THE SUPPLY OF REAL ESTATE CREDIT

IN LEBANON

by

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ACKNOWLEDGEMENTS

This work started in mid 1964 when the writer discussed with Dr. Salim Hoss, the then Chairman of the Department of Business Administration at the American University of Beirut, the construction activity which boomed in Lebanon over the past ten years. Interest arose regarding the role of real estate credit in this construction boom. Consequently a tentative outline was arranged, and with the generous cooperation of Professor Zuheir Mikdashi of the Department of Business Administration, a questionnaire was prepared to be answered by a group of specialists in the field whom the writer planned to interview.

For his field research, the writer has had the cordial assistance of many persons actively engaged in business finance, banking, insurance, law, engineering and construction. Above all, the staff Management of the Chase Manhattan Bank N.A. Beirut Branch, namely Messrs. Patrick K. Healey, Vice-President, David H. Sambar and Peter Larr, both Assistant Managers, should be gratefully mentioned for allowing the writer to leave during the Bank's time, for arranging the interviews with other local banks, and for their advice on credit policies. The writer has been greatly benefited from reading their credit-review letters, being an employee of the above bank.

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To them and to other unmentioned businessmen who have been helpful in collecting material and information, the writer expresses his deep gratitude and appreciation, and dedicates this thesis in the hope that it may in some way contribute to the progress of construction in accordance with the need of the Lebanese citizens.

INTRODUCTION

Over the last ten years, the construction activity has reshaped considerably the geographical features of Lebanon. Observers were amazed at the speed in which multi-storied buildings were constructed.

This thesis contains a detailed study of the credit aspects and practices of the construction sector in Lebanon. It may therefore provide a guide to adopt a new credit policy which would conform more to the financial need and capacity of the Lebanese citizens.

To introduce the topic, the writer means by "supply" the sources of funds. The term "real estate", mentioned together, denotes an estate or a property which is not personal or movable, such as land and buildings. For the purpose of this thesis, "real estate" refers to private-building construction in Lebanon. The period covered in this study extends from 1953 to 1963. Furthermore, the discussion is limited mainly to private-building construction which has taken place in the Mohafaza of Beirut, the capital, as no statistics covering the whole territory are available or could be obtained. In the writer's opinion, the number of square meters licensed for construction in the capital city (Beirut) reflects to a large extent the general trend for the whole country of Lebanon. As for "credit" definition, writers in the field have not been able to agree among themselves. However, the following twofold definition of credit seems tenable:

"1) Credit from the standpoint of the borrower is the ability to obtain goods, services, money or the promise of money, in return for a promise to pay an equivalent amount in the future.

2) Credit from the standpoint of the lender is the confidence felt in the integrity and solvency of a prospective borrower which enables such borrower to obtain goods, services, and money in the present on the strength of his promise to pay an equivalent amount in the future."[1]

Obviously, the distinguishing characteristic of credit is the time element, since a credit transaction is not completed immediately. It is a present transfer of wealth, or title to wealth, in consideration of future payment of an equivalent value agreed upon by the two parties, the borrower and the lender.

Since this thesis studies mainly credit for construction purposes, the topic "The Supply of Real Estate Credit in Lebanon" refers to the sources of credit that have been available for real estate construction activity in Lebanon between 1953 and 1963. Accordingly, the writer discusses the three sources of credit that have been available for the construction activity, namely: Commercial Banks, money lenders, and other specialized financial institutions.

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[1] Erwin W. Boehmler et al., Financial Institutions (Homewood, Illinois: Revised Edition, Richard D. Irwin, INC. 1956), p. 37.

The thesis is divided into the following chapters:

The first chapter investigates the evolution of the real estate construction activity together with the demand determinants of rental space.

The second chapter explains the general credit principles and practices applied by real estate creditors together with the legal documents and considerations required.

The third chapter studies the policies and practices of commercial banks regarding the terms of their credit extended to businessmen participating in the construction activity. As for the information and statistics obtained, they are entirely approximations because not a single manager of the accredited banks interviewed admitted that he maintains separate credit files or accounts for real estate loans. This is really an obstacle to researchers and policy makers in the Government.

The fourth chapter investigates the methods and terms of credit as practiced by money lenders. These are classified as: professional money-lenders, semi-professional money-lenders, and merchants. Traditionally, money lenders have always been a limited direct source of credit for real estate construction. Statistics covering that source of credit are not available, but the Notary Public of Beirut, and the director of the Land Registry have availed the writer with approximate information which was of great help in arriving at a generalization regarding the credit policy followed by that source. Moreover, the writer's personal contact with some money lenders have confirmed greatly the information obtained from the previous source.

The fifth chapter discusses the credit policies of various specialized financial institutions which have been engaged in real estate business directly, or which have been an indirect source of credit for the construction activity. These are real estate business concerns, insurance companies, and other specialized banks.

Finally, chapter six points out the emerging housing problem, and includes an evaluation of the adequacy of real estate credit as extended by the above sources. As a conclusion, the features of the available real estate credit appear inadequate to cope with the emerging housing problem, and a solution was suggested, which, if implemented, might help in channelling the necessary funds required for solving the problem.

CHAPTER I

CONSTRUCTION ACTIVITY IN LEBANON[1]

A. Evolution

During the Second-World War and in the late forties, Lebanese real estate owners were facing the problem of protecting their properties. They had either to guard their properties themselves, or to find an honest tenant to occupy the house, paying some nominal rent according to his convenience.

It was after 1943, the independence year, that the construction activity in Lebanon started to reshape its geographical features. In fact, Lebanon is currently facing "a severe housing problem which is rapidly becoming a major preoccupation for the Lebanese Government. The crux of this problem is that the greater part of the construction represents luxury apartment houses with modern facilities such as lifts, central heating, telephones, etc... which, due to their high level of rents are beyond the means of limited and low income groups who represent an important segment of Lebanon's population."[2] Partly for that reason, many apartment houses in luxury buildings have remained vacant, while popular residences have scarcely been sufficient to house limited income

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[1]The present chapter draws heavily on the analysis contained in Alfred A. Sehnaoui, "Private Building Construction Activity in Lebanon," unpublished M.B.A. thesis, Department of Business Administration at the American University of Beirut, 1963.

[2]"A New Housing Council for Lebanon," Middle East Express, (April 1, 1963), p. 3. (Quoted in Sehnaoui, op.cit., p. vii).

groups. This has caused a period of recession in the construction market between 1960 and 1962, as indicated in Table I below, which marks a drop in the number of permits granted in 1961 from 1226 to 982, and in 1962 from 989 to 869.

However, in 1963, the Lebanese Government issued a decree which allowed real estate owners to erect buildings and sell them by apartments.[1]

TABLE I

NUMBER OF CONSTRUCTION PERMITS GRANTED IN

BEIRUT AND TRIPOLI BETWEEN 1953 AND 1963

Year	Number of permits Beirut	Tripoli	Number of storeys Beirut	Tripoli	Surface in Sq. meters of storeys Beirut	Tripoli
1953	798	331	1.536	447	317.681	70.332
1954	1.055	284	1.848	429	423.037	74.812
1955	1.261	323	3.063	459	642.393	87.594
1956	884	290	2.599	442	530.480	90.110
1957	846	302	2.221	413	430.929	67.585
1958	609	163	1.499	226	389.321	44.427
1959	1.083	303	2.934	496	606.230	106.684
1960	1.226	355	3.231	653	704.211	134.202
1961	982	298	2.987	602	664.845	123.575
1962	869	427	2.271	815	572.184	184.047
1963*	1.071	270	2.575	520	770.000	119.000

Source: Bulletin Statistique Trimestriel, Ministry of Planning. Beirut, 1962, Vol. XII, p. 22.

* Bulletin Statistique Mensuel, Ministry of Planning. Beirut, August 1964, Vol. 2 Number 4, p. 32.

[1] Al-Jaridah Al-Rasmieh, Vol. 1, January 3, 1963, p. 1.

This has partly enhanced the construction activity as the low income group can now afford to own houses by paying certain instalments out of their annual salaries, and hence a new market for the construction business is created. Table I indicates that in 1963, the number of permits granted in Beirut increased from 869 up to 1071.

Although not all holders of licenses utilize these construction permits, there are good reasons to believe that the figures in Table I are representative of the volume of construction. As a matter of fact, before a permit is issued, a final draft of the project has to be submitted to the Municipality which, upon approving it, collects a fee in proportion to the number of square meters licensed. Collection fees are practically calculated as follows:[1] A rate of 1½ percent of the market price per square meter of the plot of land upon which the building is to be erected is used for the first five storeys, the fee to range between a minimum of LL 0.25 and a maximum of LL 10 per square meter. Another rate of 2½ percent is used for the storeys above the fifth with a similar provision that the fee should range between a minimum of LL.50 and a maximum of LL 15 per square meter.

Thus, no one would normally go into such trouble and incur the required expenses, unless he is certain of implementing his scheme. Furthermore, it would not matter whether all the figures in Table I are overstated by the same proportion, since relative rather than absolute values are more significant here.

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[1] Decree issued on January 20, 1964, as an amendment to Decree No. 61 issued on August 30, 1940, which is related to construction.

B. Geographical Distribution of Construction

Table II below indicates the number of construction permits licensed during 1962 and 1963 in the following important cities:

Beirut - The Capital.

Tripoli - important city in North Lebanon.

Saida - important city in South Lebanon.

Zahle - important city in Bekaa.

(No data were available for these cities before 1962).

TABLE II

NUMBER OF CONSTRUCTION PERMITS GRANTED IN

BEIRUT, TRIPOLI, SAIDA AND ZAHLE IN

1962 AND 1963.

Year	City	Number of permits	Number of storeys	Surface in sq. meters of storeys
1962	Beirut	869	2271	572.000
	Tripoli	427	815	184.000
	Saida	62	93	26.400
	Zahle	246	122	24.000
1963	Beirut	1.071	2575	770.000
	Tripoli	270	520	119.000
	Saida	44	71	19.640
	Zahle	519	514	75.000

Sources: Bulletin Statistique Mensuel, Vol. I, No. 2, December 1963, p. 22, for 1962; and Bulletin Statistique Mensuel, Vol. 2 No. 4, August 1964, p. 32, for 1963.

As revealed in this Table, the bulk of the construction activity took place in Beirut. In fact, this city boomed with private building activity, and its residents were amazed by the speed at which multi-storied buildings were constructed, to the the extent that the once-familiar streets became almost unrecognizable. Even sound buildings were sometimes demolished to give way to more modern and higher ones.

Since construction statistics covering the whole Lebanese territory are not available, the writer has assumed that the trend in the number of square meters licensed in Beirut city, reflects to a large extent the general trend for the whole country (see Table I).

C. Demand For Construction

Real estate construction activity in Lebanon is affected primarily by the demand for rent, which is in turn affected by the following essential economic factors:

1. Population growth and cultural changes.
2. Changes in per capita income.
3. Tourism and number of foreigners established in the country.
4. Changes in the level of economic activity.
5. Aspects of rent regulations.

1. Population Growth and Cultural Changes

The increase in population is one of the major factors influencing the demand for rent, and specially if it is associated with an increase in the national income and/or per Capita income as is the case in Lebanon. It was estimated that the national income of Lebanon had been increasing at a faster rate than population during the fifties.[1]

Although population growth has not been accurately calculated, it is estimated by experts to be about 2.3 percent per annum.[2] The Institut International de Recherche et de Formation en Vue du Developpment Integral et Harmonise (I.R.F.E.D.) (institute specialized in economic development, employed by the Lebanese Government in 1959 to advise an economic development) estimates that 1.416,570 individuals, excluding foreigners, lived in Lebanon in 1953. This figure rose to 1.626,000 in 1960, representing an increase of approximately 210.000 in eight years.[3] Emigration has dropped from 15.000 departures a year, between 1900 and 1914 to 4,400 departures a year between 1921 and 1939, and to 3,000 departures a year at present.[4] (These figures do not include the number of temporary emigrants to neighbouring countries).

Cultural change is also a significant factor in the demand for rental space. Newly-wed couples tend to avoid living in the house of their parents, a fact which has increased the demand for residences.[5] Moreover, the improvement in the level of education, coupled with the

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[1] Infra, p. 13.

[2] I.R.F.E.D. Mission, Lebanon Faces Its Development, 1963, p. 231.

[3] Ibid., p. 231.

[4] Ibid., p. 232.

[5] J. Donato et al., L'Habitat dans la Vie Libanaise (Beyrouth: Les Editions Orientales, 1961) p. 67 (Quoted in Sehnaoui, op.cit., p. 23).

attractions that the city offers, have brought about an exodus from rural regions to urban centers where more renumerative jobs are available, and where life conditions seem more attractive.[1] Consequently, these individuals who used to live in the family home in the rural areas, have to rent an apartment, or at least a room in the city.

Lastly, the urge of some middle class and rich bachelors to own private apartments for multi-purpose uses, was an aspect of cultural change that has affected the demand for residences, and consequently, the real estate construction activity.

2. Changes in Per Capita Income

It was mentioned earlier that the national income of Lebanon has been increasing, at least since 1950, when the first estimates of national income were accomplished by professor Albert Badre of the American University of Beirut. Regarding his computations, Professor Badre admitted that he had to resort to some unsubstantiated assessments which reduced the accuracy of his findings. After him, Professor Paul Klat, of the American University of Beirut, "extrapolated" Professor Badre's figures and came out with the results shown in Table III below for 1961. The Table reveals an increase in national income each year, except in 1958, a year of political disturbance. In fact, the national income has been increasing at annual rates varying from 3 to 9 percent between 1952 and 1957. The average of these rates was about 5 percent per annum.

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[1] *Ibid.*, p. 67.

TABLE III

THE NATIONAL INCOME OF LEBANON

1952 - 1958 AND 1961

(At current factor prices in LL millions)

Year	1952	1953	1954	1955	1956	1957	1958	1961
Trade	333	344	368	407	410	469	365	468
Agriculture	216	221	226	223	231	238	219	330
Industry	155	161	166	175	183	189	181	218
Ownership of Buildings	98	101	112	116	130	139	155	194
Services	106	122	134	165	160	148	104	180
Construction	48	47	60	60	50	41	38	69
Government	64	71	73	83	95	108	113	152
Transportation	45	50	60	75	78	80	57	68
Finance	50	51	57	70	80	91	93	110
Total	1.115	1.168	1.256	1.374	1.417	1.503	1.325	1.789

Sources: F.A.O. Mediterranean Development Project, Lebanon, Country report. (Food and Agriculture Organization Of The United Nations Rome, Italy, July 1959) Chapter II p. 13, and "The National Income of Lebanon," Middle East Express, (April 2, 1962), p. 3, for 1961.

Critics question the validity of the figures shown in Table II above, because of extrapolation. However, in the absence of any other reasonable assessment of national income, professor Klat's figures are used. Moreover, the I.R.F.E.D. Mission estimates the increase in national income at 4.4 percent per annum. If the population expands at a rate of 2.3 percent per annum, the Lebanese citizen is, on the average, better off by 2.1 percent every year.[1]

Unfortunately, statistics correlating the increase in per capita income with the increase in demand for rental space are not available. However, since the standard of living of the Lebanese population is low as compared to European standards, it is possible to conclude that any increase in income would have to be spent largely on necessities such as food, clothing, and lodging.

3. Tourism and Number of Foreigners Established in the Country

Foreigners who come to Lebanon have either directly or indirectly influenced favourably the demand for rent. Lebanon, by virtue of its unique position on the Mediterranean shore and excellent natural facilities, has long been a resort for holiday makers from neighbouring Arab countries, and from all over the world.

Excluding the year of political disturbance (1958), Lebanon has witnessed a marked increase in the number of tourists and visitors who came in for one reason or another between 1953 and 1963, as is revealed in Table IV below:

On the one hand, the demand of tourists for temporary lodgings and accomodations has encouraged the construction of hotels. Considering the increase in the importance of tourism to the national economy, the Lebanese Government included as a major objective of the Banque de Credit

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[1] Lebanon Faces Its Development, p. 237.

TABLE IV

LEBANON - NUMBER OF TOURISTS AND VISITORS

1953 - 1963

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963
Foreigners	124220	152427	179148	190815	180490	98032	183551	233083	289330	331623	388253
Syrians	160853	544008	722336	668339	369098	126413	179676	379000	235055	294204	324609
Total	285073	696435	901484	859154	549588	224445	363227	612083	524385	625827	712862

Source: "Commerce Du Levant" Numero special pour L'annee 1963, dans L'economie Libanaise et Arabe, March 4, 1964, p. 20. (the figures were made available by the Commissariat General au Tourism).

Agricole, Industriel et Foncier (a semi-public development bank established in 1954), the financing of hotel construction, and any projects that would encourage tourism, at favorable credit terms, as explained later in chapter V. In fact, many of Beirut hotels, such as Phoenicia, St. George, Carlton, and Commodore hotels, not only rival, but even excel in facilities, luxury and comfort, the world's best hotels.

On the other hand, foreigners who have resided semi-permanently in Lebanon have also encouraged the construction activity in many districts, mainly in Ras Beirut, Hamra Street and the Pigeon Rock area. These foreigners have not only been attracted by the moderate climate and the impressive geographical features of Lebanon, but also by its free economy. Foreign banks, insurance companies, stock-brokers, industrial concerns etc.... have been flourishing in Lebanon, and consequently affecting the demand for rental space of offices as well as of apartment houses.[1]

[1] J. Donato et al., p. 67. (Quoted in Sehnaoui, op.cit., p. 27.)

Statistics as to the number of foreigners that have been established in Lebanon are unfortunately unavailable. However, though not very reliable, estimates put the figure of foreigners established in Lebanon at more than 200,000.[1]

4. Changes in the Level of Economic Activity

The free economic system adopted in Lebanon is very attractive to both foreign and local traders, and some industrialists. In 1948, the Lebanese Government issued a law adopting a free foreign exchange system which was later amended as of September 26, 1949. The law provided: all exchange transactions could be undertaken without any restriction or control, and any amount of funds freely brought into Lebanon could be transferred out of it.[2] A further and equally important stimulus was devised by the Government when it enacted a law on February 5, 1954, exempting new corporations from income tax for a period of six years provided they possess the following qualifications:

a. A new type of business, which would increase and develop the national economy of Lebanon.

b. A paid up capital of LL 1 million, invested in Lebanon as of the establishment date.

c. Total wages and salaries paid to Lebanese employees amounting to more than LL 100,000 per year.

d. Business to be started within a period specified by the exempting decree.

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[1]"The Delhameyeh Country Club," December 1962, a brochure inviting potential stockholders to contribute part of the capital needed for a country club project, devised by Messrs. Kettaneh F.A., S.A.L. (Quoted in Sehnaoui, op.cit., p. 26.)

[2]Collection of Lebanese Laws. Decree No. K/16369, Sept. 26,1949.

The 1954 exempting law was later extended for another five years as of January 13, 1959.[1]

Import and export figures since 1953 have been steadily increasing, except for 1958, which was an unusual year of political disturbance. Furthermore, Table V below indicates that income originating from the trade sector has been increasing proportionately.

TABLE V

IMPORTS, EXPORTS, AND CONTRIBUTION TO NATIONAL INCOME BY THE COMMERCIAL SECTOR

1953 – 1963

(Rounded in million Lebanese pounds)

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963
Imports	362	484	527	561	627	518	700	855	1061	1049	186
Exports	88	106	121	146	152	111	139	218	397	192	193
Contribution to National Income	344	368	407	410	469	369	Not available		468	Not available	

Sources: Bulletin Statistique Trimestriel, Ministry of Planning, Beirut, 1960-61 Vol. XI, for import export figures till 1961, and Le Commerce du Levant, March 4, 1964, p. 1. for 1962 and 1963 figures. Table III for national income figures.

On the basis of the import figures of Table V, one can estimate that three times as much storage and display space may have been needed

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[1] Ibid., Decree No. 8, issued on January 13, 1959.

in 1962 and 1963 as compared to 1953. Hence it is logical to conclude that the tremendous expansion in foreign trade as between 1953 and 1963 has boosted the demand for construction or rental space.

By the same token, one can conclude that the Industrial expansion which Lebanon has recently witnessed, must have boosted the demand for construction or rental space. Statistics of 1955, which comprised the number of industrial enterprises having more than five laborers, indicate an increase from 291 in 1913, to 1861 in 1955, and that a yearly expansion has been taking place since 1945.[1]

5. Aspects of Rent Regulations

Owners of old buildings complain of the low rent income from their buildings. New leaseholders complain of the high rent they have to pay for their lodgings. Consequently, in order to attain a higher degree of equity and social justice, the Lebanese Government issued in 1944 rent regulations with an intention to reduce the gap between old rents which are low, and new ones which are relatively high.[2] Rent regulations have been continuously promulgated almost each year, and were adjusted as of May 7, 1954, June 21, 1956 and July 31, 1962.[3]

From an economic point of view, these rent regulations have had an impact on the demand for rental space, and on the supply of real estate construction. Our concern here is with the former.

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[1] Lebanon Faces Its Development, p. 261.

[2] Rent Regulations, Feb. 29, 1944, Collection of Lebanese Laws.

[3] For a complete analysis of these rent regulations refer to Sehnaoui, op.cit., p. 49 and p. 115.

As an illustration, Article 11 of rent regulations passed on July 31, 1962 reads:[1]

Starting as of January 1, 1962, rents will have to comply with the following:

a. Rents contracted before January 1, 1941, are subject to the following increments, over and above any previous increment:

Category 1- Commercial and industrial real estate:

15 % in 1962

20 % in 1963

25 % in 1964

30 % in 1965 and 1966

Category 2- Other real estate:

10 % in 1962

15 % in 1963

20 % in 1964

25 % in 1965 and 1966

b. Rents contracted in 1941 are subject to three quarters of the increments stated above.

c. Rents contracted between January 1, 1942, and June 30, 1943, are subject to half the increments stated above.

d. Rents contracted between June 30, 1943, and January 1, 1962, are subject to a 15 percent reduction.

The impact of these rent regulations on the demand for rental space has been:

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[1] Al-Jaridah Al-Rasmieh, Vol. 31, August 1, 1962.

a. Some people started to shift from old houses to newer ones as the gap between old and new rents was reduced.

b. People who shifted from old houses to new houses may have tended to some extent to rent larger apartments than those formerly occupied by them. This is due to the Law of Marginal Utility, which may be clarified in the following illustration:[1]

Assume that a large family is living in a small apartment, paying a low rent of LL 60 per month as compared to LL 90 per month rent of a similar new apartment.

In fact the family needs a bigger apartment, but the reason why it may not be willing to move from its small and old house is that it would have to pay for the new and larger house, approximately LL 90 pounds. Hence from a utility point of view, the family is more satisfied in saving LL 30 per month, and bearing the inconvenience of crowdedness.

When the Lebanese Government passes a law allowing the owner of old houses, occupied by old tenants, to increase rents by 30 percent, this family would prefer to move to this new larger house for which it has to pay LL 90, rather than staying at the smaller and older house and pay LL 78. This involves an additional sacrifice of only LL 12 per month as compared with the former additional sacrifice of LL 30 per month.

Hence, while reducing the gap of injustice between leaseholders and owners of real estate, the Lebanese Government may have promoted the shift in demand from small and old real estates to larger new ones. Thus a net increase in demand for rental space has been boosted.

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[1]A similar illustration is reported in Sehnaoui, op.cit., p. 30.

D. Summary

After the Second World War, the construction activity has reshaped considerably the geographical features of Lebanon. The increase in population, cultural change, and per Capita income are factors responsible for the increased desire of the Lebanese citizens to occupy additional space. Also, the expansion of the tourist industry, and the increase in the number of the established foreigners have boosted the demand for real estate construction. Similarly, the expansion of commerce and industry are to be considered partially responsible for such a growth. Finally, the rent regulations issued by the Government, to attain a higher degree of equity and social justice, may have unintentionally shifted the demand for modern rental space, and consequently for real estate construction.

Having studied the demand determinants of real estate construction activity in Lebanon, the writer proceeds in the remaining chapters to analyze a major determinant of supply namely, the availability of credit.

CHAPTER II

REAL ESTATE CREDIT AS A MAJOR DETERMINANT OF THE CONSTRUCTION ACTIVITY

The distinguishing characteristic of credit is the time element, since a credit transaction is not completed immediately. It is a present transfer of wealth, or title to wealth, in consideration of future payment of an equivalent value agreed upon by the two parties, the borrower and the lender.

For financing construction in Lebanon, credit is available in much larger quantities than to any other sector of the same long term nature such as industry. This point will be discussed more fully in the remaining chapter. There are three main sources of credit available for the construction activity in Lebanon:

1. Commercial banks.
2. Money lenders.
3. Other specialized institutions.

Practically, each of the above mentioned sources is very careful in selecting his debtor, since the real estate credit is of a long-term nature. Consequently, such creditors in Lebanon usually go through the following analysis before extending real estate credit:

A. Principles and Practices

The first analysis that any real estate creditor would perform before granting a loan is to find out whether the debt is likely to be paid promptly on maturity. The answer to this question would depend upon the creditor's estimation of the financial standing and credit worthiness of the debtor. Consequently, in reaching a decision as to whether credit should be extended, the creditor may require the prospective borrower to provide correct financial statements and a cash budget statement in order to estimate scientifically his credit worthiness. Besides, the creditor would have to be satisfied by a thorough investigation about the following:

1. Character

It is common sense that credit should only be extended to the debtor who enjoys a good reputation. The debtor should always possess good character. A bad debtor can escape payment even in courts.[1] Hence, the reputation of the debtor as to promptness in paying debts, his social standing in the community, business ethics, bankruptcy record, private family and court records, should be carefully investigated.

2. Capacity

Generally, creditors expect the credit to be repaid from the debtor's resources, and his ability to produce income. Hence, the debtor's ability to manage wisely his wealth should be high. His business experience, age, education, common sense, managerial ability, relation with employees, ability to adapt to and make use of modern methods, are all to be evaluated explicitly.

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[1] Interviews with managers of local and foreign banks.

3. Capital

This refers to the net worth of the debtor which is an indicator of his present capacity of payment. In case of nonpayment, are the debtor's belongings sufficient to cover the debt? What is the relation of debt to his net worth? Is he solvent or not?

4. Collateral

Usually, the creditor requires the pledge of an asset so that, in case the debtor defaults, the creditor may sell the pledged property and reimburse himself from the proceeds of sale. Hence, collateral should be greatly analyzed:

Appraisal of Collateral[1]

The long-term nature of real estate credit requires great emphasis to be placed on the analysis of the security supporting the loan. Having decided to provide the client with a secured credit facility, the second phase of analysis would be to appraise that pledged security in order to determine its market value. This is usually done either by an engineer, or an expert, on behalf of the creditor.

In determining the value of marketable securities pledged as collateral, usually the average market price of the stock is applied which is daily quoted in the stock exchange.

The assessment of a real estate property is not easily accomplished. There are three methods followed by specialists in Lebanon:

a. They consider the recent price that has been paid for a similar property, and then provide a margin for error. This is applied

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[1]Information derived from interviews with land experts, engineers and managers of local and foreign banks.

mostly in determining the value of a plot of land.

b. They estimate the cost which would be incurred to construct a similar building on the same plot of land appraised, that is, to estimate reproduction cost, and then estimate the extent to which existing real estate property has depreciated from the assumed new building. This method is more easily applied to buildings that have been recently constructed, than to buildings of considerable age.

c. A third method used in appraising the value of a real estate property is to estimate all future net receipts, such as rentals, which the owner will receive, and then calculate the present value of such net receipts. This would be an estimation of the present value of all the net future stream of income which the owner is entitled to.

Practically, creditors always provide a margin for errors to the assessed value as estimated by specialists.

B. Legal Documents and Considerations

The third phase of analysis that is performed by a creditor when granting a loan for real estate construction is the determination of the legal titles of the debtor.

1. Legal Considerations

Although it is rarely mentioned in the loan agreement that the credit is renewable, the debtor has always legal right to renew the loan for another year, provided that he submits reasonable reasons for delay to the court, and provided he would pay the interest charges in advance. However, the law limits the number of times a short term loan can be renewed up to ten years only.[1]

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[1]Mr. Raif Samara, Notary Public of Beirut.

Unless it is stated otherwise in the mortgage deed, the building in process of construction on a plot of land already mortgaged would be also considered automatically and legally as part of the mortgage.[1]

Key-money, which is related to the expected sum of money to be received by the owner of the building upon leasing a store or residence, is not legally accepted as a tangible asset which could be mortgaged.[2]

Because of such legal considerations, almost all real estate creditors in Lebanon hire lawyers on their behalf, who would be responsible to provide for all legal aspects, to inspect the instruments of the real estate finance, and to verify the validity of the title deed at the Land Registry. In case the real estate creditor does not hire a lawyer, the Notary Public would assure him of all the legal requirements.

2. Credit Instruments

Basically, a written document provides a stronger evidence to support the creditor's claim in court than does a ledger account. Usually the real estate creditor and debtor would sign a loan agreement in which all the terms of credit, obligations and rights of each party, are explicitly indicated. In the event of disagreement or default, this written evidence would be the only tangible proof of what the creditor and the debtor have agreed upon at the beginning. Hence the judge would depend heavily upon it in passing his final sentence.

Beside the loan agreement, the real estate creditor sometimes requires the debtor to sign a written promise to pay in a promissory-note

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[1] _Ibid_.; also Mr. Iskandar Sara, Lawyer, interview.

[2] _Ibid_.

form that is readily transferable and negotiable. The creditor can sell this credit instrument, or in business words, discount it and realize cash should the funds be needed prior to maturity date. He also can place it for collection at a local bank and enjoy an overdraft facility limited to a fixed percentage of its face value.

3. Legal Documents

The legal documents that should be verified on behalf of the creditor are the following:[1]

a. Evidence of title:

Ownership of real estate is transferred by the passing of a legal document called "title deed". Hence, before the creditor grants a loan to a client, supported by a mortgage on real estate, he must make certain that full ownership of the property is actually in the name of the debtor, and that the property is free from any charges or encumbrances, especially if he is to accept only first mortgage security.

b. Mortgage deed:

A mortgage is briefly defined as "a claim to proceeds from the sale of specific property when a court orders such a sale to satisfy creditor claims under debt agreements."[2] In case of a court decision to sell the pledged property, the creditor would have access only to proceeds of sale up to the amount owing to him.

This mortgage deed should be registered at the Land Registry in Beirut, and usually all the terms of credit are mentioned in it, the

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[1]Interview with the Notary Public of Beirut, Mr. Raif Samara; moreover, the writer's personal experience.

[2]Boehmler _et al_., _op.cit_., p. 442.

date, names of the borrower and lender, exact legal description of the property, amount of debt, promise to repay the debt on maturity, interest rate, etc.

Below is a translated sample of a mortgage deed contracted in Beirut:

Day Book No # 1607

Mortgage deed contract No # 1223 (Copy to the person concerned)

Mortgage Deed

At 11:20 on Thursday 25th of April 1964, in our office, before us, Munir El Aris, Assistant Head of the Real Estate Bureau, Beirut, Western Section, and in the presence of:

1. Antoine Beshara Kellab, Lebanese, born at Hadeth in the year 1926 and resident in Ras Beirut.
2. Sami Beiruti, Lebanese, born in Aley, in the year 1932, resident in Ras Beirut.

Both being legally competent of identification, have identified the competency and identity of the contracting parties:

First Party: X Company S.A.L., represented by the Chairman of the Board of Directors, Mr. A.K. Bhamdouni, Lebanese, born in Syria 1925, residing in Ras Beirut, identity card No. 584 as per attached documents;

Second Party: Y Bank, Beirut, represented by both Messers. M. Tawil, and Z. Kasir both of Lebanese nationality;

Who, after establishing their identities and competencies, have mutually agreed upon the following:

Whereas the Second Party, the Y Bank, Beirut, has opened for the First party X Company S.A.L. a credit line the maximum of which is one million Lebanese pounds (LL 1,000,000), and whereas the latter has offered, as a security for the said credit, to mortgage, to the second party, real estate No. 6244 of Horch area, both contracting parties have agreed to the following:

1. The Second Party, the Y Bank, Beirut, declares that he has opened for the first party, X Company S.A.L., a credit line, the maximum of which is LL 1,000,000.

2. In security for the credit so opened, the First Party has made a first order mortgage to the Second Party on all real estate No. 6244, Horch area. This property contains a plot of land planted with pine and parcelled out of estate No. 1830, possesses the right of passage, light, and air over property No. 1830, which right shall ipso facto be struck off on expropriating the beneficiary property as a result of implementing the Municipality's planning. The owner of the beneficiary property shall not be entitled to any compensation.

3. The term of this mortgage is indefinite and shall continue to be valid until the payment of all sums due to the Second Party from the First Party, the X Company S.A.L. The Second Party may, at will and at any time, suspend the validity of the said credit, provided he sends notice to the First Party by registered mail. Upon notification, the operation of the said credit ceases immediately and all amounts shall become due.

4. Interest shall accrue to the Second Party at the rate of 8% per annum.

5. If the First Party, on suspension of the credit as mentioned in clause 3, fails to pay the full amount due from him together with the interest, the Second Party may perform the mortgage deed and offer the mortgaged property for sale by public auction in order to collect the debts and annexes thereof.

6. The first Party shall bear all expenses for the registration of this mortgage, as well as official and non-official fees and expenses and the attorney's fees required for the performance, offer for sale, and public auction.

7. The First Party declares that only the registers and documents of the Second Party shall be proof of the correctness of the amounts due to the Second Party from the First Party.

8. The Second Party may assign the said mortgage, before and after the maturity of the mortgage, to any other person, without seeking the approval of the First Party.

Both Contracting Parties have applied for the proper recording of this Contract in the Real Estate Register.

The First Party has elected domicile in Beirut, Ras Beirut, Company Property.

The Second Party has elected domicile in Beirut, Bab Idriss, property of Khan Beik.

A fee amounting to LL 2634.50 was collected against receipt No. 4/2/179 of 4/28/1964.

The Two Contracting Parties

First Party

(Sgd.) Illegible

Second Party

(Sgd.) Illegible
(Sgd.) Illegible
Rubber stamp of
the Y Bank, Beirut.

Two Witnesses

First

(Sgd.) Illegible

Second

(Sgd.) Illegible

Recorded on 5/29/64
conforms to procedure
(Sgd.) Illegible.

Assistant Head of
the Real Estate
Office, Beirut
(Sgd.) Illegible
and rubber stamp
of office.

c. Mortgage Certificate:

As evidence of mortgage deed registration, the creditor receives a Mortgage Certificate in which such details are indicated: Kind of mortgage, name of creditor, amount of credit, maturity period and interest rate, description of the plot mortgaged, degree of mortgage, and privileges.

Below is the mortgage certificate related to the previous sample of mortgage deed.

Lebanese Republic
Land Registry Department of Beirut
Mortgage Certificate

Kind of Mortgage: Optional Credit

Creditor: Y Bank, Beirut.

Amount: A loan for LL 1,000,000.

Maturity and Interest: Maturity according to the terms of contract. The interest rate is 8% per annum in accordance with the terms of the mortgage deed, which is registered in the daily register under No. 1607 on 4/25/64 and in the Land Registry on 5/29/64.

Description of the mortgaged plot:

Location:	Land Plot No.	Owner	No. of Shares
Horch	6244	X Company S.A.L.	2400

Degree of Mortgage: First degree

Assignment, Endorsement, Release: with right of assignment

Date

Registrar of the Land Registry

(S) Illegible

(Seal)

C. Summary

Credit extended to finance real estate construction in Lebanon is usually assessed through the following stages of analysis:

The first phase of analysis that a real estate creditor performs before extending any amount of credit is to estimate the credit worthiness of the debtor. The criteria that are usually considered constitute: Character, Capacity, Capital and Collateral.

The second phase of analysis is to appraise the market value of the security supporting the loan. This is usually estimated by an engineer or an expert, by one of the three methods discussed in the foregoing chapter.

The third phase of analysis includes determination of the legal position of the debtor, verification of legal documents and other considerations that should be provided for, in order to be able to obtain possession of the pledged property in case of default. This is usually carried on either by a lawyer on behalf of the real estate creditor, or by the Notary Public.

CHAPTER III

COMMERCIAL BANKS AS SOURCES OF REAL ESTATE CREDIT

Banks in general are financial institutions which act as intermediaries between savers and users of funds. A successful banker is judged by his ability to satisfy both groups of customers, the savers with funds on deposit, and the borrowers who make use of such funds and are his source of revenue.

Due to the temporary nature of their deposits, which coincides with the temporary nature of a commercial loan, commercial banks primarily limit their operations to finance commercial transactions. Interviewed local bankers declared that loans for real estate construction are long-term while their deposits are primarily held on demand, and they are short of time deposits and saving accounts. Available statistics indicate that fixed deposits are insignificant when compared with demand deposits, though they have increased by fifteen times since 1950, reaching about 2% of other deposits.[1] Below is Table VI which reveals a steady growth of fixed, demand and total Lebanese pounds deposits as of December 31 of each year, running from 1953 up to 1963, when fixed deposits amounted only to approximately 5% of total deposits.

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[1] Lebanon Faces Its Development, op.cit., p. 284.

TABLE VI

BANK DEPOSITS IN LEBANON FOR THE

PRIVATE AND PUBLIC SECTORS

1953 - 1963

(Excluding Foreign Currency Deposits)
(in LL thousands)

December 31	Fixed Deposits	Demand Deposits	Total
1953	19,049	324,371	343,420
1954	26,699	362,058	388,757
1955	39,301	443,969	483,270
1956	42,367	440,252	482,619
1957	50,429	551,119	601,548
1958	53,539	558,994	612,548
1959	77,596	778,179	855,775
1960	113,386	955,392	1,068,778
1961	138,443	1,081,779	1,220,222
1962	184,029	1,267,741	1,451,770
1963	183,000	1,402,000	1,585,000

Sources: 1. For 1953 to 1957 from Bulletin Statistique Trimestriel, Ministry of National Economy, Beirut, premier trimestre 1958, Volume IX p. 30.

2. For 1957 to 1958 from Ibid., premier trimestre 1959, Volume X, p. 38.

3. For 1959 from Bulletin Statistique Trimestriel, Ministry of Planning, Beirut, 1960-61, Vol. XI, p. 43.

4. For 1960 to 1962 Ibid., 1962, Vol. XII, pp. 36 -37.

5. For 1963 from Bulletin Statistique Mensuel, Ministry of Planning, Vol. II, Number 1, April 1964, pp. 34-35.

Nevertheless, some bankers do not want to lose promising ventures in the local credit market where competition is severe. Thus they transform loans for real estate construction, which are of a long-term nature, into commercial loans of short-term maturities. At the beginning, they preferred to extend such loans to merchants as they were convinced of their credit standing and worthiness. Later, other landlords had access to this opportunity with some commercial banks as the construction activity was on its way to growth and prosperity.

The way commercial bankers have been following in financing the construction activity will be discussed in the remaining parts of this chapter.

A. Credit Principles and Practices

Accredited[1] bankers interviewed revealed prudent precautions in choosing their real estate debtors. They have approved primarily secured loans as recommended by financial analysts in their credit departments. Practically, they have adapted the terms of the loan to their client's capacity to meet future payments, up to a convenient extent.

About 75% of the interviewed bankers declared that they have required their clients to submit audited financial statements in order to analyze their financial position and estimate their credit worthiness on a more scientific basis. Current position, tangible net worth,

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[1]Accredited banks are those whose guarantees are accepted by the Lebanese Government.

debt to net worth ratio, and estimated yearly income, are the essential parameters considered by these bankers. Also, they require their clients to submit a projected cash flow statement in order to adapt repayment to their capacity.

Approximately 50% of the bankers interviewed have insisted that above all, the client should be of a good character, and should have the intention to repay the loan promptly.

On the other hand, 40% of the bankers interviewed insisted that in determining the credit worthiness of a client, the collateral offered as a supporting security should be the predominent factor. The reason is the nature of the loan for real estate construction. It is a long-term loan though it is extended on a short-term basis subject to automatic renewal.

In the case of credit to sole proprietorships about 5% of the bankers interviewed declared that above all the proprietor's capacity, or earning power, should be the predominent factor. His current position should be highly solvent. For corporations and partnerships, about 5% of the bankers interviewed declared that the paid-in capital should be the predominent factor. Besides, the character of each of the members on the board of directors, of the partners and managers, should be highly investigated before the credit is extended. All bankers interviewed preferred to consider the above four credit determinants together on the same footing, and not to have any priority assigned to any one of them.

Furthermore, after the credit facility has been granted, the client is not permitted to withdraw the loan in a single lump sum.

Almost all bankers interviewed declared that although they don't construct residences to their clients, they supervise and control the use of credit funds after the credit facility is granted for real estate construction. Some banks have their own engineers and experts who would follow up the construction work from the beginning. They would estimate the value of land when vacant, and later present monthly reports to management indicating the estimated amount of funds that have been invested in construction. This estimated amount would be compared to the amount of credit facility utilized to date, and any excess withdrawals would force the bank to call in the client and request immediate settlement of the outstanding debt.

Some banks require the client to approve the bills, and they in turn would pay the suppliers and contractors, together with periodic checkings performed by the expert of the bank, or by the management staff themselves.

B. Types of Security

In their attempt to extend real estate credit, commercial bankers interviewed have placed much emphasis on the collateral supporting the loan.

What are the types of security that some commercial bankers have accepted over the last ten years? What types do they accept at present and why?

1. Building With Its Income.

Approximately 50% of the bankers interviewed prefer to have a mortgage on a building and its income as a security supporting a loan for real estate construction. Some bankers have accepted in the past the assignment of income from a building alone as a security, but experience has taught them to accept it at present only in addition to a mortgage on the building itself. This is so because they foresee now the disaster that they would fall in if the apartments of the building were not rented, or if the building were destroyed accidently which is an extreme case. Moreover, the assignment of income together with a mortgage on the building represents a source for repayment of the debt. Furthermore, when, in the extreme case, the building is destroyed accidently, the bank can still sell the land and collect part of the debt, if not all.

Also, in the past, some bankers extended real estate credit supported by a mortgage on land as a backing security. However, at present they hesitate to do so because land is immobile by nature, and due to the difficulties they would have to face in selling it. Anyhow, if they are to accept a mortgage on land at present, this land should be the one on which the building is to be constructed, and the client should possess enough working capital beside the funds requested in order to start the construction work.

Regarding the above mentioned securities, about 10% of the bankers interviewed have insisted that they would prefer to deal only with merchants or corporations, and would select only those who enjoy a very high credit standing.

2. Marketable Securities

Approximately 40% of the bankers interviewed preferred to hold marketable securities as a collateral supporting a loan for real estate construction. The reason is to preserve the liquidity factor which every banker is afraid to lose. In the case of a rush by depositors, marketable securities are negotiable and could be easily sold without incurring any significant loss to the bank. Furthermore, bankers do specify that they accept only listed and non speculative securities in order to minimize the risk of market fluctuations. Some bankers specify further that a "stop loss point" should be agreed upon in-writing with the client. The "stop loss point" is the price at which bankers can inform their brokers in the Bourse to sell the securities held as collateral so as to maintain the credit extended within the collateral margin, and hence incur no loss.[1]

On the other hand, due to market fluctuations in the price of securities, the remaining bankers interviewed have never accepted such a collateral seperately, but would accept in addition, land or building. In these circumstances, these bankers would be leaning towards the profitability factor, and they hesitate to bear the risk of loss that might result from market fluctuations.

3. Building Under Construction

Approximately 10% of the bankers interviewed prefer to accept a mortgage on a building under construction as the security backing a real estate credit. These bankers are considering both liquidity and profitability factors. As to the liquidity factor, the loan would be supported by current market prices regarding materials, land and services. In case of difficulty, they can sell the project and retain their loan

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[1] "The Stop loss" method is considered as illegal by some lawyers.

which represents a small portion of the total funds invested in construction. As to the profitability factor, since the building would be in the completion process, a source of repayment either from sale of the building or from the rental income, would be available.

In the writer's opinion, these bankers hesitate to participate in the construction boom because of the long-term nature of its credit, and also because they wish to maintain a high degree of liquidity. However, they don't want to forego the profits this business is promising, and hence would only finance the most secured projects in their final stages.

4. Key-Money From The Building

No banker interviewed accepted to have the key-money expected to be collected after the construction of the building as a security in support of loans for real estate construction. All bankers interviewed would only accept key-money as an additional support besides other collateral or mortgage. The reason is due to its intangible nature, since no one can predict precisely the amount of key-money that would be collected after the construction of the building.

5. Surrender Value of An Insurance Policy

All bankers interviewed refused to accept the surrender value of an insurance policy as a security by itself for this type of credit. However they would accept it as an additional security besides other collateral or mortgage. The reason is the trouble they may have to face in case the insurance company doubts the intention of its insured client, and hence refuses to pay.

Some bankers interviewed observe the right to have an accidental life insurance policy up to the amount of the indebtedness. In these circumstances, the client would have to give them an authorization to purchase such an insurance policy and they would charge him for the premium paid.

Finally, after the engineer, or the expert of the bank has agreed on an appraised value of the collateral as discussed in chapter II, the bankers interviewed usually limit the percentage of real estate credit up to a maximum of 60% of that appraised value. This is so because actually in auction, the law always reduces the market price of a property pledged by 40%, and would require a 60% bid to start the auction.[1] Practically all interviewed bankers have rarely extended loans for construction purposes up to 60% of the market value of the security backing it, and the percentage of the loan has ranged between 30% and 40%. Furthermore, bankers do prefer to hold a first mortgage on a property, and they have rarely accepted a second mortgage in the past, except in special circumstances, when they did not want to lose a good customer whose credit standing was favorable.

C. Maturity Structure

The short term nature of deposits held by commercial banks necessitates the extension of short term loans in order to preserve their liquidity and safeguard them from financial crises.

Meanwhile, a commercial bank, like any other commercial organization, seeks profit, and further, it has to earn at least its expenses in

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[1]Dr. Chafik Baz - Assistant manager - Banque Al-Ahli; also Notary Public of Beirut.

order to maintain its existance. As investment outlets in Lebanon are relatively limited, the prosperity of construction business has attracted many bankers, eventhough its long term nature does not agree with the short term nature of funds available at their disposal. Thus some bankers have been more or less obliged to participate and earn profit by adopting the following financing method:

Bankers declared that they have not held enough time deposits, or saving accounts, with which they can finance real estate construction safely. Loans for real estate construction are of long-term nature, and most of the commercial bank's deposits are of a short-term nature, Nevertheless, some commercial bankers have decided to handle the loans for real estate construction, which normally should be extended on a long-term basis, the same way as they handle commercial loans. Hence, they have extended the loan for real estate construction on a renewable short-term basis, with a maximum time period of one year. Practically, the loan agreement does not include any obligation that the commercial bank should renew the loan, although it usually does renew it. The agreement further dictates that upon notification, the client should settle all his outstanding loan within one month period.

Approximately 10% of the interviewed bankers limited the term of the renewable loan for construction up to six months for the purpose of maintaining a higher degree of liquidity. They extend the loan on a discount basis, instead of overdraft basis, so that in case of financial need they can resort to the Central Bank (Banque Du Liban, or Banque de Syrie et du Liban previously). The law allows them to discount promissory notes with maturities reaching three months, and bearing three commercial signatures, including the signature of the discounting bank. Also, when an attractive opportunity arises and the bank is in need of funds, they can resort to the Central bank, which would discount the promissory notes at a lower interest rate than the rate they have charged, or are about to charge, and hence attain the difference in interest rates as additional profit.

In rare and exceptional cases, some bankers interviewed have extended real estate credit to their clients up to a period of three years. However they do prefer not to do it again due to liquidity reasons.

The number of times commercial bankers accept to renew the short term loan granted for real estate construction depends on the prevailing market conditions, and on the financial and credit standing of the client. If the banker is convinced of the financial ability of the customer and his good intention, he would renew the loan to him as many times as he requires.

As for the mode of repayment, bankers interviewed declared that in the fifties, almost between 80% and 90% of loans for real estate construction were repaid as one lump sum. This is so because during that time, many Saudis and Iraqis from the neighbouring Arab countries used to buy the building as soon as it was completed. Actually, the law has limited such purchases due to the associated charges and taxes that would have to be paid by non-Lebanese investors.[1] In fact at present, 80% to

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[1] Al-Jarida Al-Rasmiah, Vol. 23, March 19, 1964, p. 858.

90% of the loan for real estate construction is repaid in monthly installments specially since 1963, when the law allowed the selling of a building by apartments, which is at the same time primarily handled on credit installment basis.[1] As for the date of first repayment, all bankers interviewed admitted that it would depend upon the client's capacity, and it is usually after completion of the construction in case the customer is not a merchant or a company. Moreover, the client is required to pay-in all the key-money which might be collected. To ensure that, some bankers require the client to sign the contract of rent at the bank premises. In case the client is a merchant or a company, usually bankers request partial repayment of the loan before the construction of the building is completed, and they would agree on a convenient date. In any case, they adapt the amount of installment payment to his financial capacity.

D. Interest Rate and Other Charges

The legal interest rate in Lebanon ranges between 9% and 12% per annum.[2] However, due to competition in the market, approximately 80% of the interviewed bankers charge interest between 7% and 9% per annum (computed on the average daily balance and compounded monthly) on real estate credit. The remaining 20% of the interviewed bankers like to apply the legal terms and collect the maximum which they can attain, and

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[1] *Ibid*., Vol. 1. Jan. 3, 1963, p. 1.

[2] Interview with the Notary Public of Beirut.

hence charge interest between 7% and 12% per annum. This gap between 7% and 12% per annum generally depends upon the following aspects:

1. The financial standing and credit worthiness of the customer. Usually bankers charge a lower interest rate to clients of higher financial standing and credit worthiness and vice versa. The reason being lower risk.
2. The maturity period of the loan. Approximately 60% of the bankers interviewed declared that they would charge a lower interest rate on loans granted for a shorter period of time and vice versa. The remaining 40% of the interviewed bankers declared that they would always charge the same interest rate regardless of the maturity period.
3. T he security supporting the loan. All bankers interviewed declared that they would charge a lower interest rate on real estate construction that are backed by a more adequate and safer security, and vice versa.
4. The volume of the loan. All bankers interviewed declared that they would charge a lower interest rate on real estate loans for larger amounts of money and vice versa. The reason being the profitability factor.
5. The prevailing economic conditions of the bank and the country. Usually when bankers have plenty of deposits, they would be more lenient in extending credit at a lower interest rate and vice versa. Also, in prosperous economic conditions, bankers extend credit on a lower interest rate and vice versa.

Regarding interest charges, those clients who are granted real estate loans on an overdraft basis do enjoy better terms than those granted real estate loans on a discount basis. This is so because the client does not need the real estate loan to be delivered to him as a lump sum, and hence be charged interest from the time he receives it. On the contrary, he needs the loan in the future as the work progresses, and hence, on an overdraft basis. He will thus be charged interest monthly on his average daily balance, which in turn, would depend upon his withdrawals and deposits. Thus, on an overdraft basis, the client would have an opportunity to reduce his interest expenses.

Furthermore, approximately 50% of the interviewed bankers charge the client between 1% and 2% service charges on loans extended for real estate construction. The other 50% does not charge the client due to prevailing competitive market conditions. In fact, they try to include such charges in the higher rate of interest that they charge, and the client would be more pleased.

E. Volume

Approximately 60% of the accredited banks interviewed declared that they have extended loans for real estate construction. The remaining 40% declared that they have adapted a policy not to extend loans for real estate construction due to the following reasons:

1. Since they are commercial banks, they should limit their operations to the financing of commercial transactions only. Their deposits are of a short-term nature, which allows them to grant loans only for short periods, such as to finance imports and exports.

2. Their deposits are primarily of temporary nature, and they are short of time deposits and saving accounts. Since the loan for real estate construction is of a long-term nature, which does not conform to the nature of their deposits, it is not feasible to approve it.

Furthermore approximately 50% of those accredited banks who have extended loans for real estate construction declared that the volume granted by them ranged between 15% and 20% of the total volume of their credit for all purposes each year. Approximately, 40% of them declared that real estate loans ranged between 10% and 15% of the total loans extended each year for all purposes. The remaining 10% declared loans for construction ranged between 5% and 10% of the total credit extended each year for all purposes. Hence if we take the simple average of the above findings which is approximately 14%, and apply it to the total domestic credit extended by accredited banks in Lebanon, we arrive at the results shown in Table VII below:

TABLE VII

DOMESTIC CREDIT IN LEBANON: 1953 - 1963
(in LL millions)

Year end	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963*
Claims on private sector	270	345	454	482	602	585	709	1002	1108	1137	1733
60% generated by banks which extend real estate credit	162	207	272	289	361	351	425	601	665	682	1040
14% average	23	29	38	40	50	49	60	84	93	95	142

Sources: International Financial Statistics, International Monetary Fund, Jan. 1964, Vol. XVII, p. 176.

* Ibid., Jan. 1965, Vol. XVIII, p. 190.

Hence the total volume of real estate credit extended by commercial banks between 1953 and 1963 amounts to about LL 702 millions. Although this method is far from being accurate, the writer thinks that it may be taken as a rough guide in the absence of more reliable statistics.

Admittedly, even though some commercial banks have extended such long-term real estate loans on a short-term basis, they have not maintained a ratio between such loans and the total time deposits available at their disposal. Only 20% of those bankers interviewed declared that they maintain a ratio of 10% to 50% between real estate loans and total time deposits. Also, only 20% of them declared that they maintain a ratio of 10% to 25% between real estate loans and their paid up capital.

F. Bankers' Policy in Case of Default

Bankers interviewed declared that the rate of default on loans extended for real estate construction ranged between 5% and 10% each year. This does not indicate that such an amount has been charged as bad debt, since bankers usually deal with the problem wisely, and try to follow one or more of the steps mentioned below in order to collect their money:

1. Approximately 70% of the bankers interviewed declared that they would consider the financial standing of the client, and try to amend the maturity period of the loan. Moreover they would arrange for convenient future installment payments, and try to obtain the signature of a third party as a guarantor if feasible. Hence, as long as a client shows good intention to repay his debts, bankers are always ready to help him and arrange for convenient installment payments in the future.

2. Nearly 30% of the bankers interviewed declared that they would prefer to supervise and control the construction work in order to liquidate it and get back their money. Wise bankers tend to avoid bankruptcy, and to do their utmost to liquidate the affair, or help finding a buyer.
3. Finally, if bad intention is revealed by the client, interviewed bankers stated that they would sue him in court and declare his bankruptcy. Their comments on the legal foreclosure procedure are that they are satisfactory but take much time. It is a very lengthy routine, and the lender should have a quicker right to dispose of the pledged property and collect his money.

G. <u>The Central Risk</u>

Every commercial bank in Lebanon is required by law to submit to the central bank, Banque Du Liban, or previously Banque De Syrie et Du Liban, any indebtedness of its client in excess of 20,000 Lebanese pounds. The Central Risk Department at the Central Bank will classify this information, and later, will provide a copy to every bank in which it will indicate the total indebtedness of the bank's clients. Usually, the copy indicates the total amount of credit granted to the client in one column, and the total amount of credit utilized by him in another column. This method is helpful in minimizing the risk of loss in the banking system, since every banker now is able to evaluate the credit worthiness of his client in the light of his overall indebtedness.

Approximately 60% of the bankers interviewed declared that their membership in the Central Risk is helpful, provided that all members are honest, serious, and convey correct and complete information. They do approve of the LL 20,000 minimum level, and are ready to bear a small risk rather than to bear the cost of reporting every item of credit.

On the other hand, approximately 30% of the bankers interviewed declared that up till now the Central Risk was not of much help. Some of them suggested that all indebtedness of every client should be reported to one Lebanese pound, and that better control in the Central Bank should be adopted.

Others suggested that the level of reported indebtedness should be lowered to LL 5,000 or LL 10,000, and this is a fair level since the client cannot borrow from more than five banks without being discovered. Thus, this level if adopted, would minimize the risk of loss in the banking system, and is of more value than the estimated savings in associated overhead charges.

H. Summary

In view of the temporary nature of their deposits, commercial banks in Lebanon limit their operations to financing commercial transactions. However, some of them have financed real estate construction activity, which is of long term nature, by transforming such credit into the short-term pattern for a maximum renewable period of one year.

In their attempt to make secured loans for real estate construction, these commercial bankers have placed great emphasis on the collateral supporting the loan, and on the character of the client. At present, they would prefer mostly to hold as a security first mortgage on a building with its income, or marketable securities.

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There are no statistics available as to the volume of credit extended by commercial banks in Lebanon to finance real estate construction. The volume arrived at was a little better than a guess based upon bankers' experience.

Commercial bankers in Lebanon avoid to sue their clients in court and declare their bankruptcy; rather they try to extend the maturity period of the loan, or to liquidate the project by finding a buyer.

The Central Risk system has been very helpful to all bankers, although some of them have suggested a lower level for reporting the total indebtedness of the client.

CHAPTER IV

MONEY LENDERS AS SUPPLIERS OF REAL ESTATE CREDIT

Since the evolution of credit systems in business communities, money lenders have proved to be a good source of credit in financing various projects. They may be called private investors because they lend their own money directly. Naturally, they would be very careful in selecting their clients, and would grant only safe and highly secured loans.

In Lebanon, money lenders constitute a direct source of real estate credit but to a limited extent. They may be classified into three categories:

1. Professional money lenders.
2. Semi-professional money lenders.
3. Merchants.

A. Types of Money Lenders

1. Professional Money Lenders

This category includes individuals who own large amounts of money either through inheritance, savings, or any other source. The peculiarity in them is that they do not know or like to bear the risk of doing complicated business, and hence, they do not trouble themselves with management and control practices. Consequently, they have observed that extending real estate credit against mortgage on a tangible asset is an easy profession that would provide them with large earnings, and at the same time, would maintain their money capital intact.

2. Semi-Professional Money Lenders

These may be classified in two categories:

a. One category constitutes successful businessmen, engineers, doctors, merchants, who possess idle cash balances, and would like to invest them in an easy profitable manner that would not take much of their time..

b. The other category constitutes those hardworkers who have saved amounts of money during their lifetime, and in addition, have received their indemnities. Hence, they are individuals who have retired from work, but still think they should earn their living in order to maintain their money capital intact, and moreover, to preserve their social standing as respectable persons.

Naturally, extending real estate credit backed by a strong security would promise an attractive source of income for such money lenders, and at the same time, would maintain their money capital intact.

3. Merchants

This category constitutes those traders who deal in construction materials and equipment. In order to promote their sales amidst competitive market conditions, these merchants sell almost all the construction materials and equipment on credit, except the cement.

In the remaining pages, the terms of credit exercised by the above mentioned money lenders in financing real estate construction will be discussed.

B. Credit Worthiness of the Client

In fact when someone is risking his own money, he would be more careful in selecting his debtors, and that is why money lenders in Lebanon have been very stringent in extending real estate credit.

Practically, they never perform any technical analysis of the financial position of their debtor. Nevertheless, they investigate thoroughly his credit worthiness and his financial ability to meet future payments.

In general, professional and semi-professional money lenders have been extending only highly secured real estate credit backed by a mortgage on a tangible asset.[1] They consider thoroughly the debtor's character, capacity, and capital, but the collateral offered is the determinant factor. They prefer not to extend real estate credit, unless they are provided with a high margin of collateral protection.

On the other hand, merchants, in general, have been extending real estate credit only to those clients who enjoy good reputation and hence a good character.[2] Their close relationship with the client should have convinced them of his good intention to repay the loan, his social standing, and business ethics. Besides, they do consider thoroughly the client's capital and capacity to repay the loan. They cannot insist to have a collateral in view of prevailing competitive market conditions.

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[1]Beirut Notary Public.

[2]Interview with several merchants.

Furthermore, professional and semi-professional money lenders, in general, do not control or supervise the use of the credit funds extended for real estate construction.[1] While interviewed merchants declared that they have been very careful in such matters, and have sometimes insisted that their employees should carry on the work associated with the materials or equipment being sold on credit. Besides, they usually make personal checkings periodically.

C. Types of Security

From the previous discussion, one can foretell that in their attempt to extend safe and secured real estate credit, professional and semi-professional money lenders have placed much emphasis on the collateral supporting the loan, while merchants have emphasized mostly the personal characteristics of the client.

The types of security that have been accepted by money lenders in Lebanon over the last ten years are discussed below:

1. Building with its Income

It has been estimated that about 60% of the professional and semi-professional money lenders usually prefer to hold a mortgage on a building with its income as a supporting security to a real estate credit.[2] The reason is that income from the building would constitute a source for repayment of the loan.

On the other hand, merchants interviewed have strived to attain such a mortgage but it has not been feasible. Not a single client

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[1] Beirut Notary Public.

[2] *Ibid*.

would accept that, and hence, this would weaken considerably the merchant's sales potential.

2. Building Under Construction

Approximately 25% of the professional and semi-professional money lenders have preferred to extend real estate credit backed by a mortgage on a building under construction.[1] They prefer to finance primarily such project due to the liquidity factor. Sooner or later the building will be completed, and hence they will be able to receive back their money either through the sale of the building or from its rental income.

On the other hand, merchants cannot hold such a mortgage, due to prevailing competitive market conditions.

3. Marketable Securities

Approximately 10% of the semi-professional money lenders have been accepting listed marketable securities as a collateral supporting a loan for real estate construction, due to liquidity and marketability factors.[2] Marketable securities can be sold easily without incurring any significant loss in case of financial need.

On the other hand, professional money lenders would prefer not to accept such a collateral against a loan for real estate construction because most of them are ignorant of its nature.[3] They do not believe much in a paper, an intangible asset, as a good security. Moreover, those who are acquainted with the stock exchange transactions fear market fluctuations, and hence prefer not to accept such securities.

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[1] Ibid.

[2] Ibid.

[3] Ibid.

Merchants interviewed rarely get hold of such securities as a collateral, because not all their clients deal in this business, and, moreover, if they do, they refuse to offer it.

4. Plots of Land

In general, only few professional and semi-professional money lenders have extended real estate credit against a mortgage on a plot of land. Experience has taught them not to do that unless the loan is covered up to 80% and even 90% of its value.[1] This is due to the immobility of land, and to the difficulties they might face in selling it.

In general, merchants do not get hold of such a mortgage due to prevailing competitive market conditions.

5. Key-Money from Building

In general, all money lenders would accept to hold such an intangible asset only as an additional collateral to a mortgage on a tangible property. The reason being its intangible nature.

6. Surrender Value of an Insurance Policy

In general, money lenders would accept such an asset only in addition to a mortgage on a tangible property. The reason being that the insurance company would not pay them if it doubts the intention of its insured client.

7. Signature of the Debtor

The only collateral that most merchants have so far obtained from their clients was their signatures. Sometimes merchants have

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[1] *Ibid.*

required that a third party should sign with the client if they were in doubt. Professional and semi-professional money lenders always obtain the client's signature beside a pledged collateral.

Finally, having arrived at an appraised market value for the security by one of the methods mentioned in chapter II,[1] money lenders in general have limited the percentage of the real estate credit up to a maximum of 40% of that market value.[2] Practically, the loan granted by money lenders for real estate construction has ranged between 20% and 30% of the market value of the security supporting it. Moreover, they have only accepted first mortgage on a property as a backing security.

D. Maturity Structure [3]

In general, due to uncertainty, money lenders have extended real estate credit on a short-term basis, in order to be able to liquidate it in case unforeseen contingencies arise.

Approximately, 90% of professional and semi-professional money lenders have limited the maturity period of a real estate loan to one year. However, they have always renewed it in case of need, although it is rarely indicated in the loan agreement that the loan is subject to renewal. The number of times money lenders have accepted to renew a real estate credit depends partly on their relationship with the

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[1] See page 23 above.

[2] Beirut Notary Public.

[3] *Ibid*.

client, and partly upon his credit worthiness. In general, real estate credit has not been renewed more than four or five times.

The remaining 10% of the professional and semi-professional money lenders have extended real estate credit for a period of three years, provided they were convinced of the financial standing of the debtor, and the mortgage offered as a security was of high quality. However, at present it is very hard to find such a creditor due to prevailing adverse market conditions, precisely in the selling market of the buildings, and the political disturbances in the Arab world in general.

On the other hand, merchants have dealt with each client separately, and have arranged different credit terms for the sale of their construction material and equipment. These credit terms depend upon their relationship with their client, and at the same time upon the latter's character and credit worthiness. Generally, they have adapted the following credit policy:[1]

1. The installment payments for the value of the construction materials and equipment sold to a client are usually limited to a maximum period of six months, and are supported by a promissory note signed by the client. Merchants do know sometimes that they are going to renew the loan. Nevertheless, they usually limit the maturity period to six months in order to be able to discount these promissory notes at banks in case of financial need.

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[1]Interviews with various merchants, constructors and real estate owners and enterpreneurs mentioned in Appendix II.

2. The value of various construction materials and equipment sold to a client on open account is to be repaid within a maximum time of one year, or after finishing the construction of the building.

3. Installment payments for an elevator are usually limited to a maximum period of 18 months, and at least a 10% down-payment should have been received by the merchant. Merchants would not renew such a loan except when there are chances of losing a good client.

As to the mode of repayment, during the fifties, approximately 90% of the real estate credit extended by money lenders was repaid in a lump sum at maturity, while about 10% was repaid in installments. Recently, the tendency has been reversed: approximately 90% of the real estate credit is repaid in installments, while 10% of it is repaid in a lump sum. This is due primarily to the contraction in the demand for buildings, due to the law issued in 1963 which limited the number of buildings purchased by foreigners.[1]

As to the date of repayment of the loan, it is generally agreed upon by the two parties. In case the creditor is a professional or semi-professional money lender, the date of repayment is usually fixed after the construction period. In case the creditor is a merchant, the first installment payment for the price of the elevator is to be collected within one month after it is put into operation.

Finally, the writer concluded from the various interviews held with the notary public, land register, merchants, contractors, real

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[1] Al-Jarida Al-Rasmiah, Vol 23, March 19, 1964, p. 858.

estate owners, and some money lenders, that the maturity period of the loan is usually adapted to the financial ability of the client up to a convenient extent.

E. Interest Rate Policy [1]

Apparently interest rates charged by all professional and semi-professional money lenders on real estate loans have ranged, between 9% and 12% per annum. These are the legal interest rate limits which they indicate in the loan agreement in order to preserve their right to collect accrued interest from the debtor in case of default. However, they do charge interest rates between 12% and 20% but in two hidden manners:

1. The discount method. The debtor is usually required to sign a promissory note with a face value of 100% of which they have granted him only 85%. Thus interest rate charged is almost 18% per annum, and is collected in advance. In case of default, it is mentioned in the contract that interest should be collected at 10% or 12% per annum on the delayed period, which is the already applied legal rate.
2. The additional method. In this case, the debtor is usually required to sign a promissory note with a face value of 115%, of what he received as cash money. Thus he is paying interest at 15% per annum (assuming the note to mature in one year), while in the loan agreement, it would be mentioned that during the

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[1] Beirut Notary Public.

delay period, interest is to be collected at 10% or 12% per annum.

On the other hand, merchants use the "additional method", whereby, interest is included in the face value of the promissory note which the client is required to sign. Practically, they do limit their interest charges between 7% and 10% per annum, due to prevailing competative market conditions. This rate is almost equal to the rate charged by the merchant's discounting bank.

Generally the range between 7% and 20% interest charged by money lenders is determined by the following aspects:

1. Security. Generally, the interest rate charged by money lenders is determined mostly by the extent of collateral offered as security. They would charge a lower interest rate on loans that are backed by a more adequate and safer security and vice versa.
2. In case the creditor is a merchant, the client's character and financial standing would be the determinant factors. In general, money lenders are more lenient with the debtor who enjoys a good reputation and a high financial standing. They would charge him a lower interest rate.
3. Maturity. Due to uncertainty and unforeseen contingencies, money lenders prefer to extend short term credit. Hence, they would charge a higher interest rate on a real estate loan of longer maturity and vice versa.

F. Volume

Unfortunately, statistics covering the volume of real estate credit extended by money lenders are not available. However, the

Notary Public of Beirut, and the Director of the Land Registry estimated that it does not range more than 5 to 10% of the total construction activity which has boomed in Lebanon. Meanwhile, in the absence of figures showing aggregate expenditures on construction, the figures in Table VIII below, based on the average cost per square meter of construction LL 200 - may be used to give a rough estimate of construction

TABLE VIII

ESTIMATES OF REAL ESTATE CREDIT EXTENDED BY MONEY LENDERS FOR BEIRUT CITY

1953 - 1963

(In LL Millions)

Year	Surface in Square Meters of the Storeys [1]	Total Cost [2]	7.5% average estimated credit extended by Money Lenders
1953	317,681	LL 64	LL 5
1954	423,037	85	6
1955	642,393	128	10
1956	530,480	106	8
1957	430,929	86	6
1958	389,321	78	5
1959	606,230	121	9
1960	704,211	141	11
1961	664,845	133	10
1962	572,184	114	9
1963	770,000	154	12
Total	6,051,311	LL 1,210	LL 91

Sources: 1. Table I Chapter I - Number of Construction permits granted in Beirut and Tripoli between 1953 and 1963.

2. Average cost per square meter was taken at LL 200 as per several interviews with contractors and civil engineers. In fact, cost per square meter was estimated to range from LL 100 up to LL 400.

expenditures in Beirut city alone. Figures covering the whole territory of Lebanon are not possible to estimate due to the absence of statistics revealing the number of square meters permitted for construction. Consequently, as indicated before in Chapter I,[1] the writer has assumed that the trend in the number of square meters licensed in Beirut city reflects to a large extent the general trend for the whole country.

Hence, based upon the above average percentage of 7.5 stated by the Notary Public of Beirut and the Director of the Land Registry, total estimated volume of credit extended by Money Lenders for Beirut city on construction over the last ten years would be approximately LL 91 million Lebanese pounds, as shown in Table VIII above.

G. Money Lenders Policy in Case of Default

Many of the buildings constructed recently are intended to be sold. However, the market has been much limited, and many debtors were not able to settle their obligations promptly. Hence, money lenders have reacted in the following ways:

1. If the financial standing of the client is favorable, money lenders do renew the loan for another period, and would try to obtain the signature of a third party as a guarantor.
2. In case they doubt the intention of the debtor, money lenders would sue him at court and declare his bankruptcy. Their comments on the legal foreclosure procedure are that they are satisfactory, except for the long time needed to settle such cases.

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[1] See page 8 above.

H. Summary

Money lenders can be classified into three categories: professional money lenders, semi-professional money lenders, and merchants. As they are risking directly their own money, they have been very careful in extending real estate credit.

Generally, professional and semi-professional money lenders have emphasized mostly the collateral factor supporting the real estate loan. Merchants, due to competition, have satisfied themselves with the signature of the debtor on a promissory note only, but have selected debtors who enjoy good reputation and high financial standing.

Regarding the terms of credit, most money lenders have extended real estate credit on a short-term basis for a maximum period of one year. Also, most of them have tried to collect the maximum possible interest charges, and the interest rate has ranged between 7% and 20% per annum.

Statistics covering the volume of real estate credit extended by money lenders are not available, and the volume arrived at was nothing more than a guess.

CHAPTER V

OTHER SPECIALIZED FINANCIAL INSTITUTIONS AS SOURCES OF REAL ESTATE CREDIT

Although the real estate credit terms of commercial banks and money lenders in Lebanon have greatly encouraged the construction activity over the last ten years, as revealed in chapters III and IV above, the real estate credit terms of other specialized financial institutions have also had their own effect on the construction boom in Lebanon. These institutions are:

A. Real estate business concerns.[1]

B. Insurance companies.

C. Other specialized banks.

In this chapter, only the peculiarities of real estate credit policy of each of the above specialized institutions will be discussed, since the other terms of credit are more or less similar to those of commercial banks discussed in Chapter III above.

A. Real Estate Business Concerns

These are private commercial organizations trading in land, and constructing houses to their clients. Besides their basic objective of making profit, they enable an individual to buy a private residence

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[1]Include corporations (S.A.L.), partnerships, and sole proprietorships.

on medium- and long-term installment bases. Their operations can be summarized as follows:

They buy large lots of land which they plan to develop according to modern living conditions. At first they divide it into small plots and then open roads, install electricity and telephone communications, obtain water, and construct a sewage system. Later they sell the plots to individuals, and meanwhile offer to construct houses on them on behalf of their clients and according to their specifications. Repayment is usually arranged over a long period of time.

Another peculiar aspect of these concerns is that they construct a building sometimes on their own behalf, and later they sell it by apartments on medium- and long-term installment bases to clients, who would have either applied for such an apartment before the construction has taken place, or have decided to buy one lately. This is the kind of business that has spread much in Lebanon nowadays, that is, constructing buildings and selling them by apartments either on installment or on a cash basis. As the building has already been constructed, the credit thus extended cannot be considered as real estate credit. However, clients usually sign promissory notes, and these concerns can withdraw funds against these notes from commercial banks, in order to finance another construction project. As such, the writer considers the credit sale transaction of an apartment as an indirect source of credit for real estate construction.

From the above summary, one can conclude that the profits realized by real estate business concerns are limited mainly to the difference in the price of the realty being sold, and to the interest which they will collect from their clients over the repayment period. Hence, what is the real estate credit policy that has been followed by these concerns over the last ten years in Lebanon?

1. Credit Standing of the Client

Generally, real estate business concerns interviewed do not require their client to submit financial statements to be analyzed scientifically. Nevertheless, they inquire much about his financial standing in a strictly confidential manner from other private and public sources, i.e., commercial banks, government, his employer, etc....

Some of the interviewed concerns have insisted that the collateral supporting the real estate credit would be the most important determining factor. As such, these concerns do not register the land and the house to be erected on it in the name of the client until he has fully settled all his obligations. They consider next the character of the client since a bad client can avoid payment even in court. Finally the capacity and the capital determinants would have to be taken into consideration in order to assure themselves of a source of repayment.

Other interviewed concerns insisted that the character of the client is the determinant factor in extending real estate credit. As such, these concerns register the land and the house to be erected on it in the name of the client, provided they have already collected 25% down payment. They would also hold a first mortgage on it. Furthermore, the capacity factor would have to be considered next since it represents the source of income for repayment of the debt. After that, they would consider the other financial sources of the client, namely, collateral and capital determinants, in order to assure themselves of the safety of their money.

Some of the interviewed concerns declared that their own engineers and workers would have to carry on the construction work on the plot of land being sold on credit, and this is not left freely to the client. Others declared that they extend, in some cases, a stand-by credit to the client, or a building credit, whereby every time the client needs money to pay contractors, he has to submit evidence of the transaction approved by the engineer of the company. Furthermore, they generally pay the contractors directly.

2. Types of Security

In estimating the credit worthiness of the client, some of the interviewed concerns emphasized mostly the collateral determinant, while others emphasized the character determinant of the client. The reason for such a difference is attributed primarily to the method of holding the accepted collateral as a backing security to the real estate credit.

a. Down-payment:

All the concerns interviewed declared that their client is required to pay at least a 25% margin as a down payment on total cost, which constitutes the price of the plot of land, total estimated cost of construction, and total interest charges.

However, some of the interviewed concerns insisted that title to the land and the construction to be erected on it are to be left registered in their name until full settlement of all outstanding debt.

Other interviewed concerns accept to register the land and the construction to be erected on it in the name of the client, but they would hold a first mortgage on it, provided they have already collected the 25% down payment.

b. Other types of security:

All the concerns interviewed have not accepted and would not accept other assets as collateral except if they were to be considered as additional security to the 25% down payment. Such an offer has very rarely taken place in the past, and the assets accepted varied from a plot of land to assignment of income from other buildings, or building with its income.

The approximate percentage of the loan for real estate construction has not been less than 75% of the market value of the mortgaged property.

3. Maturity Structure

Besides profitability, the basic objective of real estate concerns is to help an individual financially, and hence enable him to buy a private house on medium- and long-term installment bases. Some of the interviewed corporations have limited the time period during which they permit their client to repay his debt up to eight years on a monthly installment basis. Other interviewed corporations have extended the period of repayment up to ten years on a monthly, quarterly, or yearly installment bases, depending on the financial characteristics of the client, and upon his relationship with the corporation. Furthermore, they have been more lenient with a good client and have allowed him to pay the 25% margin of collateral over six months, after which, they would register the land and the construction in his name, but would hold first mortgage on it.

On the other hand, partnerships and proprietorships have limited the repayment period up to three years on monthly, quarterly, or yearly bases, depending on the financial characteristics of the client or other social relationships.

All the concerns interviewed declared that the first payment has been usually fixed during the first year after the delivery of the house, or after the construction of the house by the client. The exact date of the first payment would always depend upon the client's capacity, and upon his relationship with the business concern to a limited extent.

4. Interest Rate.

Real estate corporations do not only help the individual to buy a private house on a long term basis, but also at a fair interest rate. Real estate corporations interviewed have limited the interest rate between 7½% and 8%. Moreover, there are two methods followed by real estate corporations regarding the calculation of interest charges:

a. Monthly balance:

Some of the interviewed corporations collect interest on the monthly balance. After the corporation has estimated the total amount of credit needed, and agreed upon the maturity period, it resorts to a kind of amortization table which enables it to determine the monthly installment payment that would include interest too. The client usually signs promissory notes.

b. Average daily balance:

Like commercial banks, some interviewed corporations extend the real estate credit on an overdraft basis, and hence would collect interest on the average daily balance. Every three months, the client either has to pay the interest charges, or they would be charged to his account. Besides, the client is also required to sign monthly promissory notes for the total estimated amount of credit needed, and these are only considered as a measure of protection to the company. They are not to be protested since the land and the construction work are still in the name of the corporation.

Practically, interest rate charged by real estate corporations has never been affected by the maturity period or the security supporting the loan. They charge fix rates.

On the other hand, partnerships and sole proprietorships charge a flat rate of interest between 7% and 10% per annum, depending on their relationship with commercial banks and on the financial position of the client buying the apartment house. The client usually signs promissory notes.

5. Volume of Credit.

Unfortunately, statistics covering the volume of credit extended by real estate business concerns in Lebanon are not available.

Practically, all real estate corporations interviewed limit the ratio between the loans assigned for real estate construction and their paid up capital up to a maximum of 50%.

6. Measures Taken by Real Estate Business Concerns in Cases of Default

Interviewed concerns limited the percentage of default between 3% and 5% per annum of the loan for real estate construction over the last ten years. This ratio does not represent the amount charged as bad debts. In fact, negotiations have always taken place with the defaulting clients, in accordance with the following policy:

a. First, creditor concerns would try to extend the maturity period of the loan, because they consider the client as a partner in such a business. Some of the interviewed corporations declared that they would then charge the client 9% interest per annum instead of

7½% per annum. The difference is considered as a penalty for renewal, which any client would try to avoid.

b. They would supervise and control the construction activity and try to find a new buyer in order to get back their money.

c. In case of failure of negotiations, some of the interviewed concerns declared that the final step would be to repay the client his already paid money, but would deduct due interest charges. This policy is based on the fact that the value of land would always increase. Even in 1958, the year of political disturbance, the value of land was stable and even rose.[1]

d. Some interviewed concerns declared that in case negotiations were unsuccessful, the final step would be to go to court, and hence a troublesome lengthly routine in order to get back their money. As such, they have never done this and they hope not to be forced to do it in the future.

Finally, all the interviewed concerns declared that patience was the best policy in cases of default. Personal contacts proved to be useful.

B. Insurance Companies

Insurance companies are the most important single institutions which provide long-term funds.

Due to risk and uncertainty, the human urge for security has helped insurance business to flourish. This business consists mainly of two major groups: life insurance companies and fire and casualty companies. At any one moment and for any individual, all types of risk

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[1]Mr. Alfred Buckley, Societe Libanaise d'Amelioration Fonciere (SLAF), S.A.L.

are remote, but when they occur, their consequences can be disastrous. However, by cooperating in sharing such risks, their severity can be reduced to manageable portions. Hence, insurance is one of the devices through which people cooperate in sharing risk, and consequently, attain protection and security. As such, an ordinary insurance policy is a contract whereby the insurance company agrees to pay a stipulated amount to the beneficiary, or to the insured person, upon the occurence of a certain type of risk, in consideration of certain periodic payments to the company. The basic element in determining the amount of premium that has to be made by the insured person is the probability of occurence of the risk in a certain future period of time. Consequently, until the risk occurs, funds are accumulated with the insurance company on account of its liability for payment of the face value of the insurance policy issued. These accumulated funds form a major part of the policy reserves which are the principal source of funds for investment by insurance companies. Fire and casualty insurance companies do not accumulate large reserves like life insurance companies, but nevertheless, their assets and security investments are quite substantial.

Being profit seeking organizations, insurance companies do not hold such funds and reserves idle in their vaults. Also, the fact that insurance companies, and especially life insurance companies, hold most of their assets against rigidly fixed liabilities, has made them a very important source of long-term funds.

In Lebanon real estate credit has been one of the many investment outlets for some insurance companies with large policy reserves over the last ten years. Those who are reluctant to extend real estate credit have generally given the following reasons:

1. Foreign insurance companies have to obtain a special permission to hold a mortgage on real estate.

2. In case of default a special permission would also be needed to declare a public auction.

3. It is more profitable to deposit such funds with banks, and probably issue some policies to the latter's employees, i.e. exchange business.

What policy do insurance companies follow regarding real estate credit?

1. Credit Standing of the Debtor

Interviewed insurance companies usually do not require their debtor to submit neither financial statements nor a cash flow statement, and hence do not bother themselves in performing scientific financial analysis. Nevertheless, they do estimate the debtor's credit worthiness by studying verbally and confidentially his financial situation. They emphasize mostly the collateral that the debtor can offer together with his reputation and his character. In addition, they consider his financial capacity to repay the loan and his total net worth in order to be safe in case of financial difficulties.

Insurance companies do not construct houses to their clients. However, after they grant real estate credit to a debtor, the company's experts and engineers would check the debtor's construction work periodically, and hence would follow every step that has taken place. As such, insurance companies do control and supervise the use of the credit funds in order to safeguard the money of their insured persons.

2. Types of Security

The very essence of insurance business is safety. Consequently, insurance companies limit their investments to safe outlets only, due to the fact that the funds they hold are the property of the insured persons, that is, their clients. As such, interviewed insurance companies in Lebanon have mostly emphasized the following types of security to support real estate credit:

a. Surrender value of an insurance policy:

Insurance companies have given priority to the surrender value of an insurance policy as a backing security to a real estate credit provided that:

(i) The policy is still in force and is not void.

(ii) It has not been endorsed.

(iii) All premiums are fully paid.

(iv) Policy should be a clean one, that is, no cases should have been raised against it.

(v) The presence of a notary public is necessary when the beneficiary is required to endorse the policy. This is so because the signature of the beneficiary is a legal requirement.

b. Guarantee:

The second type of security that insurance companies have given priority to is a bank's guarantee. In such cases, the bank would be liable to the company if the debtor does not fullfil his obligations as agreed upon. Insurance companies have always been able to get hold of first class bank guarantees, but this has rarely happened and in exceptional cases.

c. Other Types of Security:

Insurance companies, like commercial banks, have accepted other types of security in support of real estate credit, namely, mortgage on a building with its income, mortgage on a building under construction, and mortgage on a plot of land.

Practically, insurance companies have limited the percentage of the loan for real estate construction between 30% and 50% of the appraised market value estimated by their engineers and experts, through one of the methods discussed in chapter II.

3. Maturity Structure

Due to uncertainty, insurance companies can never predict precisely when a certain type of risk is going to occur, and hence, the time when they would be required to pay an insured person. Interviewed insurance companies have adapted the policy of extending real estate credit only on a short term basis not exceeding one year in maturity, subject to renewal. The conditions pertaining to renewal are never included in the terms of the loan contract. Nevertheless, insurance companies always renew the loan, unless they are in need of funds, or they doubt the debtor's financial standing.

Hence, insurance companies do consider their liquidity factor, like the commercial banks, because if they do not pay any insured person in due course, their reputation would be hampered. Thus, interviewed insurance companies have decided not to renew a short term real estate credit more than three to four times maximum. Furthermore, to conserve their liquidity, they extend real estate credit on monthly, or quarterly repayment basis. Also, they require the first installment to be made not later than one year after the loan for real estate construction has been granted, depending on the debtor's financial capacity.

4. Interest Rate:

The interest rate charged by the interviewed insurance companies on real estate credit ranges between 8% and 9% per annum, depending on the financial situation of the debtor and the collateral offered as a backing security.

Practically, interviewed insurance companies follow two methods in extending real estate credit:

a. On an overdraft basis, in which case, interest will be calculated on the average daily balance and charged monthly to the account of the customer.

b. On a discount basis. In this case, the debtor is required to sign monthly or quarterly promissory notes, which will be discounted, and he will be given the proceeds. Hence, they will be collecting interest in advance, plus 1% or 2% service charges or commission.

5. Volume

Unfortunately, statistics covering the volume of real estate credit extended by insurance companies in Lebanon over the last ten years are not available. However, interviewed insurance companies declared that they maintain a ratio of 15% or 20% between loans extended for real estate construction, and their total policy reserves. These reserves are the money of the insured, and insurance companies cannot afford to run greater risks in investing them.

6. Policy in Case of Default

Interviewed insurance companies declared that the rate of default has been about 3% or 5% per annum, but they have always been able to collect it later by adopting the following policy:

a. First, they would try to extend the maturity period of the loan.

b. Second, they would supervise and control the construction activity in order to liquidate it, and get back their money.

c. Finally, they would insist on immediate repayment even if it leads to declaring the debtor's bankruptcy in court. This has never happened so far, and they hope not to be forced into such actions in the future.

Also, interviewed insurance companies have declared that they would deal with each debtor separately, and would consider his circumstances in the light of convenient negotiations, rather than resorting to courts.

C. Other Specialized Banks

The other specialized banks discussed below adapt almost the same banking policy towards real estate credit as the commercial banks discussed in chapter III above. Nevertheless, they possess certain peculiarities which will be pointed out in the remaining sections of this chapter.

1. Mortgage Banks

The operations of these banks center around extending credit to any economic sector provided they hold a first mortgage on some real estate property. Hence, the collateral offered in support of real estate credit is the determining factor in approving the loan by such banks.

Another peculiar aspect of the real estate credit extended by such banks is the maturity structure. They extend real estate credit for the period required to finish the construction of the building, and to settle the debt, provided that the time period remains between three and four years. As such, they try to deal with each client seperately, consider his financial circumstances, and try to adapt the maturity period to his capacity but up to a reasonable period accepted by the bank.

The interest charged by such banks ranges between 8% and 9% per annum like the commercial banks, and it is either calculated on a discount basis or on an overdraft basis, depending on the form of the credit facility approved by them.

Finally, the volume of real estate credit extended by such banks is already included in the volume estimated for commercial banks, since they are considered as accredited banks operating in Lebanon. Those interviewed declared that they maintain their loans for real estate construction in a ratio of 40 to 45 percent of their paid-up capital.

2. The Development Bank of Lebanon.

This bank is called "Banque de Credit Agricole, Industriel et Foncier". It was established in July 1954 by the Lebanese government to encourage lagging economic sectors namely, agriculture, industry, and the construction of hotels and other touristic projects..

One of the peculiar aspects of this development bank is that it extends credit on short-, medium-, and long-term bases to agriculture, industry, and real estate construction that would encourage tourism, such as hotels and restaurants. The objective behind the bank's policy is to develop these economic sectors which other commercial banks hesitate to finance either because of the long-term nature of the credit involved, or because of the high risk that is associated with such credit. However, this kind of credit requires long-term deposits which are very scarce in Lebanon.

At its initiation, 40% of the capital was to be paid by the Government together with its guarantee for 45 million Lebanese pounds for funds other than accrued interest borrowed from the Banque De Syrie et Du Liban, which was the acting central bank of Lebanon in 1954.[1]

With a paid up capital of 5 million Lebanese pounds, and the Government's guarantee for twenty million, this development bank started its operation in 1954, and has since then adapted the following credit policy towards real estate construction that would encourage tourism:[2]

a. Credit worthiness of the Client:

In view of modern banking practices, this bank performs financial analysis of the client in order to estimate his credit worthiness more correctly, and hence to minimize the risk of default. The collateral factor is mostly emphasized together with the debtor's capacity, capital and character.

Before granting a loan, engineers or experts of the bank will have to investigate the project, and submit a report indicating whether the project is worth undertaking, and whether it would encourage tourism.

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[1]By-laws of BCAIF.

[2]Afif Matar, Head of Industrial and Real Estate Department at BCAIF.

Also, after granting the loan, the bank's specialists would have to follow-up the construction activity, and report whether the funds were utilized in the mentioned project or not. After each LL 50,000 withdrawals, the bank's specialists would have to investigate the project and submit a report.

Hence the bank, in general, supervises and controls closely the use of the credit funds.

b. Types of security:

The peculiar aspect of the security accepted by the Development Bank is that it would prefer to hold a first mortgage on land as a security to real estate credit, and especially land on which the construction work is to be erected. The reason is related to its development policy, and almost all its debtors do not possess other assets than their plots of land.

The other types of security that the Development Bank would accept are: a mortgage on a building with its income, a mortgage on a building under construction provided that the debtor would insure the building against fire and accidents, and would endorse the insurance policy to the Bank.

Practically, the approximate percentage of the loan for real estate construction is limited up to 40% of the forced selling price estimated by experts.[1] As usual, the Bank's expert would give an estimate of the market value of the asset offered as a collateral. The Bank would then deduct 20 to 50% as a margin for forced sale condition, depending on

[1] *Ibid.*

the location of the asset and the Bank's opinion of the client. Finally, 40% of the estimated sale value would be granted as a loan for construction.

c. Maturity structure:

In accordance with its overall development objective, the Bank extends real estate credit on short-, medium-, and long-term bases.

The maximum period for a short-term real estate credit is limited up to one year, and is intended to finance current expenditures which would be covered in one year. The Bank would then renew the loan provided that the debtor's financial position is favorable.

The maximum period for a medium real estate credit is limited to eight years, and is intended to finance development projects. Repayment is to be affected on a yearly installment basis, and should always cover the accrued interest on the outstanding balance.

The maximum period for a long-term real estate credit is limited to sixteen years, and is intended to finance development projects. Repayment is to be affected on a yearly installment basis, and should always cover the accrued interest on the outstanding balance.

Generally, the first payment is fixed by the Board of Directors one year after the date of the loan. However, it has rarely been fixed for three or five years after the date of the loan for medium-, and long-term credits, depending on the debtor's financial capacity and the project itself. In all cases, interest should always be paid yearly on the outstanding balance.

d. Interest rate:

Since it is a development bank intended primarily to encourage the various economic sectors mentioned above, it charges a low interest rate. The bank's policy is to charge 5½% interest per annum on loans granted for real estate construction. However, in case of default, the rate would be raised up to 7.5% per annum. This extra charge of 2% per annum is considered as a penalty which every debtor would like to avoid, and hence would do his best to repay the loan promptly.

Interest is always collected in advance on the remaining balance as of the date of first payment, and as such the final payment would not include any accrued amount of interest.

e. Volume:

Table IX below reveals the amount of real estate credit that has been granted by the Development Bank since it started operating in July 1954.

Hence, a sum of LL. 17,629,410 have been extended by the Development Bank to finance real estate construction that would encourage tourism. Moreover, the increase in the amount of real estate credit extended by the bank each year is a good indicator of the increase in real estate projects that have been developed over the last ten years, and which have encouraged tourism in one way or another. Except for 1958, the year of political disturbance, there was a continuous increase in the amount of real estate credit extended.

In fact, most of the real estate credit extended by the Bank was granted to finance construction in Beirut and the Mountain, since these form the central locations for big hotels, night clubs, restaurants and the like (including the Casino du Liban, and few other touristic places).[1]

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[1]1961 Financial Statement of BCAIF.

TABLE IX

REAL ESTATE CREDIT EXTENDED BY THE

BANQUE DE CREDIT AGRICOLE, INDUSTRIEL ET FONCIER

1953 - 1963

Year	Amount extended	Amount collected	Balance end of year
1955	LL. 379,000	LL.	LL. 379,000
1956	2,381,500	128,800	2,631,700
1957	2,099,425	358,700	4,372,425
1958	400,000	185,325	4,587,100
1959	3,267,500	515,900	7,338,700
1960	1,511,840	823,225	8,027,315
1961	2,619,400	1,055,053	9,591,662
1962	2,221,300	1,894,699	9,918,263
1963	2,749,445	1,468,473	11,199,235
Total	LL. 17,629,410	LL. 6,430,175	

Source: Annual Reports of the Bank.

f. Bank's policy in case of default:

The rate of default on real estate credit extended by the Development Bank has ranged between 10% and 15% per annum.[1] However, negotiations have always taken place according to the following policy:

1. If the debtor does not invest the loan granted in the mentioned project, the Bank would sue him, and interest would then be calculated at 7.5% instead of 5.5% per annum.
2. The Bank usually tries to extend the maturity period of the loan. Only half the installment could be postponed to a maximum period of one year, and interest would have to be paid at 7.5% instead of 5.5% per annum.
3. The Bank would supervise and control the construction activity in order to sell it, and collect its money.
4. When negotiations fail, the Bank would insist on immediate repayment, even if this would lead to the client's bankruptcy. Generally, the Bank would not sue the debtor as long as he pays interest at 7.5% per annum, plus the installment payment.

D. Summary

The real estate credit policy followed by other specialized financial institutions, may be summarized as follows:

1. Real Estate Business Concerns.

One of the peculiar aspects of such concerns is that they build houses on behalf of their clients. The minimum collateral

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[1] Mr. Afif Matar, BCAIF.

accepted against the loan is approximately 25% downpayment of the total costs of the land and the house to be erected upon it (interest charges included). Real estate corporations extend credit on a long-term basis up to ten years, and charge an effective interest rate between 7.5% and 8% per annum. Partnerships and Proprietorships extend credit up to three years, and charge a flat interest rate between 7% and 10% per annum. In case of default, some of them charge an extra 1% or 2% per annum as a penalty charge.

2. Insurance companies

The large policy reserves that are accumulated in insurance companies, urge them to invest only in safe and profitable projects, such as real estate construction. The main feature of such companies is that they accept an insurance policy as a collateral, while all the other sources of real estate credit discussed in this thesis consider it only as an additional security. Another type of security that they stress to have is a bank's guarantee.

3. Other Specialized Banks

a. Mortgage banks: The policy of such banks is to extend credit to any economic sector provided they hold a first mortgage on real estate property. Meanwhile they accept to extend the credit up to three or four years.

b. Banque De Credit Agricole Industriel et Foncier: This bank is intended to encourage the various economic sectors that are relatively underdeveloped, namely, agriculture, industry and construction of hotels and other touristic projects. This Bank extends credit on short-, medium-, and long-term bases, at a very low interest rate of 5.5% per annum. However, in case of default, it charges an extra 2% per annum as a penalty.

CHAPTER VI

THE CONSTRUCTION ACTIVITY AND THE AVAILABILITY OF CREDIT

The foregoing chapters indicate that between 1953 and 1963, credit for real estate construction was available at different terms and from three sources in Lebanon, namely:

1. Commercial banks
2. Money lenders
3. Other specialized institutions

Further, the availability of such credit was a major determinant in the supply of the real estate construction activity which constitutes a significant factor in the Lebanese economy.

A. The Housing Problem

As a matter of fact, over the last ten years, Lebanon witnessed a substantial growth in the construction sector, and in particular an over-expansion in luxury buildings with modern facilities such as lifts, central heating, telephones, etc... Actually, these luxury buildings are quite abundant in number, and the rental space they provide exceeds considerably the rental space provided by the popular (non-luxurious) ones.

Available statistics indicate an income elasticity of demand for rent of approximately 0.61, and an expenditure (private) elasticity of demand for rent of approximately 0.80.[1] This indicates a high cost of living for the

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[1]"Household Consumption Survey", a pilot survey made in 1964 by Dr. Hisham M. Al-Kaylani, Central Office of Statistics, Ministry of Planning (information not published officially yet).

The elasticity was measured by using the logarithmic model: $\log y = a + b \log x$, where b = elasticity, x = expenditure on rent; y = is used for both total income and private expenditures.

population, as rent, which is a necessity of life, has a high expenditure elasticity of 0.80.

Below is presented Table X which shows rent as a percentage of total family expenditure paid by different income groups in Lebanon, obtained personally from Dr. H.M. Al-Kaylani, from the Central Office of Statistics at the Ministry of Planning.

TABLE X

MONTHLY FAMILY TOTAL EXPENDITURE GROUPS

AND EQUIVALENT RENT RATIOS

(In Lebanese Pounds Per month)

	Less than LL 500	500-1,000	1,000-1,500	1,500-2,000	2000 and above
Percentage of rent out of total family expenditures	19.0%	19.8%	16.0%	14.0%	15.[illegible]

Source: Data obtained personally from the Central Office of Statistics at the Ministry of Planning.

Below is also Table XI which reveals the percentage distribution of expenditures for a household of 5.2 persons, having a yearly income of less than LL 6,000, also obtained personally from Dr. H.M. Al-Kaylani.

TABLE XI

PERCENTAGE DISTRIBUTION OF EXPENDITURES

AVERAGE HOUSEHOLD = 5.2 PERSONS

	Food & Drinks	Rent	Clothes	Household durables & operations	Miscellaneous
Family income group with less than LL 6,000 per year.	48.3%	18.8%	9.1%	5.9%	17.9%

Source: Same source as Table X.

The above tables indicate that a significant part of a family's income is paid on rent, and family income groups of less than LL 6,000 per year pay 18.8% of their income as rent, which is relatively very high. Statistics covering the last decade also indicate that the majority of the Lebanese population falls in that group which earns less than LL 6,000 per year.[1]

Hence, the price for the satisfaction of one of man's most urgent need is high in Lebanon, and is increasing year after year. As indicated above, the majority of the Lebanese population is paying presently 18.8% of their income as rent, and the housing problem is emerging slowly. The present Government is aware of this problem, and the five-year plan for economic development includes the construction of popular residences. The Government's aim is to enable individuals of the low income group to own each a private

[1] Emile Ghattas, "The Functioning of the Banking System in Lebanon", unpublished doctoral dissertation, Columbia University, 1964, p. 51.

house either in Beirut, on the outskirts of the city, or in the Lebanese villages.

B. Adequacy of Credit

As revealed in the previous chapters, credit for real estate construction in Lebanon is available at different terms on the money market which includes organizations and individuals dealing in short term funds. However, the absence of reliable statistics to correlate the exact volume of credit extended with the corresponding demand, is an obstacle to assessing reasonably well the adequacy of real estate credit. Nevertheless, the evaluation of the terms of available real estate credit, as discussed below, reveals that the latter's main features are inadequate to cope with the emerging housing problem, and could also be considered, to some extent, an important factor in the emergence of this problem.

A noted deficiency of real estate credit is the disproportion between the weak means of finance for long and medium term investments, which are vitally needed for the construction activity, as compared with the concentration of the creditors' activities on short-term finance. In general, creditors in Lebanon (other than real estate business concerns) who extend real estate credit, have transformed such loans from the form of long-term obligations, into commercial loans of short-term maturities running up to a maximum renewable period of one year. Of course, the objective of this policy is to preserve the liquidity factor. Theoretically, such logic cannot be accepted, especially when it is practiced by commercial banks which are short of fixed or term deposits. A major factor behind the bankruptcy of the Banque Fonciere Libanaise in 1964 was its engagement in real estate credit of long-term nature, which does not conform with the nature of its demand deposits.[1]

Another deficiency of real estate credit is the gap between the interest rates charged by the various sources of credit. With the exception of the special case of BCAIF (the Banque de Credit Agricole Industriel et Foncier)which charges 5.5% on loans for hotel construction and other touristic projects, the interest rate charged by the remaining sources of real estate credit ranges between 7% and 20% per annum. This rate of interest is relatively high, and forms a major part of the total construction costs of a building. Consequently, the real estate entrepreneur demands higher returns on his investment, which means high rental costs for the public.

A third feature of the inadequacy of real estate credit could be observed from the fact that some real estate entrepreneurs have resorted to money lenders who charge higher interest rates reaching 20% per annum. Obviously, these borrowers would only resort to money lenders after their application for credit has been turned down by the other creditors who charge lower interest rates. It is true that the latter creditors always perform some sort of credit investigation and, usually, extend secured credit facilities only to clients with good financial standing. Nevertheless, sometimes, these creditors may also turn down an application for credit because of the unavailability of funds at their disposal. Hence

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[1]Decision of the First Court of Beirut on the Bankruptcy Case of Banque Fonciere Libanaise, S.A.L., published in Al-Nahar Newspaper, April 9, 1964, p. 6.

it is quite reasonable to conclude that there are symptoms of shortage in the supply of real estate credit.

C. Conclusion

As indicated above, Lebanon is currently facing a housing problem, which is increasing year after year, and is liable to disturb the entire economy in case officials do not succeed to control it in the proper time. Meanwhile, its solution cannot be achieved overnight because the dimensions of the task are enormous. Financially, the cost will not be small, and many tens of millions of Lebanese pounds will be needed in the long-run. In the meantime, the real estate credit available on the Lebanese money market, which is a major source of funds, appears to be inadequate to cope with the financial requirements of the problem. In fact what is lacking in Lebanon is a capital market through which long term funds could be raised by selling bonds and stocks.

Hence, a progressive and aggressive policy towards developing a capital market should be adopted, whilst all elements of success are on our side. Such a development policy requires a new philosophy of the function and organization of the Government, as the present pattern appears to be inadequate for the task we face.

As a suggested solution, which is by no means the only workable one, the government should develop a mortgage market in which mortgage bonds would be traded, with maturities reaching twenty years, and with interest rates equal to prevailing average market rates. Such a market could be initiated by promoting the establishment of mortgage banks that would deal in mortgage bonds, and savings banks which would attract the savings of the public to be circulated in the mortgage market rather than hoarded under the ground. Encouragement by the Government could be in the form of contribution in the paid capital of the institution, or by giving its guarantee up to a certain amount of money, as was the case when the development bank (the Banque de Credit Agricole Industriel et Fonciere S.A.L.) was initiated in the year 1954 (see page 81 above).

Finally the immediate question that any investor would then raise is the political stability of the country and the extent to which it can be preserved. Investors should be greatly assured of the long-run political stability of the country, otherwise they will hesitate to participate in the above suggested mortgage market.

The writer's opinion is that investors should have more faith in the Government and its capacity to do the job well. In fact, if we mobilize our resources, and bring together the best minds from our business and financial communities to act boldly for the common purpose, then we may come much closer to the solution of the financial aspect of the housing problem, and to providing the credit needs of the construction sector.

APPENDIX I

QUESTIONNAIRE[1]

To the Manager,

I am a graduate student at the American University of Beirut preparing for the Master's Degree in Business Administration. One of the requirements to be fulfilled towards this degree is to write a thesis in my area of concentration which is Finance.

I am writing on this subject:

"The Supply of Real Estate Credit In Lebanon"

Your kind cooperation in answering the attached questionnaire will be greatly appreciated. May I assure you that your answers to this questionnaire will be held as strictly confidential.

Many thanks,

Mustafa Ghalayini
A.U.B.
P.O. Box 236/527
Home Tel. 222257

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[1]This questionnaire was also used during the interviews with Money Lenders and other Specialized Financial Institutions, except for some verbal modifications.

"The Supply of Real Estate Credit In Lebanon"

* Please check or fill in the answers for the following questions:

1 - When did the Bank start its operations in Lebanon? Year ________

2 - What is the capital of the Bank? Authorized Paid up

3 - What amount of capital is assigned to finance the Bank's operations in Lebanon? Currency ______________

4 - Has the Bank extended credit for real estate construction since ten years, or since it started its operations in Lebanon?

____ Yes ____ No

5 - Does the Bank require the real estate clients to submit a balance sheet and an income statement?

____ No balance sheet and income statement demanded.

____ Audited balance sheet and income statement demanded.

____ Unaudited balance sheet and income statement accepted.

6 - Does the Bank require the customer to submit a projected cash flow statement? ____ Yes ____ No.

7 - The following considerations affect the Bank's decision to extend loans for real estate construction (assign numbers indicating order of importance):

____ Total income of the customer , capacity

____ Total property of wealth of the customer, capital

____ Asset pledged as security , collateral.

____ Reputation of the customer, character.

8 - Does the Bank supervise and control the use of the credit funds after the loan is granted for real estate construction? If so, describe briefly how ?

9 - Does the Bank accept a plot of land as a mortgage against a loan for real estate construction ? ____ Yes ____ No.

10 - Would the building-in-process be also considered automatically as part of the mortgage on land offered as security against the loan for real estate construction ? ____ Yes ____ No.

11 - Does the Bank accept a mortgage on a building as security against a loan for real estate construction? ____ Yes ____ No.

12 - Does the Bank accept the assignment of income from a building as a security against a loan for real estate construction?
____ Yes ____ No.

13 - Does the Bank accept a building under construction as a mortgage against a loan for real estate construction? ____ Yes ____ No.

14 - Does the Bank accept the key-money from a building as a security against a loan for real estate construction? ____ Yes ____ No.

15 - Does the Bank accept the surrender value of an insurance policy as a security against a loan for real estate construction?
____ Yes ____ No.

16 - Does the Bank accept marketable securities as a security against a loan for real estate construction? ____ Yes ____ No.

17 - Which type of security would the Bank prefer to have against the loan for real estate construction at present? Assign numbers indicating order of importance and acceptance:

__ plot of land __ building with its income __ building under construction __ key money from the building __ marketable securities __ Surrender value of an insurance policy.

18 - Which type of mortgage would the Bank accept as supporting collateral and security against loan for real estate construction?

__ First mortgage __ Second mortgage __ Third mortgage.

19 - Does the Bank construct houses on behalf of customers under the agreement that the loan would be repayed from the personal income of the customer over a certain period of time?
____ Yes ____ No.

20 - What is the approximate percentage of the loan for real estate construction in relation to the market value of the mortgage behind it, that the Bank accepts to extend at present? % ____

What was that percentage ten years ago or when the Bank first started its operation in Lebanon? % ____

21 - In general, was the percentage of loan for real estate construction extended by the Bank relative to the market value of its security, <u>higher</u> or <u>lower</u> than the percentage of other types of loans relative to the market value of their security over the last ten years? namely:

Please state whether higher or lower:

____ -------- than the commercial loan.

____ -------- than the agricultural loan.

____ -------- than the industrial loan.

22 - Does the Bank extend the loan for real estate construction on a renewable short-term basis? ____ Yes ____ No.

23 - What is the maximum-time period for a renewable short term loan that is granted by the Bank at present for the following types of loans? What was that maximum-time period since ten years or when the Bank started its operations in Lebanon?

	at present	since ten years
a) Commercial loan	________	________
b) Agricultural loan	________	________
c) Industrial loan	________	________
d) Loans for real estate construction	________	________

24 - For how many times does the Bank accept to renew a short term loan extended for real estate construction at present?
* times ________
What was it since ten years or when the Bank first started its operations in Lebanon * times ________

25 - Does the Bank extend credit for real estate construction for more than one year? ____ Yes ____ No.

If yes, for how long? years ________

26 - What percentage of the loan for real estate construction is repaid by installment at present? % ________

What was that percentage ten years ago or when the Bank first started operating in Lebanon? % ________

27 - When does the Bank require the first installment payment to be effected on the loan for real estate construction?

At present	When was it ten years ago
- After one year	- after one year.
- during construction period	- during construction period
- after the construction of the building.	- after the construction of the building.

28 - In general is the maturity period granted on loans for real estate construction longer or shorter than the maturity period granted on other types of loans?

Please state whether longer or shorter.

a) ___________ than the maturity period for commercial loans.

b) ___________ than the maturity period for agricultural loans.

c) ___________ than the maturity period for industrial loans.

29 - What was the approximate volume of credit that the Bank has extended for real estate construction over the last ten years in Lebanese pounds, or since the Bank started its operation in Lebanon?

1953 LL ___________	1957 ___________	1961 ___________
1954 ___________	1958 ___________	1962 ___________
1955 ___________	1959 ___________	1963 ___________
1956 ___________	1960 ___________	or a total figure for the last ten years LL _______

(If not available please answer the next two questions).

30 - What was the approximate total volume of loans extended by the Bank for all types of loans over the last ten years or when the Bank started its operation in Lebanon?

1953 LL ___________	1957 ___________	1961 ___________
1954 ___________	1958 ___________	1962 ___________
1955 ___________	1959 ___________	1963 ___________
1956 ___________	1960 ___________	or a total figure for the last ten years LL _______

31 - From experience and in your own personal opinion, what do you think was the percentage of loans for real estate construction of the total volume of loans that was extended by the Bank over the last ten years?

1953	LL ____________	1957	____________	1961	____________
1954	____________	1958	____________	1962	____________
1955	____________	1959	____________	1963	____________
1956	____________	1960	____________	or an approximate % for the last ten years % ________	

32 - Do you maintain any fixed ratio between loans for real estate construction and the Bank's paid up capital? If so, what is that ratio in percent? a % ratio at present ____________________
b What was that ratio ten years ago or when the Bank started its operation in Lebanon? % ratio ______________________

33 - Do you maintain any fixed ratio between loans for real estate construction and the total time deposits at your disposal? If so :

a What is the ratio at present % ________________

b What was that ratio ten years ago or when the Bank started its operation in Lebanon? % ________________

34 - The composition of the Bank's portfolio is generally confined to the following approximate percentages:-

* Real estate construction % ________
* Commercial loans % ________
* Agricultural loans % ________
* Industrial loans % ________

35 - What is the range of interest that the Bank charges on loans for real estate construction at present ? range ____________ %

What was that range ten years ago or when the Bank first started its operation in Lebanon ? range ____________ %

36 - In general was the rate of interest that the Bank has charged on loans for real estate construction higher or lower than the rate of interest charged by the Bank on other types of loans namely:

Please state whether higher or lower:

a ____________ than the interest rate charged on commercial loans.

b ____________ than the interest rate charged on agricultural loans

c ____________ than the interest rate charged on industrial loans.

37 - Was the rate of interest charged on loans for real estate constructio higher on loans of longer maturity period?
_____ Yes _____ No.

38 - Does the Bank charge a lower interest rate on loans for real estate construction that are backed by a more adequate and safe security? __________ Yes ________ No.

39 - On what base balance does the bank calculate the interest on loans for real estate construction?

_____ average daily balance.

_____ other basis.

40 - On what basis does the Bank extend the loan for real estate construction?

_____ on an overdraft basis ______ on a discount basis.

41 - What is the percentage of opening commission that the Bank charges on loans for real estate construction at present? % ___________

What was that percentage ten years ago or when the Bank first started its operation in Lebanon?

42 - In general, was the percentage of opening commission charges on loans for real estate construction higher or lower than the percentage of opening commission charges on the following types of loans:

Please state whether higher or lower:

a _________________ than the commercial loans.

b _________________ than the agricultural loan.

c _________________ than the industrial loan.

43 - Are the loans for real estate construction more or less expensive to handle administratively than other types of loans? namely:

Please state whether more or less:

a ________________ expensive than the commercial loans.

b ________________ expensive than the agricultural loans.

c ________________ expensive than the industrial loans.

44 - Was the rate of default on loans for real estate construction higher or lower than the rate of default on loans for other purposes namely:

Please state whether higher or lower:

a ________________ than the commercial loans.

b ________________ than the agricultural loans.

c ________________ than the industrial loans.

45 - What was the approximate rate of default on loans for real estate construction over the last ten years? or since the Bank started its operation in Lebanon? rate %

46 - In case of default, do you find the legal forclosure procedures satisfactory or not? If not satisfactory indicate in what respect:

47 - In case of default, what would be the Bank's policy towards the client? assign numbers indicating order of importance:

- to extend the maturity period of the loan.
- to lower the amount of interest due on the client.
- insist on immediate repayment even if this leads to the client's bankruptcy.
- supervise and control the construction activity in order to liquidate it, and get back its money.
- others - comment if necessary:

48 - Do you find your membership of the Central Risk helpful or not?

Please comment :

APPENDIX II

PERSONAL INTERVIEWS

<u>Accredited Banks Interviewed</u>

1. Mr. Samih Barbir, Manager, The Arab Real Estate Bank S.A.L. (Affiliate of Intra Bank S.A.L.)

2. Mr. Chafik Baz, Assistant Manager, Banque Al-Ahli S.A.L.

3. Mr. Anis Bibi, Chairman, Union National Bank S.A.L.

4. Mr. Megeurditch Bouldoukian, Credit Department, Bank of America, Beirut Branch.

5. Mr. Adnan Hammoud, Credit Department, Bank of Beirut and the Arab Countries S.A.L.

6. Mr. Patrick K. Healey, Vice President, The Chase Manhattan Bank N.A. Beirut Branch.

7. Mr. Elias Jeara, Credit Department, Banque Libanaise pour le Commerce S.A.L.

8. Mr. Fouad Kraytem, Credit Department, Beirut Riyad Bank S.A.L.

9. Mr. Ishak Lati, Chairman, Banque Joseph Lati & Fils S.A.L.

10. Mr. Omar Mahmassani, Credit Department, Arab Bank Limited, Beirut Branch.

11. Mr. Afif Matar, Assistant to the Head of the Industrial and Real Estate Department, Banque de Credit Agricole, Industriel et Foncier, S.A.L.

12. Mr. Yassin Mazboudy, Financial Manager, Banque de Credit Agricole, Industriel et Foncier, S.A.L.

13. Mr. Usama Mikdashi, Head of the Credit Department, The First National City Bank, Beirut Branch.

14. Mr. Nabih Namani, Manager, Banque Misr Liban S.A.L. Beirut Branch.

15. Mr. Roland Sada, General Manager, Credit Hypothecaire Libanaise S.A.L.

16. Mr. Karim Samaha, Assistant Manager, Banque du Liban et d'Outre Mer S.A.L.

17. Mr. Nassif Sawaya, Assistant Manager, Bank of Lebanon and the Middle East S.A.L.

18. Mr. Morad Shamla, Manager, Banque de l'Economie Arabe S.A.L.

19. Mr. Sami Shoucair, Chairman, Banque S. Shoucair S.A.L.

20. Mr. Badr Younis, Credit Department, Saudi National Commercial Bank.

Information on Money Lenders Obtained Through

1. Mr. Kheir Abu Habib, Partner, Etablissement Elias Abou Habib.
2. Mr. Abdel Kader Anouti, Real Estate Onwer.
3. Mr. Munir Al Aris, Assistant Head of the Real Estate Bureau, Beirut.
4. Mr. Marcel Bitar, Salesman, Maison Pierre Michaca.
5. Mr. Hasan Chatila, Real Estate Owner.
6. Mr. Michel E. Doumet, General Manager, La Cimenterie National S.A.L.
7. Mr. Ratib El-Kurd, General Manager, United International Co (UNALCO)
8. Mr. Kabalan Khair, Partner and Manager, Philippe Khair and Bros.
9. Mr. Fawzi Labban, Merchant and Real Estate Owner.
10. Mr. Sami Oueini, Active Partner, Sami Oueini & Co.
11. Mr. Raif Samara, The Notary Public of Beirut.
12. Mr. Michel Sfeir, General Manager, Etablissement Abdul-Rahim Diab S.A.L.

Real Estate Business Concerns Interviewed

1. Mr. Alfred Buckley, Member of the Board and Managing Director, Societe Libanaise d'Amelioration Fonciere (SLAF) S.A.L.

2. Mr. Salah Hamouie, Member of the Board and Managing Director, Societe de Construction et de Commerce (SODECO) S.A.L.

3. Mr. Abdel Hafiz Itani, Active Partner, Concorde-General Contracting Co.

4. Mr. Michel Kahil, General Secretary, Societe Fonciere pour l'Amelioration de l'Habitat S.A.L., President, Finance & Gestion S.A.L., and Director, Banque Al-Omran S.A.L.

5. Mr. Abdel Kader Minkara, Real Estate Onwer and Contractor.

6. Mr. Iskandar Sara, Member of the Board and Managing Director, Compagnie Immobiliere Libanaise (CIL) S.A.L.

7. Mr. Salah Shamma, Contractor and Real Estate Owner.

8. Mr. Nadeem Shwayri, Manager, El-Ektessadia S.A.L.

9. Mr. Adnan Sidani, Active Partner, Sidani & Sakr.

10. Mr. Ahmad Tabsh, Real Estate Owner and Contractor.

11. Mr. Yacoub Yacoubian, Manager and Civil Engineer, Etablissement Yacoub Yacoubian.

12. Mr. Anis Yassin, Director, Societe Fonciere du Liban S.A.L. Also, Federal Bank of Lebanon S.A.L.

<u>Insurance Companies Interviewed</u>

1. Mr. Jean Chidiac, Director and General Manager, Societe National D'Assurances S.A.L. (S.N.A.)

2. Mr. Ali Dakrouk, Assistant Manager, Societe Karnak S.A.L. (Representativ of the Seven Provinces Insurance Co. Holland).

3. Mr. Salim Halabi, Assistant Manager, Jordan Insurance Company Limited.

4. Mr. Andre Kassab, Claims Assistant, American Life Insurance Co.

5. Mr. George M. Mansour, Manager, Arabian Insurance Co.

6. Mr. Emile Rababy, Assistant Manager, Al-Ittihad Al-Watani S.A.L. (L'Union National), Societe Generale D'Assurances du Proche Orient.

7. Mr. George Sasi, General Manager, Al-Chark.

Other Sources

1. Mr. Rafik Al-Muhib, Civil Engineer and Real Estate Owner.
2. Mr. Mohamed Amin Bohsali, Civil Engineer and Shareholder, Building Society, S.A.L.
3. Mr. Antoine B. Kallab, Land Expert.
4. Mr. Sami I. Khoury, Land Expert.
5. Mr. Nasri Malouf, Lawyer.
6. Mr. Othman Nuweiri, Civil Engineer.
7. Mr. Samir Saleh, lawyer.
8. Mr. Ramzi Sambar, Civil Engineer.
9. Mr. Faysal Tabbara, Lawyer.
10. Mr. Ahmad Tannir, Civil Engineer and Contractor.

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