APPENDIX A
Economic Tools

A brief economic background on the housing market in Lebanon

The demand for housing in Lebanon is mainly fueled by a large diaspora that outnumbers the resident population. Lebanese expatriates around the world, and mainly in the oil-exporting Gulf States, strive to purchase homes in their homeland as an insurance for their inevitable return for retirement or as an investment. Housing prices in Lebanon have seen a surge of more than 300% between 2007 and 2013. Then after 2014 the market cooled but prices have been rigid downward. The number of real estate transactions dropped significantly since 2014.[1] Therefore, housing prices have gone up by more than 15 times the rise in income between 2007 and 2013. According to the IMF reports, GDP growth has decelerated from 8% in 2010 to less than 1% in 2011 then inched upward to around 2-3 percent in the following years.[2]

There is a heated debate amongst Lebanese real estate investors and analysts whether the cooling of the housing market that started in 2015, is indicative of the bursting of housing bubble. Pessimists believe that the reasons behind the fear of a housing market freeze are legitimate. First, due to the continuous drop in oil prices during the years 2014 and 2015, Lebanese homebuyers residing in the Gulf Countries Council (GCC), who have been always perceived as the fuel of the Lebanese economic engine, have dwindled their investments and remittances into their home country. Second, the influx of the Syrian refuges that flooded Lebanon since the war in Syria broke out in 2011, has its toll on the Lebanese economy, draining its limited resources and threatening its national security. Third, the Gulf nationals who traditionally buy extravagant vacation homes in Lebanon have been banned to travel to Lebanon by their own governments for security reasons. Therefore, a major component of demand has come to a halt since 2012. Fourth, the housing market has grown excessively leveraged since 2007. The Central Bank provides subsidized interest rates on loans up to $500,000 per homebuyer. However, there exists a shadow financing market for home purchase outside the banking sector whereby developers offer the homebuyer to pay a small amount as a down payment as low as 5%, and the rest be paid off in equal installments during the construction period over 3 or 4 years, and 30% of the price would be settled at delivery. All these reasons combined have slowed down the housing market and led to excess supply which is reflected by hundreds of unoccupied dwellings in the streets of Beirut and elsewhere across the country. Was this really a housing bubble that has come to burst?

The housing market in Lebanon is under-researched. The main reason is the lack of time series data on home prices. Studies on the Lebanese housing market can be classified in two strands. One that analyzes housing from a pure urban dynamics angle, and another that examines the socio-economic dynamics of housing. For instance, Zein (1999) provides a historical account of the mortgage market in Lebanon in light of the Central Bank interventions in this sector. Gebara et al. (2016) investigate urban development in post-2000 Beirut using GIS data. Krijnen and Fawaz (2010) study regulations, public interventions, and construction modalities in Lebanon between 1990 and 2010. Fawaz (2016) examines construction “exceptions” that bypass urban planning bylaws which have led to significant distortions of urban territories and sovereignty arrangements and to the creation of slum-like zones on the peripheries of Beirut. Most studies admit that the housing market in post-war Lebanon is riddled with both, a high level of income inequality and dysfunctional institutions.

Research on the U.S. housing market also reveals that for government spending of $3 billion, a demand-oriented program serves 719,000 households, but the supply-side construction program would serve only 455,000 households for the same $3 billion expenditure.[4] This result indicates that providing mortgage subsidy or housing vouchers directly to homebuyers has far more outreach than the supply-side program for its lower transaction cost in identifying the needy households, contrary to the bureaucratic complications associated with applying subsidies to housing production. However, the obvious and evident cost of the demand-side program is the inevitable increase of housing price levels that will affect participants and non-participants alike.

In his book: *Housing Policies for the Urban Poor*, Raymond Struyk asks the question “Which Housing Policy is Best?” his answer was: “It depends. It depends on which objectives are weighed most heavily; on conditions in the housing market at the time the program is introduced, and on income trends, growth in the number of households, and the cost of producing housing. There is no single answer; indeed, there may not even be a single answer for each metropolitan area.”

Another area that needs to be tackled in making housing more affordable in Beirut in particular and in Lebanon in general is taxes. Capital gain tax is levied in most developed countries to help support financing public housing construction or providing rent subsidies to the poor. In Lebanon, usually the buyer of a real estate property pays a “registration fee” to the government. Unlike what is a common practice in other parts of the world, the seller does not pay a capital gain tax. A capital gain tax is the tax paid by the seller on the difference between the purchase price and the sale price. At best, it can be adjusted for inflation. For example, suppose someone purchased an apartment for $150,000 in 1995 when the Consumer Price Index (CPI) was 105. Suppose that in 2015, this person sold the apartment for $300,000 when the CPI was 180. That is, the nominal capital gain on this transaction is $150,000. However, the real capital gain if one adjusts this sale for inflation is only $107,000.[3] Therefore, a 10% inflation-adjusted capital gain tax should be levied on $107,000 instead of $150,000 resulting in $10,700 tax revenue due to government rather than $15,000. Applying capital gain tax brings additional funding to finance public housing programs.

Overall, in examining the economic dynamics of the housing market in Lebanon and in devising new housing policies, the following elements should be considered:

1. Inclusiveness of the program.
2. Impact on the price level of housing.
3. Balance between demand-side and supply-side programs.
4. Cost of implementing the program.
5. Financing of the housing program.

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[1] Increase in housing prices is based on data reported by Information International, issues of 2007 and 2013. Data on number of transactions of real estate is obtained from Economena.

[2] IMF Country Report No. 15/190, July 2015, page 4.
[3] The inflation rate between 1995 and 2015 is nearly 71.5%. Therefore, an amount of $150,000 paid in 1995 is equivalent to $257,000 in 2015.