



Palestine Economic Policy Research Institute

Round Table Discussion (1)

**The Construction Sector in the Palestinian Territory:
Is there real estate bubble?**

2012

Summary of Round Table Discussion

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Background and Rationale

The construction sector (housing in particular) in the West Bank and Gaza saw a significant growth in the early 1980s, with reported value added totaling \$ 300 million in 1987, just before the outbreak of the first Palestinian Intifada. The commencement of the peace process in 1991 coincided with a relative optimism in the Palestinian territory. This occasioned a marked improvement in the various economic activities, including the construction and housing sector. The relative growth in this sector continued until the late 1990s, with a value added standing at \$ 618 million in 1999. However, the years of the second Intifada induced a decline in all productive industries, including the construction sector. Relevant data indicate that the housing sector was among the most affected industries, such that its contribution to the GDP fell from 13.7% in 1999 to 8.9% in 2000. The relative contribution continued declining, hitting a rock bottom of less than 4% in 2002. It, however, started recovering again, standing at about 10% (526 million dollars) in 2010. Together with the value added of real estate activities, the contribution of the construction sector rises to 17% (Palestinian Central Bureau of Statistics, National Accounts).

With regard to prices, the Palestinian territory has seen no particular decline (or even stability) in prices of land, housing or commercial buildings since the mid-nineties. Head of the Contractors Association, engineer Adel Odeh, says that the annual average increase of prices of apartments is 10%, while the price of a square meter of construction land (in Ramallah) doubled between 2006 and 2012 (from 500 to 1000 Us dollars). Nevertheless, the prices have soared remarkably. For example, the price of 150-170 square meters apartments rose to 170 thousand dollars in the upscale neighborhoods in Ramallah. In contrast, two studies by the Palestine Economic Policy Research Institute (in 2002 and 2009) maintained that the price of an affordable 130-square- apartment was estimated at \$ 60 thousand.

Evidently, then, there have been substantial increases in prices; yet the talk about a bubble in the Palestinian real estate market is still questionable, since the rise in prices in itself is not a sufficient proof of the existence of a bubble. The answer to the question of whether such a bubble exists is not that easy, mainly owing to the lack of information on the real estate market. However, there are strong indications that the Palestinian real estate market has sustained a serious crisis which is manifested in two aspects: 1) There is a difference between what the public demands (in terms of areas and prices of apartments) and what is supplied; and 2) The emergence of an unprecedented recession in the real estate market since the second half of 2011- a recession which qualifies as a severe crisis. In spite of the downturn in sales, the building licenses have not so far seen a slowdown. The number of new residential building permits even increased by 42% in the fourth quarter of 2011 compared to the corresponding quarter of 2010.

Given that bubbles often lead to adverse economic implications that accompany the slump of liquidity in the banking sector, and as they trigger devastating social consequences (as many households are forced to leave their homes and declare bankruptcy), it is MAS's intention to shed light on this issue. Many questions will be raised before experts and business stakeholders in the roundtable meeting.

Participants

Keynote speakers:

Dr. Nidal Sabri Professor of Accounting and Finance at the University of Birzeit
Mr. Issa Kassis: General Manager, Palestine Mortgage and Housing Corporation

Nizar Al Rimawi: Chairman of Union of Palestinian Developers

Key questions for discussion

First: What are the main structural problems facing the real estate market in Palestine?

Second: Is there a real estate bubble that might burst in the Palestinian territory? What will be the consequences of such a burst?

Third: What policies can be put in place: first to reduce the quantitative and qualitative gap between supply and demand in the Palestinian territory, and second to avoid bottlenecks in the real estate market?

Summary of the Main Contribution

Dr. Nu'man Kanafani, Research Coordinator of (MAS) and moderator, summarized the background paper prepared by MAS for discussion. He said:

"A real estate bubble is a run-up (not justified by objective facts) in land and real estate prices. This run-up continues even when the supply is lower than the demand. It is fueled by speculation, lack of information and the belief that recent history is an infallible forecast of the future which will always see a rise in prices. At some point of time, demand decreases and supply increases, resulting in a sharp drop in prices - and eventually the bubble burst.

Economists have developed a set of indicators to anticipate a bubble before it bursts; yet there is no general agreement among them. The Housing Affordability Index measures the ratio of median house prices to median familial disposable income. When this ratio exceeds 4, it is an indication of the existence of a bubble. The main reasons behind the emergence of bubbles are the lack of information (e.g. on actual future demand for housing); poor expectations (e.g. expectations on what others do: How much profit they gain); and slow response (long construction period).

❖ Real estate market in Palestine

Over the past forty years, the housing sector in Palestine has experienced many developments in terms of supply and demand. However, the price of land and housing has not seen any decline or stability since the mid-nineties. Head of the Contractors Association, Engineer Adel Odeh, says that the annual average increase of prices of apartments is 10%.

Concerning the reasons behind this considerable, ongoing increase in prices, experts interviewed believe that many reasons led to such a steady increase: the limited land, especially in the cities (areas A and B); an increase in the number of speculators; and a rise in the demand for apartments, which is attributed to many reasons (the increase in population, the education factor that links between safety and ownership, an increase in the facilities offered by banks and the concentration of economic activities in major cities).

❖ Is there a real estate bubble in Palestine?

Given the lack of information on the real estate market, there will be no conclusive answer to this question. However, there are strong indications that the Palestinian real estate market is experiencing a serious crisis which is manifested in two aspects:

- There is a difference between the public demands (in terms of areas and prices of apartments) and what is supplied. The supplied apartments do not fit with the requirements of the public, whether in price or in size.
- The emergence of an unprecedented recession in the real estate market since the second half of 2011- a recession which qualifies as a severe crisis. In spite of the recession in sales, the building licenses have not so far seen a slowdown.

❖ **Will the bubble burst (assuming it exists)?**

There are two points of view regarding the possibility of the bubble burst:

The first view argues that the situation in Palestine is exceptional, and thus what occurs in the other parts of the world may not well apply to the Palestinian case. The real estate bubble in Palestine, if any, cannot burst due to several reasons, including the limited land and the reliance of the majority of Palestinian developers on their own funds. The current recession is not new; indeed it occurs whenever a political solution is intractable.

The other view believes that the mismatch between supply and demand is considerable, especially in terms of prices and areas of apartments. The belief that developers are able to continue to freeze millions of dollars and wait a long time is unrealistic. The strict laws regulating rents preclude these contractors from leasing housing when the sale market is down.

What are the potential consequences of a real estate bubble burst (assuming the existence of such a bubble)?

Would a bursting bubble in Palestine lead to devastating effects like those other countries sustained? In general, the answer is 'no'. Those who argue that the bubble will not burst believe that the degree of exposure of banks and Palestinian mortgage institutions to real estate loans is relatively limited.

On the other hand, the potential consequences of a collapse in prices should not be underestimated. The number of mortgage loans totaled about 12 thousand, suggesting that 12 thousand households might sustain bankruptcy (the value of their debt becomes more than their property: the houses they dwell) once the prices decline."

Summary of keynote speakers

Mr. Issa Kassis outlined the factors that lead to a bubble in real estate, such as: difficulty in creating equilibrium between supply and demand due to the lack of reliable data before the developer and the public; poor government oversight on the banking system; speculation (which leads to unjustified surge in prices); and selectivity when buying a residential unit (i.e., not all housing units are sold). Though some of these factors do exist in the Palestinian real estate market, Kassis believes that the Palestinian market is enjoying some growth. It has not, thus, fully developed into a bubble-like. It is still an emerging, promising market, particularly in light of the growing population and the increasing demand for housing.

However, Mr. Kassis emphasizes the need to take actions that would develop the real estate sector— preventing a real estate bubble from building up. The recommended steps include reinforcing the banking regulatory system; creating a meeting point between supply and demand through the control of the market; encouraging registration of real estate since banking facilities are only granted to real estate officially registered (a problem Palestine faces); increasing transparency and the provision of economic data on an ongoing basis; controlling the sharp rise in prices; and controlling geographic concentration of housing units.

Mr. Kassis further addressed the role of mortgage companies in informing the financial stability through its support of the housing sector, as they provide the means and capabilities that lead to a safe, effective emergence and development of this sector in a way that reduces risks the mortgage markets in the world have lately experienced.

Engineer Nizar Al Rimawi believes that despite the problems in the real estate sector (which begins with purchasing the land and ends with the delivery of the apartment to the consumer), the real estate sector in Palestine does not experience a property bubble. Mr. Rimawi talked of the sensitivity of this issue and the need for caution and scrutiny in communicating information. The rumor about a bubble in the market would create a bubble. Despite the high demand for apartments in Ramallah (the temporary political and economic capital— home of government institutions and

non-governmental organizations), no real bubble is building up. According to Rimawi, the unlikelihood of such a bubble is due to the limited amount of tradable land as a result of the Oslo Accords, which classified the Palestinian territory into A, B and C areas and demarcated them accordingly. Besides, much of the A-area land is untradeable because of the problems of inheritance that accumulated through several generations.

Mr. Rimawi concluded that the prices of apartments in Palestine are reasonable. The recent downturn, he expounded, is closely related to the political situation, and is not peculiar to the real estate industry; rather it extends to all other industries, suggesting that a real estate bubble is a myth.

Last speaker, Dr. Nidal Sabri, concluded with a test of nine criteria. The availability of these criteria signals a real estate bubble in the Palestinian housing sector, while the inexistence of these standards is a sign that such a bubble is a figment, Sabri said. These criteria are: an extraordinary increase in the volume of investments; an exceptional growth in the number of building licenses and areas; an increase in the rate of housing loans; a decrease in rates of commercial lease; a notable increase in contributions to capital formation and gross domestic product; a drop in the ratio of the prices of housing units to the average income; a more than 200% increase in the ratio of debt to the proprietorship of real estate companies; a drop in rates of profitability of various housing projects; and a rise in the value of the assets of construction companies. Sabri believes that because not all these criteria have been reported in the Palestinian market, one cannot safely conclude that a bubble is building up.

With respect to investments, Professor Sabri maintained that the volume of investment in the real estate sector was normal if compared with 1999, when it peaked at \$ 1050 million. Even in that year, the boom did not develop into a bubble. In addition, the growth in the value of mortgages is modest; and the percentage of loan facilities granted to mortgage industry is barely 9% of total loans. Regarding debt, Sabri asserted that the ratio of debt is scarcely 15% for real estate companies (such a low percentage cannot of course qualify as a bubble). By the same token, the real estate sector, at best, has only 8% as value added.

Sabri also spoke of previous sources of supply in the Palestinian market, including the public sector, the municipal sector and local governments, UNRWA, the private sector and cooperative housing projects. He said that because these sectors refrained from supplying housing units, the likelihood of a bubble has diminished.

Finally, Professor Sabri outlined the policies that must be adopted to eliminate a real estate bubble. In terms of financing policies, Sabri recommended setting and controlling loans granted by the Monetary Authority. With regard to tax policy, he suggested imposing taxes that would reduce investment in real estate. Concerning policies for construction license, he advised the government to increase license fees.

Summary of the Discussion

Attendees engaged actively in the dialogue after the experts had concluded their contributions. The discussion went on in an intimate, harmonious and professional manner. Below is a summary outlining the inputs provided by the participants in the dialogue session:

Mr. Ali Faro'on (Director of public relations and market discipline - the Monetary Authority) highlighted the difficulty of predicting a bubble due to the lack of data on the developers sector from the Monetary Authority. He said that in order to take appropriate actions, there should be accurate data available before policymakers.

Mr. Adel Odeh (Head of the Contractors Association) remarked that this sector is closely related to the political situation. He also spotlighted the outrageous increase of prices of land and buildings. Further, Odeh echoed what other speakers said concerning the bubble myth, describing what is happening as only poor organization, especially by the government.

Ms. Lena Ghbaish (Director General of Mortgage) addressed the ongoing rise of land and apartment prices; the impact of speculation; and the scarcity of land. She remarked that the actual volume of mortgage lending is greater than what is reported, since 70% of mortgage lending is granted informally.

Mr. Afif Said (from the Ministry of Works) reviewed the reasons behind the surge in the price of land and apartments, including splitting and scarcity of land; and the rise in prices of construction materials on a monthly, and sometimes, daily basis. He also reiterated that there is no real estate bubble; rather this sector is only 'floundering'. He underscored the need to revisit the PNA regulations; amending the laws of strict rent; and promoting building in area C.

Mr. Jafar Hudeib (CEO of Investment Promotion Board) restated that the talk of a bubble is only hypothetical. What the real estate sector is experiencing is a muddle, he said. Hudeib also tackled the extraordinary situation in Palestine, where developers and investors invest their personal funds and do not resort to banks. He looked over the negative impact of occupation on the Palestinian real estate market, especially settlements and the confiscation of land, and the consequent impact on horizontal construction.

Mr. Ala Abu Ein (Director-General of Royal Group) addressed the nature of real estate investment in Palestine, saying that it depends on personal savings. Investment in this industry is safe because of a cultural matrix which sees home ownership as a basic need. In addition, most Palestinians real estate investors are individuals or microenterprises, Abu Ein said.

Dr. Said Haifa (Professor of Economics at the University of Birzeit) believes that the Palestinian real estate market is stalled, pointing out that what is happening in the real estate market is not an increase in supply, but a slowdown in demand, i.e. there is a gap between supply and demand in the market. Haifa stressed the need to allocate part of the price of an apartment to cover the price of the land.

Key Recommendations

The round-table meeting was concluded with a number of recommendations, namely:

- ✧ Reinforcing the banking regulatory system and its effectiveness.
- ✧ Creating meeting points between supply and demand through controlling the market.
- ✧ Energizing the role of the public sector in taking immediate prudential procedures to meet the housing needs whenever the market is reluctant to supply.
- ✧ Developing strategies to encourage construction in area C.
- ✧ Boosting transparency and providing detailed real estate data on an ongoing basis.
- ✧ Reducing the surge in the prices of apartments by placing some controls.
- ✧ Amending certain laws involving the development of the real estate sector, including the Rent Act.

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Name	Institution
Dr. Nidal Sabri	Birzeit University
Dr. Sa'id Hayfa	Birzeit University
Shadi Rimawi	Engineers Union
Ghadeer Haifa	Arab Bank
Rasha Suleiman	Ministry of Local Government
Shireen AL Ahmed	PMA
Mohammed Tarshan	Ministry of Planning
Samer Odeh	Palestine Land Authority (PLA)
Majdi Nouri	PCMA
Shehadeh Huseein	PMA
Wa'el Abbas	Amar Real Estate
Hazem Shunnar	Ministry of National Economy
Ibrahim Abu Kamesh	Alhayah Aljadeeda
Afeef Sa'id	Ministry of Public Works and Housing
Bilal Ghaith	Ma'an News Agency
Jamal Hourani	Arab Bank
Firas Al Karaki	PIF
Rabee' Dakoon	PMA
Mohammed Atallah	PMA
Amal Daraghme	OGARIT group
Dr. Nizar Rimawi	Union of Palestinian Developers
Mohammed Qirresh	Palestinian Economists' Association
Naseem Shaheen	Legislative Council
Su'oud Abdul Fattah	Palestinian Standards Institution
Izzat Shu'aibi	PMA
Ayman Qan'eer	PCBS
Bassam Sha'lan	Ministry of Public Works and Housing
Hani Fannoun	Palestine TV
Maher Al Masri	PCMA
Issa Qassis	Palestinian Mortgage and Housing Corporation
Mohammed Antari	PCBS
Jawad Sa'adeh	Ministry of Public Works and Housing
Lina Ghbeish	PCMA
Khaled Awartani	Islamic Arab Bank
Arwa Abu HashHash	MAS
Jameel Taher	PIF
Ra'fat Al Jallad	AMAR group
Nawwaf Sa'd Aldin	AMAR Group
Muna Sal'ous	PIF
Firas Tneenah	Ma'an News Agency
Khaled Akram Faris	Al Nabali and Al Faris Real Estate
Ja'far Hdeib	PIPA (Palestine Investment Promotion Agency)
Ala' Abu Ein	ROYAL group
Osama Amro	Abaad Contracting Company