to a standstill. The loss of this financing mechanism creates a further impediment to any remaining demand for Lebanese property. As Executive went to print, Parliament did legislate a one-year $66 million budget to subsidize housing loans. But how much this temporary solution will help is dependent on future decisions—including efforts by Parliament to establish a more permanent solution, and by the next government to implement a comprehensive housing policy.

The subsidy disruption has called into question the health of the entire real estate sector value chain—including a number of construction businesses, material suppliers, and home furnishing outlets—which industry insiders estimate constitutes up to 25 percent of the economy.

Zero demand

Executive spoke with six developers and real estate asset management firms in September for this report. They described a troubled market and a sector in crisis. Some see a prolonged downturn of the market, while others suggest that real estate will bounce back with local and regional economic revivals. All of them, however, agreed that today's demand for housing is practically zero.

From 2008 to 2011, Lebanese real estate was the business to be in. The market was on full blast: money poured into Lebanon in the form of investments in new development projects and property sales peaked. Property prices multiplied during this period, says Walid Moussa, president of Lebanon's real estate brokers syndicate (REAL) and CEO of Property Brokerage & Management. He tells Executive that there were several reasons behind these price hikes. "There was the election of the new president of Lebanon at that time [and] there was the Doha Accords, giving political stability." Moussa says. "Plus we had the international financial crisis and people wanted to get their money out and put it in Lebanon, so a lot of money came from outside into the market. All that resulted in development in the market."

Abdullah Hayek, CEO of construction and real estate services firm Hayek Group, says that the period saw a high in building permits and sales transactions. In his view, however, this high growth was marred by excesses and developments that later would prove to be detrimental to the sector. According to him, the downside of the boom was an invasion of unprofessional developers. "They started building the way they wanted to but not the way they should have," he says. "Most of them, since they are not professional, bought the wrong land, used inadequate designs and specifications, and incurred higher costs, and therefore wanted to sell at higher rates. That's why we have a lot of vacant apartments these days. Those apartments were built in that interval."

Today, the market's boom times are firmly in the rearview mirror. The downturn began in 2011 as unrest swept across the region, disrupting economies. Gulf citizens—including nationals from Saudi Arabia, the Emirates, and Qatar—no longer traveled to Lebanon and stopped eyeing property in the country for political and security reasons. Lebanese expats stopped buying because of job insecurity, particularly those working in oil-producing countries who preferred to hold onto their cash. From 2011 to the fall of 2017, the real estate market continued to slow down, before a shock accelerated this decline. In November 2017, when then-Prime Minister Saad Hariri announced his resignation, the market started to cool even more rapidly, and this freeze—which remained in force even after Hariri rescinded his resignation—was further exacerbated by the closure of the subsidy well in spring 2018. These two incidents marked the turning point from market downturn to market crisis, developers tell Executive.

A crisis for whom?

Is Lebanon's real estate sector actually in crisis? The answer depends on whom you ask.

Landowners aren't experiencing a crisis, says Mireille Korab, head of business development at FFA Real Estate and vice president of Lebanon's developers syndicate, REDAL. Korab tells Executive the number one issue concerning the market is a lack of demand. "This is where the crisis comes from: People are scared and don't know what to do. [Should they] keep cash or put it in real estate?" She says that, for now, landowners are content to sit on their properties and wait for better times to sell. "If it is a big [piece of] land and the owner is in debt [then you may find a willing seller], but these are peculiar cases," Korab explains to Executive in a mid-September interview. "All in all, land did not lose value in Lebanon because of its scarcity. Definitely there are discounts, but there is no crisis for land [prices]."

Wealthy developers are also far from crisis, says Massaad Fares, CEO of Prime Consult, a real estate asset management firm. Fares says well-to-do developers will be able to hunker down and carry on once market conditions improve. He also says that the banks, in general, are still in a comfortable position and not overleveraged. "Lebanese developers are rich, they have the money in general," Fares says. "We hear that some are not doing so well, but, [for] banks, even if [a developer] is not paying down the principal, they are paying the interest. This is why we don't have foreclosures, and the banks are not afraid of real estate, because it is valuable. They are not so worried about it—even if they end up foreclosing [on properties], they are not afraid because it is a good asset for them, a good security."

Wealthy players in the real estate market—landowners, rich developers, banks—are going to be fine, industry stakeholders agree. But those who are not so well off might have to pay a steep price.

Smaller developers may be the first to go under, says Carlos Chad, general manager of Demco Properties, the sales arm of the Lebanese steel conglomerate Demerjian Group. "It's like the ice age, when there were so many species of animals it was survival of the fittest. This is what is going on in the property market today. When you have a wounded animal in the herd, he won't make it."

All of those interviewed by Executive agree that it is a buyer's market and some developers are still selling—to those who can pay cash. But buyers who were on a payment plan and expecting delivery of their apartment may be in trouble if the developer they bought from goes belly up.

For some projects under construction, prepayers will be losers, says Fadi Jreissati, general manager of Sakr Real Estate. Jreissati explains that some projects still being built are at risk of not being delivered because of poor sales disrupting cash flow to the builder. Lack of liquidity by the builder coupled with an inability to pay back loans borrowed from a bank may push the bank to foreclose on the project, effectively punishing the presale apartment buyers. “I think so far it is under control, but you’ve heard what’s happened with Sayfco and Badawi—probably many [builders] have not declared yet but are in bad shape and are running out of ideas,” Jreissati says. “Banks are pressuring them. Is there a risk on the market? Yes, I would say there is a very high risk now. [Project foreclosure would create] an even bigger crisis because so many clients would have [prepaid] by then up to 50 percent [of the value to purchase an apartment]. So if the bank takes over [an unfinished project], they are inheriting hundreds of problems and creating a social problem—a huge one.”

Weak economy, weak real estate

The market situation the sector faces is just a normal reflection of the deterioration of the overall economy, Hayek tells Executive. He also says that the discontinuation of the financing mechanism means Lebanon is now subject to a housing loan crisis. The central bank’s decision means no more cheap credit is available for banks to lend out for mortgages, cutting off borrowers’ access to subsidized loans in the process (see subsidy story).

The central bank’s decision terminated the financing mechanism it had used to intervene in the housing market for the better part of two decades. According to Moussa, this was done for two reasons: to maintain the currency and to contain inflation. Hayek speculates to Executive that the diminished economy since 2011 has reduced consumer buying power, meaning that the banking sector would rather park money in government debt then risk mortgage defaults. “[This is] what worries the banks. They prefer guaranteed low-risk treasury bills, rather than going into housing loans, because they want to avoid any default from now on, if the central bank does not subsidize loans.”

Banks are still offering home loans, but with cheap credit from the central bank no longer available and subsidized mortgages on hold, borrowers must pay more for their loans over the long run. “Banks have plenty of money, but, if they offer mortgages, the interest rate is around 9 to 10 percent, and this is not attractive for consumers,” Hayek explains.

Who are the losers?

The central bank’s decision puts a $2 billion segment of the market in jeopardy. That was the knockout blow for market demand, FFA’s Korab says. The Lebanese state was expected to fill the void and a recently passed law allocating $66 million to subsidize home loans may manage to do that for the coming year—though, as Executive went to print, it was unclear exactly how the legislation would work, how many loans could be serviced, and where this money would come from.

Any prolonged delay implementing the state’s solution for this part of the market could spell trouble for developers. Many builders are not able to sell their current stock, meaning they may not be in a position to build what the market wants—smaller and cheaper apartments—when demand recovers. The lack of accessible financing for homebuyers could put the developers in a cash bind, themselves unable to pay back loans to banks, settle bills with suppliers, or pay employees’ salaries. Plummeting sales could bring problems up and down the real estate value chain. A project under construction means employment for many specialized workers and requires raw materials. After an apartment is sold, it must then be furnished. This cycle, from construction to delivery to occupancy, creates value up and down the chain and drives revenue to government coffers in the form of taxes and fees. If the whole cycle stops, companies can go out of business, people stop working, and the government loses revenue.

The sector may now be approaching the end of a boom-bust cycle that was in a boom phase from the mid-2000s until 2011 or 2012. If there is to be a bust, it will be—for developers engulfed by the real estate ice age—the final calamity after a long decline.

All we can do right now is identify clear losers: low-income households looking to buy starter homes. Because first home buyers can no longer access cheap credit to finance the mortgage on their property, for many young people, life—marriage, children, building wealth—is on hold.

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