PRIVATE BUILDING CONSTRUCTION ACTIVITY IN LEBANON

by

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Undoubtedly, many deserving persons have been unintentionally left out. To these, the writer also extends his gratitude.

April, 1963
INTRODUCTION

Londoners have the weather as a daily topic for conversation; Lebanese have construction. Until recently, people were amazed at the rapidity in which multi-storied buildings shot up in a matter of months, and once-familiar streets became almost unrecognisable, particularly in the Beirut area. They were astonished and then scandalised at the number of still sound buildings which were being torn down to make way for new ones. They envied so-and-so for the astronomical figure at which he sold his plot of land, ¹ once purchased inadvertently, and blamed themselves for failing to grasp the golden opportunity which was presented to them only a few years earlier. They held their head up in pride while showing their new city to foreigners; and yet, this very fact added to the shame they already felt regarding the small, overcrowded, dirty houses which looked even bleaker by comparison. Pessimists predicted a crisis in the construction sector, for who would rent so many new luxury buildings at such high prices? The optimists eagerly hoped for a smooth reduction in rent and were disappointed when no such reduction

¹. To give an example, Mr. Nageeb Khoury who had purchased in the early thirties a plot of land in the now Hamra Street at approximately LL. 10,000, sold it in 1960 at LL.1,875,000.
materialised. The lay-economist was puzzled: Was the theory which demonstrated that price movements would adjust demand and supply purely textbook stuff? Businessmen rejoiced as sales soared to new heights and they regarded with approval the spur that construction gave to related industries.

Recently, however, there has been much concern in business and economic circles, over the health of the private construction sector in Lebanon. The reason for such a preoccupation is that the continuous upward trend in the construction activity of the late fifties (except for 1958, a special year of disturbances), suddenly took a sharp decline in both 1961 and 1962. Below, is a table which reveals the number of construction permits granted in the "Mohafazah" of Beirut, as from 1957 and up to 1962.
**TABLE I**

NUMBER OF CONSTRUCTION PERMITS GRANTED IN BEIRUT

FROM 1957 to 1962

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Permits</th>
<th>Number of Storeys</th>
<th>Surface in M²</th>
</tr>
</thead>
<tbody>
<tr>
<td>1957</td>
<td>846</td>
<td>2,271</td>
<td>431,345</td>
</tr>
<tr>
<td>1958</td>
<td>610</td>
<td>1,496</td>
<td>387,898</td>
</tr>
<tr>
<td>1959</td>
<td>1,083</td>
<td>2,933</td>
<td>590,427</td>
</tr>
<tr>
<td>1960</td>
<td>1,220</td>
<td>3,231</td>
<td>704,211</td>
</tr>
<tr>
<td>1961</td>
<td>982</td>
<td>2,987</td>
<td>664,845</td>
</tr>
<tr>
<td>1962</td>
<td>1,296</td>
<td>3,086</td>
<td>572,184⁺</td>
</tr>
</tbody>
</table>


⁺ Instead of the correct figure of 572,184 M² licensed in 1962 for construction in Beirut, the article from which Table I is quoted reveals 756,231 M², a figure that includes both the areas licensed for in Beirut and Tripoli in that year. The writer called for the attention of the "Middle East Express" Editor in a letter that was published and favourably commented on, in the issue of March 18, 1963, on page 15.
In spite of the fact that some holders of licenses fail to utilize them, there are good reasons to believe that the above figures are representative of the volume of construction. Indeed, 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 value of square meters licensed. The landlord would normally not go into all that trouble and incur relatively high expenditures, unless he is certain to implement the scheme. Furthermore, it would not matter whether all the figures in Table I are overstated by the same proportion, since relative rather than absolute amounts are required here. Statistics covering the whole Lebanese territory are unfortunately not available and the 1962 Tripoli figures which have been reported for the first time, cannot be of much use. However, it can be safely assumed that the bulk of construction in Lebanon takes place in the Beirut "Mohafazah", and that the number of square meters licensed in the capital, reflects the general trend for the whole country.

In Table I, under the caption "Surface in M²", it can be seen that from 1957 to 1960, the volume of construction increased significantly at an average yearly rate of approximately 17.5%.

1. LL.10 per square meter for the first five storeys and LL.15 per square meter for the storeys above the 5th, for a building to be constructed in Beirut on a plot of land worth LL. 900/square meter.
Suddenly, in 1961, construction fell by 6%, as compared to 1960, and by 14% in 1962, as compared to 1961.

In addition to this phenomenon, 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, telephone, 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." Partly for that reason, many luxury buildings have remained vacant, whereas popular habitats have barely been sufficient to house limited income groups.

The problem of the construction sector in Lebanon is, therefore, twofold. First, after a "sensational" boom in the fifties, the sector under study is facing a marked decline, the effects of which are indeed far reaching. Second, whereas luxury buildings are still overabundant, popular habitats are only too scarce. Clearly, some action has to be taken to remedy the situation at hand.

However, before any recommendation is given, a closer examination of the data is necessary. The first chapter of this thesis will try to evaluate the role of the construction sector in the Lebanese economy, in respect to both monetary and social considerations. To arrive at a complete diagnosis of the sector in question, a partial analysis of the factors that have led to the recent boom is made in chapter two. The question is more thoroughly examined in the Appendix at the end of this paper, where five actual construction cases are studied. Chapter three tries to forecast the most likely pattern that the construction sector will follow in the future and on the basis of which, recommendations are made in the concluding chapter. Thus, in the final chapter, the dominant question calling for an answer is: What should be done to bring an adequate solution to the problem?

The task is indeed challenging, and it is with this spirit that the present thesis is being written.
CHAPTER I.

THE CONSTRUCTION SECTOR AND THE LEBAANESE ECONOMY

A. CONTRIBUTION TO NATIONAL INCOME AND EMPLOYMENT

In April, 1962, Professor Paul Klat of the Economics Department at the American University of Beirut, published a statistical table in the "Middle East Express", revealing estimates of the absolute amounts in Lebanese pounds contributed by each of the nine sectors of the Lebanese economy over a number of years, as follows:

TABLE II.

THE NATIONAL INCOME OF LEBANON

1952-1958 and 1961

(at current factor prices in LL.millions)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>216</td>
<td>221</td>
<td>226</td>
<td>223</td>
<td>231</td>
<td>238</td>
<td>219</td>
<td>330</td>
</tr>
<tr>
<td>Industry</td>
<td>155</td>
<td>161</td>
<td>166</td>
<td>175</td>
<td>183</td>
<td>189</td>
<td>161</td>
<td>218</td>
</tr>
<tr>
<td>Construction</td>
<td>48</td>
<td>47</td>
<td>60</td>
<td>60</td>
<td>50</td>
<td>41</td>
<td>38</td>
<td>69</td>
</tr>
<tr>
<td>Transport</td>
<td>45</td>
<td>50</td>
<td>60</td>
<td>75</td>
<td>78</td>
<td>80</td>
<td>57</td>
<td>68</td>
</tr>
<tr>
<td>Commerce</td>
<td>333</td>
<td>344</td>
<td>368</td>
<td>407</td>
<td>410</td>
<td>469</td>
<td>365</td>
<td>468</td>
</tr>
<tr>
<td>Banking</td>
<td>50</td>
<td>51</td>
<td>57</td>
<td>70</td>
<td>80</td>
<td>91</td>
<td>93</td>
<td>110</td>
</tr>
<tr>
<td>Real Estate</td>
<td>98</td>
<td>101</td>
<td>112</td>
<td>116</td>
<td>130</td>
<td>139</td>
<td>155</td>
<td>194</td>
</tr>
<tr>
<td>Government</td>
<td>64</td>
<td>71</td>
<td>73</td>
<td>83</td>
<td>95</td>
<td>108</td>
<td>113</td>
<td>152</td>
</tr>
<tr>
<td>Services</td>
<td>106</td>
<td>122</td>
<td>134</td>
<td>165</td>
<td>160</td>
<td>148</td>
<td>104</td>
<td>180</td>
</tr>
</tbody>
</table>

How valuable is the information in Table II? It is relevant to note here that it was only in 1950 that Professor Albert Badr, also of the Economics Department at the American University of Beirut, computed the first set of estimates about the national income of Lebanon, from primary data. Even then, he had to resort to some assessments which, by his own admittance, reduced the accuracy of his findings. Beginning with 1951, no further systematic computation was carried out in Lebanon. Instead Professor Klat "extrapolated" Professor Badr's figures and came out with the results appearing in Table II.

Professor Klat does not make any reference to the method used in his extrapolation and the writer has strong reason to question the validity of the figures appearing in Table II. A systematic study undertaken by a group of graduate students of Business Administration at the American University, revealed a large discrepancy between Professor Klat's estimate of the contribution to national income by the construction sector (69 million LL), and their own findings (104 million LL).

Does it follow that the information available in Table II should be ignored? The answer is no. In spite of all that has been said, it is impossible to carry out the analysis in the absence of any other reasonable assessment of national income. Bearing in mind, therefore, that in respect to national income, the construction sector is more important than as it appears in Table II, it will be assumed that on the whole, Professor Klat's figures are fairly close to reality.

The following table shows the 1952 and 1961 estimates of national income, in percentage form.

**TABLE III.**

**NATIONAL INCOME OF LEBANON**

1952 & 1961

(in percentages)

<table>
<thead>
<tr>
<th></th>
<th>1952</th>
<th>1961</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>19.2</td>
<td>18.6</td>
</tr>
<tr>
<td>Industry</td>
<td>13.8</td>
<td>12.2</td>
</tr>
<tr>
<td>Construction</td>
<td>4.3</td>
<td>3.9</td>
</tr>
<tr>
<td>Transportation</td>
<td>4.3</td>
<td>3.9</td>
</tr>
<tr>
<td>Commerce</td>
<td>29.8</td>
<td>26.2</td>
</tr>
<tr>
<td>Banking</td>
<td>4.2</td>
<td>6.2</td>
</tr>
<tr>
<td>Real Estate</td>
<td>8.9</td>
<td>10.9</td>
</tr>
<tr>
<td>Government</td>
<td>5.9</td>
<td>8.0</td>
</tr>
<tr>
<td>Services</td>
<td>2.6</td>
<td>10.1</td>
</tr>
<tr>
<td></td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>
If in relative terms the construction sector contributed less in 1961 than in 1952 to national income, the absolute amounts in Lebanese pounds have, on the whole and until recently, been upwards.

However, the construction sector should not be divorced from the real estate sector that reflects income arising mainly from rents. If added together, these two complementary sources, which will be referred to hereafter as the "building sector", show a net increase as from 1952, both relatively and absolutely.

Thus, income originating from the "building sector" increased from LL.146 million, or 13.2 percent of national income in 1952, to LL.263 million, or 14.8 percent in 1961. Needless to say, such an important source of income cannot be permitted to decline. The tremendous impacts of a crisis in building activity will gradually be exposed as the discussion progresses.

However, it is important to note now that around 33,000 individuals were directly employed in this sector in 1957, representing 7.3 percent of the labour force which, in turn, was only 36 percent of the total population.¹

Although these figures do include the non-Lebanese who come from neighbouring countries to handle the rough work, they do not include the very many who work in commercial enterprises and industries related to construction. Such industries vary from cement factories and round-iron-bars foundries to pipes, taps, aluminium, furniture manufactures, etc., and all of these would be adversely affected by a decline in construction activity.

The list is indeed endless. The point to note is that the building sector is far from being independent of other income producing sectors of the economy. They are so closely interwoven to the point that even a squib in any, shakes the whole economic structure. To demonstrate this point further, a comparative table is given below showing the breakdowns of Government receipts in 1959, 1960, and 1961.
From the above table, it can be seen that if the amount earned by the Government from customs duties on building materials and from stamp duty levied on lease contracts is ignored, the aggregate taxes on construction, transfer of real estate and cement amounted to 34 million Lebanese Pounds in 1961, or 14 percent of total government receipts. Clearly, therefore, a crisis in the building sector is too costly, in respect to fiscal, employment, industrial and income considerations.

1. Ibid., p.1-2-E-11.
Up till now, it has been demonstrated that the Lebanese economy could not afford the cost implicit in a decline of the sector under study. Yet, nothing has been mentioned so far about the sociological or psychological aspects of construction in Lebanon. If anything is to be done to relieve the economy from the dangers that threaten the building sector, it should not be done irrespective of social needs and desires. The "money end of things", as well as the human element, should be the guiding criteria upon which planning has to be made. If anything is to be done, it should be both quantitative and qualitative.

Hence, before any suggestion is proposed, the present non-financial aspects of building activity in Lebanon should be unveiled.

B. GEOGRAPHICAL AND SOCIAL DISTRIBUTION OF CONSTRUCTION

In 1961, the total area licensed for construction in Lebanon amounted to 1,686,455 square meters. The breakdown of this total by Mohafazāts was as follows:
### TABLE V.

**AREA LICENSED PER MOHAFAZAT**

1961

<table>
<thead>
<tr>
<th></th>
<th>Area</th>
<th>Percentage Area</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beirut</td>
<td>623,855</td>
<td>38.0%</td>
</tr>
<tr>
<td>North Lebanon</td>
<td>171,812</td>
<td>10.0%</td>
</tr>
<tr>
<td>Bekaa</td>
<td>63,102</td>
<td>3.5%</td>
</tr>
<tr>
<td>South Lebanon</td>
<td>50,846</td>
<td>3.0%</td>
</tr>
<tr>
<td>Mount Lebanon</td>
<td>767,840</td>
<td>45.5%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,686,455</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

Table V does not necessarily reflect the total built up area in each of the Mohafazat, but rather the increase or marginal area built in 1961.

These findings would not have been of any interest, had the "I.R.F.E.D. Mission" not made available a breakdown in percentages of the Lebanese population. In the following table, the percentages appearing in Table V are repeated for purposes of comparison.

---

1. Al-Rā'īd al-'Arabi, 40.
### TABLE VI.

**APPROXIMATE DISTRIBUTION OF THE LEBANESE POPULATION BY REGION IN 1961**

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage of Population</th>
<th>Percentage of Area Constructed in 1961</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beirut</td>
<td>27.7%</td>
<td>38.0%</td>
</tr>
<tr>
<td>North Lebanon</td>
<td>20.8%</td>
<td>10.0%</td>
</tr>
<tr>
<td>Bekaa</td>
<td>14.0%</td>
<td>3.5%</td>
</tr>
<tr>
<td>South Lebanon</td>
<td>14.6%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Mount Lebanon</td>
<td>22.9%</td>
<td>45.5%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

Since the populations of Beirut and Mount Lebanon are the richest, it seems reasonable to find that the percentage of area constructed in these localities is higher than the percentage of the total population living in these regions. It is interesting to note, however, that in spite of the fact that Beirutis enjoy a higher standard of living and purchasing power and comprise a greater portion of the population, as compared to that of Mount Lebanon, the latter accounted for a greater area of construction.

---


2. From Table V.
in 1961. This alone could be interpreted as a sign of saturation in the construction market in Beirut. It shall be dwelt at length on this subject in Chapter II. The other regions of Lebanon, i.e. the North, South, and Bekaa, which together account for almost half the total population, had to content themselves with 16.5% of the total area constructed in 1961.

So far, the discussion has been confined to the analysis of the portion of constructed area for which the population of each of the five regions was responsible in 1961. The analysis has again been quantitative. However, it is not sufficient to state that an individual is living in a 100 square meters apartment without qualifying the statement with terms denoting the extent of physical and psychological comfort. For, a square meter, which is nothing but a geometrical measurement, could belong to a luxury palace as well as to a shabby, unwholesome house, depending primarily on the owner's or lessee's level of income.

To be able to bring forth the necessary qualifications, the data given in the following table has to be examined.
<table>
<thead>
<tr>
<th>Percentage of Families (%</th>
<th>Average Income Per Family (in LL.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>9</td>
<td>1,200</td>
</tr>
<tr>
<td>40</td>
<td>2,500</td>
</tr>
<tr>
<td>30</td>
<td>5,000</td>
</tr>
<tr>
<td>14</td>
<td>15,000</td>
</tr>
<tr>
<td>4</td>
<td>30,000</td>
</tr>
</tbody>
</table>

Note: The article from which the above figures were taken does not state to which year these pertain. Since the article was written in 1961, it could be assumed that the figures belong to that year.

If it is assumed that the Lebanese population at present consists of 1,500,000 inhabitants and that the average family is composed of five members, the following table can be derived.


2. This assumption was used by the I.R.F.E.D. Mission for other purposes.
### TABLE VIII.

**INCOME BRACKETS AND NATIONAL INCOME**

<table>
<thead>
<tr>
<th>Number of Families in Lebanon</th>
<th>% of Families &amp; Respective Income Per Family</th>
<th>Number of Families &amp; Respective Total Incomes</th>
<th>Percentage of National Income</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Income Per Family (LL)</td>
<td>Total Income (LL)</td>
<td></td>
</tr>
<tr>
<td>300,000</td>
<td>9</td>
<td>27,000</td>
<td>32,400,000</td>
</tr>
<tr>
<td>300,000</td>
<td>42</td>
<td>126,000</td>
<td>315,000,000</td>
</tr>
<tr>
<td>300,000</td>
<td>31</td>
<td>93,000</td>
<td>465,000,000</td>
</tr>
<tr>
<td>300,000</td>
<td>14</td>
<td>42,000</td>
<td>630,000,000</td>
</tr>
<tr>
<td>300,000</td>
<td>4</td>
<td>12,000</td>
<td>360,000,000</td>
</tr>
<tr>
<td></td>
<td>100</td>
<td>National Income</td>
<td>1,802,400,000</td>
</tr>
</tbody>
</table>

Computed in this manner, the national income figure is fairly close to that estimated for 1961, in Table II. This fact suggests that the two assumptions upon which Table VIII was constructed are reasonably accurate.

In their survey of construction activity in Lebanon, a group of students (referred to earlier) at the American University of Beirut, carried a random sample to find out the relative proportions of classes of constructions built in 1961. Their findings appear below:
TABLE IX.

BUILDINGS CONSTRUCTED IN 1961
BY CLASSES

<table>
<thead>
<tr>
<th>Class</th>
<th>Proportion</th>
<th>Standard Error</th>
</tr>
</thead>
<tbody>
<tr>
<td>5th</td>
<td>41.5%</td>
<td>4.3% (of 41.5%)</td>
</tr>
<tr>
<td>4th</td>
<td>13.7%</td>
<td>3.0% (of 13.7%)</td>
</tr>
<tr>
<td>3rd</td>
<td>26.5%</td>
<td>3.8% (of 26.5%)</td>
</tr>
<tr>
<td>2nd</td>
<td>14.0%</td>
<td>3.0% (of 14.0%)</td>
</tr>
<tr>
<td>1st</td>
<td>4.3%</td>
<td>1.7% (of 4.3%)</td>
</tr>
</tbody>
</table>

To simplify matters and allow the reader to concentrate on a fewer number of items, classes 5 and 4 are grouped together in the analysis that follows and labelled "poor class", class 3 is left unmerged and labelled "average class" or "middle class", classes 2 and 1 are again grouped together under one category, the "rich class".

From the information available in Table VIII, and from the modified "class" distribution of Table IX, the following final statistical conclusions are inferred, on the assumption that, on the whole, the Lebanese population is rational, i.e. it will tend

1. Al-Rā'id al-'Arabi, 41.
to rent or construct houses of a class which reflects its means or purchasing power.

1. The "poor" or 51 percent of the population, earned only 19.24 percent of national income and built or rented very poor and poor quality houses covering 55.2 percent of the total constructed area in 1961.

2. The "middle class", or 31 percent of the population, earned 25.81 percent of national income and built or rented fair quality houses covering 26.5 percent of the total constructed area.

3. Lastly, and in the same year, the "rich" or 18 percent of the population earned 54.95 percent of national income and built or rented good and excellent quality houses covering 18.3 percent of the total constructed area.

It appears that area-wise, 55.2 percent representing the "poor", have improved their position in 1961, as they built or rented a slightly greater proportion of the total constructed area than what it seems they would be entitled to, being 51 percent of the total population. Though such an area constructed is often of a very low quality, it nevertheless gives the "poor" some
additional space per capita. This slight boost was, and still is, badly needed.

Conversely, the "middle class" seems to have lost some terrain, as it occupied 26.5 percent of the constructed area, whereas it accounts for 31 percent of the total population.

Lastly, the rich have made a slight forward move as they took hold of 18.3 percent of the total constructed area in 1961, while population-wise, they represent 18 percent of the total.

There are deep rooted causes that are interacting to set the share of construction that each of the classes is getting. These considerations will be taken up in Chapter III.

C. CONCLUSION

In this chapter, the main concern was to place the construction sector of the Lebanese economy in its true proportions. The purely economic side of the picture was discussed in part A, and was followed in part 5 by a socio-economic analysis.
The emphasis in the first place was on the importance of the construction sector in so far as national income and employment are concerned. It was demonstrated, furthermore, that being closely interwoven with other sectors of the economy, a crisis in the construction activities would certainly have adverse repercussions on all other productive sources.

In the second place, the analysis led to establishing relationships between the level of income of various "classes" of the population in various regions of Lebanon, with the proportion and quality of the area constructed in 1961. The year 1961 was chosen on purpose since it represents the most recent trend which the construction sector seems to be heading for.

The reader might have noticed that whenever reference was made to the distribution of the area per class of the population, the terms "rented or constructed" were used, and not the term "occupied." The reasons is that there is no statistical proof that whatever was built in 1961 was occupied. What was actually built represents the supply of construction in 1961. Theoretically speaking, demand over a period of time could be smaller or greater than supply, causing price movements to adjust the situation in the long run. The price mechanism will prompt entrepreneurs of the needs of the population and they will act accordingly so that in
the long run demand and supply will move in harmony, i.e. expanding at the same rate, rents remaining the same. However, unless the long run is defined as infinitely long, there is no chance that a harmonious equilibrium be reached in Lebanon.

The poor, on the one hand, have for a very long time now, been pressing for a greater area per capita, but have not, apparently, been able to convince the entrepreneur that he could make a reasonable profit out of supplying them with popular houses. As a result, they have to live like "sardines in a tin", their potential demand remaining unanswered. "On the basis of statistics established in 1954 by an expert on popular houses, Stephan Ronnart, 6,500 families, consisting of around 35,000 persons, live in Beirut under conditions well below the minimum acceptable." ¹

On the other hand, first and second class apartments are over-abundant. There is no need for statistical evidence to make this assertion. It is sufficient to walk around the cities' streets, or to have a look at any newspaper's small advertisements, to be convinced that such excess capacity does exist.

1. J. Donato et al., 19.
Many new apartment buildings were constructed at the expense of demolishing older ones. Such a trend squeezed the "poor" families into very dense quarters where promiscuity reigns and where general restlessness prevails. Bearing in mind that almost half the Lebanese families earn less than 2,500 Lebanese pounds annually, it goes without saying that annual rents exceeding LL.600 or one quarter of the budget of the "poor" are beyond the reach of half the Lebanese families.

In the book "L'Habitat dans la Vie Libanaise", Dr. Marcel Torti, a United Nations financial expert, demonstrates that the construction of popular houses can be remunerative to the owner in Lebanon. ¹ If this is so, why has the entrepreneur kept on building luxury apartment houses and increased the number of vacancies, when he could realise at least the same return on investment by erecting popular buildings for which, undoubtedly, a back-log of demand exists? Why hasn't the law of demand and supply led to that optimum, which liberal economists have resolutely believed in?

¹. Ibid., pp. 102-122.
The answers to these questions will be discussed in the following chapter which analyzes the factors in both the demand for and the supply of construction. The Appendix at the end of the paper will, in turn, bring some additional light to the puzzling problem, as it will reveal some unique features of the Lebanese entrepreneur.
CHAPTER II.

THE CONSTRUCTION BOOM ANALYSED IN ITS RECENT HISTORICAL CONTEXT

The fact that the supply of poor quality habitats has been falling short of demand, whereas excess capacity has characterised the first and second class houses for so long in Lebanon, is a puzzling phenomenon that has to be explained.

To do so, the best method would be to discuss each of the items that have led to such an intricate situation, under two main headings: Factors in the Demand for Rent, and Factors in the Supply of Construction. In the third section of this chapter, an attempt will be made to determine to what extent these factors have interacted in giving rise to the present problem.

A. FACTORS IN THE DEMAND FOR RENT

The list of the factors in the demand for rent is indeed very long. One could probably extend the discussion by establishing a correlation between traffic jams in the cities and demand for rents in the suburbs. However, similar correlations have either been completely discarded or have been included under one of the more important headings in this section.
It was not possible to measure the importance of each group of factors. Was the increase in population the greatest determinant of demand for rent, or was it the rise in per capita income?

To be able to weigh these factors, a lot more statistical information would be needed as badly as an econometrician's skill to manipulate same.

Nevertheless, the usefulness of the analysis is not impaired because the reader is at least provided with the basic tools with which to work, if and when more data is made available.

1. **Increase in Population and Cultural Change**

   Undoubtedly, the increase in the population is one of the main factors in the demand for rent. Of course, an equivalent drop in national income could, theoretically, offset the ability of people to demand additional habitats. This, however, is not the case in Lebanon, since national income has been increasing faster than the population.

   Although the demographic expansion has not been calculated to the last decimal, it is a certainty that the
population growth is in between 2 and 2.4 percent per annum.\(^1\) The Lebanese population is therefore expected to double every 30 years, or, to look at it differently, the Lebanese population today is double what it was only 30 years ago. The I.R.F.E.D. Mission estimates that in 1953, 1,416,570 individuals, excluding foreigners, lived in Lebanon and multiplied to 1,626,000 in 1959, an increase of approximately 210,000 in 7 years.\(^2\) Emigration does not any more affect the growth of the population, as it has dropped from 15,000 departures a year,\(^3\) as between 1900 and 1914, to 2,850 a year\(^4\) as between 1951 and 1959. Luckily for the purposes of this paper, these figures do not include the number of temporary emigrants to neighbouring countries. The increase in population has not only affected construction directly, but indirectly as well. This is because an increasing number of crumbling buildings, which had been constructed in the past at an increasing rate as a result of population growth, have had to be replaced with an increasing number of new ones, year after year.

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As compared to demographics of other countries, the Lebanese population is young,¹ which explains the relatively high frequency of marriages. Nowadays, newly-wed couples tend to avoid living in the house of their parents, a fact which has increased the demand for habitats.²

Such a cultural change in the Lebanese population is by no means the only one to have boosted demand. The improvement in the level of education, coupled with the attractions that the cities offer, have brought about an exodus from rural regions to centres where more remunerative jobs are available and where life seems more attractive.³ Whereas these people used to live in the family home, they now have to rent an apartment or at least a room to sleep in.

Last, but not least, among the aspects of cultural change boosting demand is the urge of some middle class and rich bachelors to own apartments for multi-purpose use. Some building owners are happily encouraging the trend. The following small advertisement, that has recently appeared in a local newspaper,⁴ is a good example.

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2. J. Donato et al., 67.
3. Ibid.
"LL.350 per month or LL.110 per week, rent a furnished apartment ...... etc.... Comfort and complete liberty at moderate prices."

2. The Rise in Per Capita Income

It was mentioned in the previous section that Lebanon has been witnessing a rise in per capita income, at least as from 1950, when the first estimates of national income were made. Table II clearly shows such an increase, except for 1958, the year of disturbances.

The I.R.F.E.D. Mission puts the increase in national income at 4.4 percent yearly. If the population expands at a rate of 2.3 percent, the Lebanese citizen is, on the average, better off by 2.1 percent every year.¹

Statistics correlating the increase in per capita income to the increase in demand for rent are not available. However, since on the whole the Lebanese population is poor, as compared to European standards, it goes without saying that any increase in income is quickly spent on necessities such as food, clothing and lodging.

¹. Étude Préliminaire sur les Besoins et les Possibilités de Développement au Liban, 1-1-26 & 1-1-27.
consequently, affecting the demand for rent of offices, as well as apartment houses.  

4. **Expansion of Commerce and Industry**

It has already been mentioned that the economic climate in Lebanon has been favourable to both foreign and local traders and industrialists. "In 1948," the Government "adopted a free foreign exchange system under which, all exchange transactions 'could' be undertaken without any restriction or control and any amount of funds freely brought into Lebanon 'could be' taken out of it. A further and equally important stimulus was devised by the Government in 1953 when it enacted a law exempting new corporations from income tax for a period of six years."  

The continuous deficit in the balance of trade has not prejudiced commercial activities in Lebanon. As from 1952, when statistics became available, both imports and exports kept on growing, except for 1958, a special year of disturbances. At the same time, income originating from the commercial sector has increased proportionately.

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1. J. Donato *et al.*, 67
2. "Foreign Investment in Lebanon", *Middle East Express*, November 12, 1962, p. 3.
TABLE XI.

IMPORT AND EXPORT FIGURES FOR
THE YEARS 1952 TO 1961
(in L.L. millions)

<table>
<thead>
<tr>
<th>Year</th>
<th>Imports</th>
<th>Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961</td>
<td>1061</td>
<td>397</td>
</tr>
<tr>
<td>1952</td>
<td>347</td>
<td>77</td>
</tr>
<tr>
<td>1953</td>
<td>361</td>
<td>87</td>
</tr>
<tr>
<td>1954</td>
<td>484</td>
<td>105</td>
</tr>
<tr>
<td>1955</td>
<td>527</td>
<td>120</td>
</tr>
<tr>
<td>1956</td>
<td>561</td>
<td>145</td>
</tr>
<tr>
<td>1957</td>
<td>627</td>
<td>152</td>
</tr>
<tr>
<td>1958</td>
<td>518</td>
<td>110</td>
</tr>
<tr>
<td>1959</td>
<td>699</td>
<td>130</td>
</tr>
<tr>
<td>1960</td>
<td>854</td>
<td>218</td>
</tr>
</tbody>
</table>

Source: Import and export figures were made available by the I.R.F.E.D. Mission up till 1959, thence from "Le Commerce du Levant" of 12th Sept., 1962, p.1.

The tremendous expansion in foreign trade as between 1952 and 1961 could not have taken place without affecting the demand for construction or rent. Roughly speaking, approximately three times as much storage and display space was needed in 1961, as compared to 1952 on the basis of the import figures appearing in Table XI.

By the same token, the industrial expansion that Lebanon has recently witnessed, must have increased the demand for construction. Table XII clearly indicates that such an expansion did take place. Unfortunately, figures are only available up till 1957.
5. Aspects of Rent Regulations Affecting Demand

Upon analysing the rent regulations that have appeared beginning with 1944 in Lebanon, it is clear that the Lebanese Legislator had in mind the attainment of a higher degree of equity or social justice in respect to lease-holders and owners of real estate. Looked upon from the economic point of view, it can be seen that these same laws have also had an impact on the demand for rent and the supply of real estate. The concern here is the former. The latter will be taken up later in this chapter.

1. From Table II

"If," the Legislator seems to have said, "I can reduce the gap between old rents which are low, and new rents which are high (due to an increase in the monetary replacement value of the asset), I would be closing the gap of injustice between old tenants and owners of real estate on the one hand, and recent tenants and owners of real estate on the other."

The dual economic consequence was as follows:

First, people started shifting from old houses to newer ones, as the gap between old and new rents was wiped out.

Second, people who shifted from old houses to new ones have, on the whole, tended to rent larger apartments than those formerly occupied. To establish the validity of such a statement, an illustration is given below.

Assume a large family is living in a small apartment and paying a low rent as compared to that of a similar new apartment. Assume, furthermore, that the rent of the old apartment is LL.50 per month, that of the new one LL.70 per month.

This family would need, for practical reasons, an apartment with an area greater than that it is occupying by,
say, 10 percent. 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.77 per month.
Looking at this picture from a utility point of view, the
family will find more satisfaction in saving LL.27 per month
and bearing the inconvenience of crowdedness rather than in
paying an extra LL.27 per month, even if the new house is a
bit larger. What happens if suddenly the Government passes
a law stating that the owner of old houses, occupied by old
tenants, has the right to increase rents by 40 percent?
The same family has to pay now LL.70 per month for the same
small house, or LL.20 more than before the law was passed.
If the minimum rent it has to pay now is LL.70, the LL.77
larger apartment becomes much more attractive, for it involves
an additional sacrifice of only LL.7, as compared with the
former additional sacrifice of LL.27.

Clearly, while the Legislator tries to decrease the
gap of injustice, he is at the same time, and probably quite
unconsciously, promoting the shift in demand from small and
old real estates to larger new ones with, on balance, a net
increase in the demand for rent.
Under the title, "Appendix to Section 5, Chapter II", rent regulations affecting demand are stated and briefly analysed at the end of this chapter. They cover the years 1944 to 1961. The 1962 rent law will be analysed separately in Chapter IV which aims at setting down the prospects of the construction sector in Lebanon.

B. **FACTORS IN THE SUPPLY OF CONSTRUCTION**

As a reminder, this chapter aims at explaining why such an over-expansion in the first and second class buildings has taken place. Part A analysed the factors in the demand for rent to be contrasted to those in the supply of real estate discussed hereunder. Finally, Part C will, on the basis of the former analyses, try to extricate the fundamental causes that have led to the above mentioned problem. It will be supplemented by case studies presented in Chapter IV, wherein an attempt to reveal the monetary and psychological motives behind the attitude of real estate entrepreneurs will be made.

1. **The Supply of other Investment Opportunities and the Relative Rate of Return**

If the volume of investment in construction is to be compared to those in other sectors, the "Service Producing Sector" has to be left out, for, in spite of the fact that
both are closely interwoven, they remain essentially of a different nature. Whereas investments in services are generally of a short duration and therefore can more readily be adapted to changing economic conditions, investments in real estate are permanent to a certain extent and, consequently, less apt to adjustment.

The only sector which involves investments of at least as long a duration as the construction sector, is industry.

The relevant question to ask now is as follows: Does the Lebanese entrepreneur favour one of these sectors at the expense of the other? And, if yes, why?

During a period of 8 years (1950–1957), new industrial investments amounted to LL.150 million. The average yearly investment was LL.18.7, and approximately 35,000 workers were employed in this sector.

Over the same period, new investments in construction amounted to LL.380 million. The average yearly investment

1. Ibid., p.1-2-B-11.
was LL.47.5 million, and approximately 33,000 individuals\(^1\) were employed in this sector.

These figures are eloquent enough to demonstrate that the entrepreneur in Lebanon favours construction much more than industry. To dramatise things even more, a simple arithmetical operation reveals that, while the average yearly investment per worker employed in industry was LL.534, that of the worker employed in construction was LL.1,439, almost three times as much.

Except for the textile industry, the rate of return on capital invested in industry is relatively high, ranging from 10 percent to 18 percent.\(^2\) It will be shown in the case studies of Chapter IV that the net rates of return on capital invested in construction rarely do exceed the 11 to 12 percent range. Why then has the entrepreneur stubbornly chosen the latter?

The most important factor is that industry in Lebanon is a risky task. Market fluctuations, due mainly to political

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1. Ibid., p.1-1-33.
2. Ibid., p.1-2-B-10.
considerations, can either be extremely profitable or ruinous. In addition, most of the now successful industrial concerns have had to struggle in their early life to turn the loss into a profit. In the event they were unable to improve their efficiency, industrialists, with big political backing, were able to force upwards customs duties on imported competing goods. Over and above, many industrial projects have remained on paper for lack of adequate long term credit. All these drawbacks to industrialisation are not found in the real estate sector.

For financing construction, credit is available in much larger quantities than to industry. (This will be more fully discussed in Part 3 of this section.) The real estate entrepreneur does not have to resort to political backing to realise a profit on his investment. In fact, it is impossible for him to incur a loss unless his maintenance expenses exceed his rent income, which is unlikely. Moreover, the management of a real estate is much easier than that of an industry, as it does not require full time attendance, technical, financial or managerial skills.

Often, real estate investment gives the entrepreneur an opportunity to realise a profit not during or at the end
of the fiscal year as in industry, but in advance, in form of key money or pre-received rents. This fact, coupled with the urge that Lebanese entrepreneurs have for realising quick profits, have tipped the scale in favour of real estate investment.

Other factors, equally if not more important than those discussed above, are analysed separately in the following sections.

2. Inflow of Capital Into Lebanon

It is a well known fact that year after year, the deficit in the balance of trade has been increasing in Lebanon. Yet, the balance of payments has continuously shown a surplus. What are the items that finally account for that surplus?

In summary form, Table XIII below, reveals the answer.
TABLE XIII.

THE BALANCE OF PAYMENTS OF LEBANON

(*in LL. million*)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Deficit in the Balance of Trade</td>
<td>-311.5</td>
<td>-332.1</td>
<td>-239.3</td>
<td>-350.1</td>
<td>-497.0</td>
<td>-549.3</td>
</tr>
<tr>
<td>B. Sundry Receipts (tourism, transit, etc.)</td>
<td>+250.6</td>
<td>+229.7</td>
<td>+132.4</td>
<td>+228.4</td>
<td>+321.1</td>
<td>+344.1</td>
</tr>
<tr>
<td>C. Deficit Balance</td>
<td>-60.9</td>
<td>-102.4</td>
<td>-106.9</td>
<td>-121.7</td>
<td>-175.9</td>
<td>-205.2</td>
</tr>
</tbody>
</table>

Compensating Items:-

1. Private Gifts and Emigrant Remittances
   (+ 54.4) (+ 69.0) (+ 76.2) (+ 82.3) (+ 84.4) (+ 91.1)

2. Aids to Government
   (+ 0.5) (+ 2.5) (+ 4.3) (+ 18.2) (+ 24.2) (+ 42.4)

3. Cultural & Charity Institutions’ Receipts
   (+ 10.2) (+ 13.5) (+ 10.7) (+ 15.2) (+ 19.2) (+ 25.2)

4. Capital Movement
   (+ 14.7) (+ 43.7) (+ 48.6) (+ 63.0) (+ 80.2) (+ 84.0)

D. Total Compensating Items
   (+ 79.8) (+128.7) (+139.8) (+178.7) (+208.0) (+242.7)

SURPLUS (D - C)
   (+ 18.9) (+ 26.3) (+ 32.9) (+ 57.0) (+ 32.1) (+ 37.5)


It appears from Table XIII that the deficit is mainly offset by the compensating items. The most important of which is, on the one hand, "Private Gifts and Emigrant Remittances," and on the other, "Capital Movement." These compensating items are emphasized because there are indications that they
have affected the supply of construction in Lebanon. First, it is a certainty that a portion of emigrant remittances has gone to finance either the purchase of real estate or actual construction. The primary concern of emigrants towards their relatives in Lebanon is, to insure them a home, and towards their fellow villagers, schools, hospitals, etc. Second, "part of the capital imported has gone into real estate and has occasioned a terrific building boom in Beirut and in neighbouring localities. The whole aspect of the capital city has been transformed in a relatively few years."  

Most of the capital that flowed into Lebanon came from oil producing Arab countries whose citizens, frightened by political instability in their own land, saw it appropriate to put part of their fortunes in safer climates. Lebanon has a triple advantage over other countries in being Arab, enjoying a relatively stable economy and finally in enforcing its bank secrecy law.

Although the larger share of such capital movements swelled bank deposits, quite a big amount went into real estate. The I.R.F.E.D. Mission estimates that 80 percent of

the LL.206 million invested in Lebanon in 1957, came from savings of Lebanese people, whereas 20 percent originated from capital movements, "chiefly" invested in real estate. Of course, only part of this amount financed new construction, the remainder being used for the acquisition of already existing buildings. However, the Lebanese entrepreneur became encouraged to make available more buildings which he could sell at a high profit upon completion to interested foreign investors.

Clearly, whether looking at the direct or indirect effects of these capital movements, the net result has been an expansion in the supply of construction.

3. Availability of Local Funds for Construction

As mentioned in the previous section, part of the capital inflow has directly financed real estate construction, part of it has financed alternative investment projects and the remainder has been deposited in the vaults of commercial banks, making more local funds available for construction.

1. Etude Prélminaire sur les Besoins et les Possibilités de Développement au Liban, 1-1-34.
True, the increase in bank deposits has mainly been beneficial to the commercial sector of the Lebanese economy. At the same time, however, commercial bankers, finding themselves with extra money balances, have started the seemingly unorthodox practice of extending medium-range credit to the construction sector.

As one banker\(^1\) put it, real estate entrepreneurs usually fall short of funds at the last stage of their project. As far as guarantee is concerned, risk is not involved in extending a loan, since the almost completed asset is more than sufficient as security. As far as the time element is concerned, the loan is usually needed for two to eight months upon which, rents received in advance, if properly estimated by the banker, will liquidate the loan. Loans for the completion of construction are much like regular commercial loans in that they are self liquidating, safe, and of a relatively short duration.

The answers to a questionnaire submitted to bankers in Lebanon revealed that, on average, around 11 percent of total

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1. Interview with the Manager of Beirut Riyad Bank, Rivoli Branch, November, 1962.
credit goes to the construction sector, as compared to only
6 percent to industry. In reality, the 11 percent rate is
understated, since some traders use part of their line of
credit to finance construction, without informing their banker.

In addition, two commercial banks have recently opened
fully owned real estate subsidiaries. These are "Intra Bank
S.A.L." and "Banque Sami Shoucair S.A.L." Such a trend
indicates that some commercial bankers in Lebanon consider
specialisation in real estate medium range credit a sound
practice, on the grounds of both profitability and safety.

Except in very rare instances, commercial banks have
not, however, extended long term credit to the construction
sector. This lacuna has more or less been adequately wiped
out with the birth of BCAIF (Banque de Crédit Agricole,
Industriel et Foncier) from which real estate entrepreneurs
have, over the period 1954 to 1958, received LL.42,270,000

1. Mr. Usama Mikdashi, who has been carrying an
investigation concerning industrial finance
in Lebanon, was kind enough to ask interviewed
bankers to reveal the share of their total
credit that goes into construction, and supply
the information to the writer.
in long term loans. Such credit has mainly been channelled into financing hotel construction as well as other constructions with a touristic appeal.

4. Aspects of Rent Regulations Affecting Supply

Up to 1951, dislodging an old tenant was quite a difficult task. The laws did stipulate that owners of real estate could break the rent contract if the lessee did not pay his rent in due course, or if he caused damage to the property. Surely, it was more advantageous for old leaseholders to respect the law rather than to be dislodged into a far more expensive apartment. This fact made it almost impossible for the landlord to evacuate the tenant from his property.

The innovation of the 1951 rent law, was that it made it possible for owners of apartment houses to dislodge their tenants, if the property was old and if another building was to replace the old one, within a given period of time (see appendix to section 4, Part B, Chapter II). This, however, could be done only if the landlord pledged to take back the

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old tenant once the new building was completed, at a rent not exceeding 150 percent of the old one. As time passed, succeeding rent laws dropped this last provision: the old tenant would receive a compensation to be set by the court. At the same time, the law came to include not only tenants of apartment houses but also those occupying any other type of real estate.

These laws are stated and briefly commented upon in the appendix already referred to. The point to note here is that their enforcement helped boost the supply of construction. Not only did it become possible for owners of old houses to build new ones, but their task was also made easier, year after year, as the obstacles to be overcome were gradually removed.

The reader might have reasoned out that whatever was constructed must have necessitated the demolition of what existed in the first place, and that, consequently, no net increase in the supply of real estate did actually take place. Such, however, was not the case. Those who went into the trouble of dislodging old tenants to bring down their real estates and construct new ones, used their now expensive land more thoroughly as gardens were abolished and multi-storied
buildings erected. Even when the law prevented the landlord to construct very high buildings, ceilings of apartments were lowered to make a maximum use of the permissible height. In any case, the supply of area constructed was increased.

C. SUMMARY AND CONCLUSION — A SURVEY OF PRESENT CONDITIONS

In the Introduction and in Chapter I, it was established that a crisis in the construction section, caused mainly by an over-expansion in first and second class buildings, might have adverse repercussions on the Lebanese economy and by the same token, on all aspects of life. The prominent role that the sector under study has been performing, was demonstrated. The ill distribution of real estate was also pointed out, both qualitatively and quantitatively. In other words, the problem, as it appeared in 1961, was defined.

The examination of the 1961 problem was static, in that it consisted in analysing only one phase in a series, i.e. the 1961 phase. However, the discussion became dynamic, when the evolution of the factors giving rise to the problem were taken up in Chapter II, under the title "The Construction Boom Analysed in Its Recent Historical Context".
These factors were broken into those affecting the demand for rent and those affecting the supply of construction.

On the demand side, the increase in population and cultural change in Lebanon, were shown to be responsible for the increased desire of the Lebanese to occupy additional space. The ability of the population to acquire such space was subsequently demonstrated when the rise in per capita income was discussed. The expansion of the tourist industry and the increase in established foreigners, were correlated to the growth of demand. Similarly, the expansion of commerce and industry were shown to have partially accounted for such a growth. Finally, it was demonstrated that some rent regulations have also been responsible for an increase in the demand for rent.

On the supply side, investment opportunities other than those in construction were shown not to be very attractive. It was argued that the inflow of capital into Lebanon, coupled with the availability of local funds for construction, were two important factors in the supply of real estate. Lastly, it was demonstrated that the evolution in some rent regulations could not be altogether divorced from the increase in habitats.
The picture, as it appears today, is far from being pleasant. Whereas an over-expansion in the luxury building exists at present, the supply of average quality habitats is not sufficient to lodge the greater portion of the population. At the same time, and as a whole, construction activity in Lebanon is facing a down-turn. It could be argued that some aspects of the down-turn are, after all, welcome. Possibly so, but it cannot be denied that a slowdown in construction does affect national income and employment adversely. These considerations will be discussed in the last chapter of this paper.

However, and as far as the construction sector is concerned, the analysis of the ill-working of the liberal mechanism should not be deferred. True, factors in the demand for rent and factors in the supply of construction have been discussed. Yet, what has not been discussed is the manner in which these factors did combine to lead both to an under-expansion and an over-expansion in one and the same sector of the economy.

The under-expansion in the average quality habitats is evidenced by the tremendous recent migration to the towns already analysed earlier. It is also attributed to the irrational behaviour of many investors in real estate. To them, a building is often not as much a productive asset as it is a mark of power.
and prestige. Consequently, their primary aim is often to achieve excellence in constructions that would bear their names. Unfortunately, these buildings are beyond the reach of the poor. Strange as it seems to be, the above mentioned irrationality, attributed to many investors in real estate, is nevertheless true. Another factor behind the excess capacity in luxury buildings stems from the fact that entrepreneurs often overestimate their expected rates of return on investment. In their forecasts, they almost never consider the market value of the land at the time of construction as representing its real value, but rather look at the cost incurred upon acquiring it.

Similarly, Arab investors from neighbouring countries have not, until recently, cared much about the rate of return on investment, as they were chiefly interested in having permanent assets in a country like Lebanon. Their way of estimating the worth of a building consisted in finding out its cost to the builder rather than in capitalizing returns. On the whole, it cannot be said that they were highly educated, or even aware of the subtleties of business. Often, they were led by unscrupulous middlemen into buying expensive real estates. Having suddenly become rich without much effort, it was normal for them to become conspicuously spendthrift overnight. In addition, political instability in their countries has impelled them to channel, hurriedly, part of their wealth into real estate in Lebanon. All these facts are partly responsible for the construction of expensive but uneconomic buildings in this country.

1. Every Arab citizen (non Lebanese), is entitled by law to acquire 10,000 square meters of land (more in some cases), irrespective of whether such land is built up or not. Roughly speaking, he can acquire 10 huge buildings (50 by 20 meters). Kindly refer to the Appendix to Part C at the end of this chapter, where the law is stated.
In other instances, disequilibrium was caused by the fact that speculation had inflated the price of land to such an extent that it did not pay to waste it for average quality constructions. It is said that aside from the island of Manhattan, nowhere in the world has the price of land become as expensive as in Lebanon.

All these considerations will be illustrated arithmetically in the case studies at the end of this paper.
APPENDIX TO SECTION 5

PART A - CHAPTER II

RENT REGULATIONS AFFECTING DEMAND

1. Rent Regulations of 1944

Article 5: Rent contracts signed prior to 31st December, 1939, are subject to the following increases depending on the category a particular contract falls in:

Category 1: Includes living houses only:

Rents from LL. 1 to LL.250 per annum, 30%
" " LL.251 to LL.500 " " , 40%
" " LL.501 to LL.750 " " , 50%
" " LL.751 and above " " , 60%

Category 2: Includes Hospitals, libraries, Engineers' and Lawyers' offices, Scientific and Charity Institutions:

Rents from LL. 1 to LL.250 per annum, 40%
" " LL.251 to LL.500 " " , 50%
" " LL.501 to LL.750 " " , 60%
" " LL.751 and above " " , 70%

1. Lebanon, Al-Nass al-Rasmi li-Qanun al-Ijarat, July, 1962, pp.7-8-
Category 3: Includes Trade and Industrial Concerns and all other types of rent not mentioned under Categories 1, 2, or 3.

Rents from LL. 1 to LL.250 per annum, 60%
" " LL.251 to LL.500 " " , 80%
" " LL.501 and above " " , 100%

Article 10: Rent contracts signed between 31st December, 1939, and 31st July, 1941, are subject to the following increases depending on the category a particular contract falls in:

Category 1: Includes all types of contracts except those related to hotels and boarding houses , 30%
Category 2: Includes hotels and boarding houses , 15%

Critical Note

No matter how wide the gap was between very old rents (before 1939) and relatively newer ones (1940-1941) as compared to those of 1944, the tremendous increases in rents allowed on old contracts by the legislator, must have had the effect of raising the whole demand schedule for rents. Placing ourselves back in 1944, note that the increases allowed on very old contracts (before 1939) are, on average, higher than those allowed on relatively recent ones (1940 & 1941). This is so, simply because rents shot up tremendously in 1940, when the Second World
War started, forcing the Legislator in 1944 to reduce injustices created by economic phenomena under war conditions by increasing old rents much more than relatively recent ones.

Also note that, to reduce the gap, the Legislator did not resort to decreasing the 1943 or 1944 rents. He only worked forward, trying to reconcile the past with current (1944) realities.

To reduce the gap further, later rent regulations favoured both forward and backward reconciliations at the same time. This was done by raising old rents and reducing very recent ones simultaneously.

2. **Rent Regulations of 1945, 1946, and 1947**

   No new rent law was promulgated during the above three years. Instead, the validity of the 1944 law was extended.¹

3. **Rent Regulations of 1948**²

   **Article 2:** In addition to the increases stated in articles 5 and 10 of the 1944 law, rents that have been contracted before

1. Ibid., p. 10.
2. Ibid., p. 11.
1st July, 1941, are subject to a further increase of 10% for living houses, and 15% for any other type.

Article 3: All rents contracted after 1st July, 1941, are subject to a 10% reduction.

Critical Note

The originality of this law is that it works both from down up, and from up down, to close the gap of injustice. Here again, the economic effect is a net increase in demand for rent.

4. Rent Regulations of 1949 and 1950

No new rent law was promulgated during the above two years. Instead, the validity of the 1948 law was extended. ¹

5. Rent Regulations of 1951 ²

Article 2: In addition to amendments brought about by previous laws, rents that have been contracted prior to the 1st of July, 1943, are subject to the following increases:-

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1. Ibid., p. 11.
2. Ibid., p. 12.
First: Commercial and Industrial Concerns
From LL. 1 to LL.250, 7%
From LL.251 to LL.500, 9%
From LL.501 to LL.750, 12%
From LL.751 and above, 15%

Second: The Remainder
From LL. 1 to LL.250, 5%
From LL.251 to LL.500, 7%
From LL.501 to LL.750, 8%
From LL.751 and above, 10%

Article 3: Rents contracted between the 1st of July, 1943, and 31st of December, 1948, are subject to the following reductions:

Case 1: If the rent is that of a real estate built before 31st December, 1939, 25%.

Case 2: If the rent is that of a real estate built between 31st December, 1939, and 1st January, 1949, 20%.

Critical Note
The 1951 law seems to be accentuating even more than that of 1948 law, as almost the same types of rents are subjected to
the same repeated treatment. The net economic effect is again an increase in the demand for rent.

6. **Rent Regulations of 1952 and 1953**

No new rent law was promulgated during the above two years. Instead, the validity of the 1951 law was extended.¹

7. **Rent Regulations of 1954 and 1955**²

**Article 11:** In addition to any amendments brought about by previous laws, rents contracted up to 31st December, 1948, are subject to an increase of 10%, for real estate not employed for trade or industry.

**Critical Note**

Same as under 3 and 5.

8. **Rent Regulations of 1956**³

**Article 11:** A. In addition to any amendment brought about by previous laws, rents contracted before the 1st of January, 1941, are subject to the following increases, depending on the category

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2. *Al-Ahrar*, 8th April, 1954, p. 3.
a particular contract falls in:--

Category 1: Commercial & Industrial Real Estate:--

20% in 1956
40% in 1957
60% in 1958

Category 2: The Remainder:--

15% in 1956
30% in 1957
45% in 1958

B. Rents contracted during 1941 are subject to 3/4 of the increases stated in "A" above.

C. Rents contracted between 1st January, 1942, and 30th June, 1943, are subject to 1/2 of the increases stated in "A" above.

D. Rents contracted between 30th June, 1943, and 1st January, 1956, are subject to the following reductions:--

25% for real estate built before January 1, 1940
20% " " " " " July 1, 1943
15% " " " " " January 1, 1956
Critical Note

Same as under 7.


No new rent law was promulgated in any of the above five years. Instead, the validity of the 1956 law was extended.

10. Rent Regulations of 1962

The long awaited new law was finally promulgated on the 31st of July, 1962. Some of its aspects will no doubt affect construction in the years to come. In view of this fact, the analysis pertaining to this new law was postponed until Chapter IV which outlines the prospects of the construction sector in Lebanon.

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APPENDIX TO SECTION 4

PART B - CHAPTER II

RENT REGULATIONS AFFECTING SUPPLY

1. Rent Regulations of 1944

   Article 14: The rent contract is no longer binding if the lease holder

   - Does not pay the lease within one month of the day he is notified by the landlord.

   - Causes damage to the property or uses it for purposes other than those stipulated in the contract.

Critical Note

In 1944, the above law was the only one that could invalidate the contract. It was not difficult for tenants who had no desire to be dislodged to observe such a law.


   No new rent law was promulgated during the above first three years. Instead, the validity of the 1944 law was extended. The 1948 law that contained Article 14 of the 1944 law, was again extended to 1949.

I. Ibid., pp. 7-23.
3. Rent Regulations of 1951

Article 14, appearing in the 1944 law, remained valid. In addition, a new law concerning the invalidation of the rent contract, is stipulated in Article 5.

**Article 5:** Provided he starts building another habitat, not later than three months after the real estate becomes vacant, the landlord has the right to recover his property, if occupied for habitation purposes and if such property is old and crumbling.

**Critical Note**

The originality of the above article is that it gives an opening to landlords to recover their property. Since they have to construct another building, supply of real estate is positively affected.

**Article 8:** Once the building is terminated, the past tenant has priority to re-occupy an apartment which offers the same facilities as those in the previous real estate by paying not more than 150 percent of the old rent.

4. Rent Regulations of 1952 and 1953

No new rent law was promulgated during the above two years. Instead, the validity of the 1951 law was extended.
5. Rent Regulations of 1954 and 1955

Article 6: Provided he starts building another habitat not later than three months after the real estate becomes vacant and provided the construction is terminated within two years, the owner has the right to recover his property, if such property is old and crumbling.

Critical Note

The above article affects any type of real estate and not merely living houses. Again, supply of real estate receives an additional spur.

Article 8 appearing in the 1951 rent regulations remains valid.

6. Rent Regulations of 1956

Article 6 of the 1954 and 1955 rent regulations remains valid. Article 8 of the 1951 rent regulations does not appear any more, which means that the old tenant has no more priority to occupy a similar new apartment built. Instead, he is indemnified with an amount set by the court.
Critical Note

To dislodge the old tenant, the landlord has to overcome a lesser number of obstacles now. Clearly, this would ultimately lead to an increase in the supply of real estate.


No new rent law was promulgated in any of the above five years. Instead, the validity of the 1956 law was extended.

8. Rent Regulations of 1962

The analysis pertaining to this new law is postponed until Chapter IV, which outlines the prospects of the construction sector in Lebanon.
APPENDIX TO PART C - CHAPTER II

CONDITIONS FOR THE TRANSFER OF REAL ESTATE IN THE LEBAINESE TERRITORY, TO FOREIGNERS

OFFICIAL DEGREE Nº 110 OF JUNE 12, 1959

Article 1: The transfer of real estate in the Lebanese territory to foreign citizens, falls under the jurisdiction of the present law.

Article 2: Any Arab citizen is entitled to acquire the following properties, without any special license:

First: Buildings, in whatever location, provided the lands on which they fall do not exceed 10,000 square meters.

Second: Land for the purpose of construction, within the cities of Beirut, Tripoli, Saida and Zahli.

Third: Non agricultural land outside the cities enumerated above, provided it does not exceed 10,000 square meters in any one real estate zone.

In respect to non Arab foreign citizens, a special license has to be secured for the transfer of real estate.

Articles 3 to 6: (Provide for penalties, in the event the above laws are not conformed with).

Beirut, June 12, 1959

1. Made available at the Real Estate Department, Beirut, June 1963.
CHAPTER III

THE PROSPECTS OF CONSTRUCTION IN LEBANON

Where is the construction sector of the Lebanese economy heading for? This is a question that economists, politicians, sociologists, entrepreneurs, engineers, businessmen, and speculators alike, would like to see answered. The present analysis does not pretend to provide a detailed forecast. Indeed, so many factors interact to set the total amount of construction year after year, that one cannot measure the exact net effect over say, the next decade. Yet, if exact measurements cannot be made, at least the direction towards which the construction sector is heading for can be deduced from a careful examination of the likely pattern that the factors affecting construction are taking.

Some of these factors have already taken a definite shape in which case the effects are almost immediate; others are still in the making or changing, in which case the effects will be felt less rapidly, but over a longer period. This being the case, the prospects of construction will be reviewed both over the short and long run.

Though the short run is usually defined as the maximum period of time which is just insufficient to allow any change in capacity,
it is used differently here. Irrespective of capacity, it will mean that period of time in which the level of construction will be immediately affected by some institutional factor such as a newly enacted law. Of course, the effects of such a law, if not modified, will extend over the long run as well. It is essentially in this respect that the terminology used here will differ from the conventional one.

What would the long run be? Some of the factors that affect construction are in the process of more or less slow evolution. The long run, as used in this text, will mean that period of time in which the level of construction will be slowly affected by relatively complex factors that cannot be changed overnight, in the same way as laws can.

The short run prospects will therefore comprise an analysis of the 1962 rent law and rent tax law, as well as the currency and credit draft law. The subsequent section will try to point out the probable long run effects on construction, of changes in population, culture, income, tourism, commerce, industry and capital, both local and foreign.

A. SHORT RUN PROSPECTS

1. The 1962 Rent Law

When the 1962 rent law was enacted, some of its critics felt that it would encourage construction, while some felt that
it would depress further the sector in question. What are the facts? Below, six articles from the law that are believed to affect construction in one way or another, are briefly analysed.

Article 6 of the law will definitely act as a stimulant as it empowers the owner of an old building who wishes to construct a new one instead, with great latitude to do so, in contrast to previous laws which made it almost impossible. Article 6 gives the owner the right to evacuate his property irrespective of whether it is crumbling or not, and enables him to construct on the terrace of the existing building, even if it would involve dislodging tenants. Below, is the article in question, fully stated.

Article 6

The landlord has the right to evacuate his leased property if he intends to pull it down and construct a new building in its place. Similarly, if he wants to build on the terrace of his property, he is entitled to evacuate whatever is constructed on such terrace, provided it covers less than half the area which can be used for construction in accordance with Municipal regulations, or provided he intends to construct two storeys and above.
If the landlord agrees with the tenants, occupying three-fourth of the building, to evacuate the property, he becomes automatically entitled to evacuate the rest, if he intends to construct a new building.¹

Of course, the 1962 law provides that compensation has to be paid to the dislodged tenants, but the amount is not any more at the discretion of the court as it was in the past. It is set within a minimum and a maximum which allows the landlord to evaluate his risks before going to court. Again, Article 7, stated below, is a factor that will certainly affect construction positively.

Article 7

The landlord who wishes to evacuate his property for the purpose of constructing a new building, will have to pay the leaseholders an indemnity that would not be less than five times the difference between the rent that would have to be paid for a similar premise and the old rent currently paid, and which would not exceed ten times that difference. In respect to commercial and industrial premises, he will have

¹ L'Orient, September 10, 1962, p.4.
to pay in addition, an amount set by the court representing the key money that would be paid for a similar premise.¹

Very much like previous laws, Article 11 of the present law tends to reduce the gap between old and new rents, a phenomenon already shown to affect construction favourably. Below, is the article in question.

Article 11

Beginning with 1962, rents will have to comply with the following:

1) Rents contracted before 1st January, 1941, are subject to the following increases, over and above any previous increase:

   Category 1 - Commercial & Industrial Real Estate

   15% in 1962
   20% in 1963
   25% in 1964
   30% in 1965 & 1966

¹ Ibid.
Category 2 - The remainder

10% in 1962
15% in 1963
20% in 1964
25% in 1965 & 1966

2) Rents contracted during 1941 are subject to \( \frac{3}{4} \)th of the increases stated in 1) above.

3) Rents contracted between the 1st of January, 1942, and the 30th of June, 1943, are subject to \( \frac{3}{4} \) of the increases stated in 1) above.

4) Rents contracted between the 30th of June, 1943, and the 1st of January, 1962, are subject to a 15\% reduction.\(^1\)

Somewhat in contradiction to the above law, Article 12 provides that the leaseholders of commercial and industrial concerns, can refuse to abide by the above increases. The court will then have to determine the adequate rent that cannot be less than 4\%, or exceed 6\% of the value of the leased premise. The point to note here is that the legislator

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1. Ibid.
seems to regard a 4 to 6% return on properties rented to commercial and industrial concerns as normal earnings; a fact that undoubtedly will depress the construction of such premises, assuming actual returns on similar properties are at present higher than 6%. Below, is Article 12 to which reference was made.

Article 12

In respect to commercial and industrial concerns, the leaseholder can refuse to accept the increases set by the above law, on condition he agrees to pay an equitable rent set by the court, amounting from 4 to 6% of the value of the leased premise. ¹

Another article of the law under study that cannot but make investment in construction less attractive, is Article 13 which does not require any comment.

Article 13

Irrespective of any previous agreement or custom, rents cannot be requested in advance for a period of more than three months. The leaseholder is entitled to pay his rent on a

¹. Ibid.
monthly basis without being charged with anything extra, if the lease pertains to a living house. In respect to other types of leases, the payment of rent on a monthly basis is subject to a 10% increase over the monthly rent.¹

If, on the whole, the articles discussed above tend to affect construction adversely, the following article cannot but induce entrepreneurs to build agricultural and luxury constructions, as these two categories do not fall under the law. By refraining from subjecting luxury buildings to restrictions, the legislator has failed to bring a remedy to the construction sector, precisely where it is most needed.

Article 14

The following types of properties are exempted from the provisions of the law:

1) Agricultural properties.
2) Luxury constructions designed for habitation. The remaining types of buildings are subject to the above law.²

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¹ Ibid.
² Ibid.
To conclude, it can be said that the 1962 rent law, on the whole, does not favour construction. Whereas previous laws comprised articles that could only stimulate the sector under study, the present law is not altogether favourable to construction. True, luxury and agricultural buildings do not fall under the jurisdiction of the law, but these do not account for the larger share of the construction sector anyhow. Whereas the construction of needed popular habitats should have been encouraged by the legislator, the 1962 rent law favours the construction of the already overabundant luxury buildings.

2. The 1962 Rent Tax Law

"In the course of a press conference, the president of the Beirut Engineers and Architects Association severely criticised the new tax on built up property and said it would slow down the building movement in Lebanon." What is the nature of that controversial law and what would its real effects be?

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Until 1962, the landlord was paying a flat tax of 11.33% on the rents received, (8.33% to the Ministry of Finance and 3% to the Municipality). This tax was regressive in nature in that, no matter how considerable the amount of rent was, the same rate was applicable, taking from the small landlord an amount representing a greater sacrifice than that born by the larger real estate owner.

The innovation of the 1962 Rent Tax Law (applied as of January 1, 1963), consists of a progressive tax on net revenues from rents exceeding LL.20,000 per year. To decrease the burden of the tax that small landlords have to pay, the law exempts the first LL.500 of rent from the tax. As many landlords, especially outside the cities, do not earn more than LL.500 per annum from rent, the burden of the past 11.33% tax has been completely wiped out. The next LL.20,000 above the first LL.500 are subject to an 11.0% tax, or 0.3% less than previously. As a matter of fact, the 11.0% rate is applicable on whatever net revenue is realised over and above the first LL.500. It is only beyond LL.20,000 and in addition to the 11% rate, that the tax becomes progressive.

"After deducting the first LL.500 received as rent and in addition to the 11% rate applicable thereon, the following
rates are applicable on rents exceeding LL.20,000:

- 3% on rents between LL.20,000 and LL.50,000
- 5% on rents between LL.50,000 and LL.100,000
- 8% on rents between LL.100,000 and LL.200,000
- 11% on rents between LL.200,000 and LL.400,000
- 15% on rents exceeding LL.400,000."

The law provides for some exceptions and contains many details on how and when taxes are to be paid. These will not be analysed here as they are not liable to affect future construction.

To begin with, the fact that the first LL.500 received as rent are not subject to any tax will certainly stimulate construction of modest houses for two reasons. First, simply because it would involve a lesser annual expense on the asset, and second, because the value of the property will consequently tend to appreciate as compared to buildings whose rents are taxable. Consider the following example. A small house costing LL.5,000 is being rented at LL.500 per annum. Whereas under the old law, LL.56.65 (11.33%) would have been paid as taxes, leaving the owner with a net LL.443.35 (8.8% return on investment), the present law would
permit him to realise a profit of LL.500, representing 10% on investment. To carry the argument one step further, assume a buyer is willing to pay an amount for the property that would yield him 9% on investment. Under the old law, if the transaction takes place, the seller would receive LL.4,926 and would be incurring a capital loss of LL.74. Under the new law, the seller would receive LL.5,555 and would be realising a capital gain of LL.555 on his property. Clearly, therefore, the new law will stimulate the construction of small and most probably popular houses.

On the other side of the picture, higher rents implying larger buildings, are at a disadvantage from a tax point of view. The higher the rent, the higher the tax and the lower the rate of return, other things remaining equal. The point to note here is that the potential investor in real estate would tend to try and decrease the impact of the tax as much as possible. Sooner or later, he will come to realise that it is more economical to construct a less than luxury building which could be rented for a lesser amount, thus avoiding the progressivity of the tax.

The aim of the whole rent tax law is dual. First, the legislator has in view more income to the government. On the
other hand, he is after a more equitable distribution of the
tax burden. Most probably, the other effects of the law
escaped his mind and it is for this reason that he is being
currently blamed. These effects have already been referred
to in the above analysis. To repeat what has been said, the
1962 rent tax law will have as a consequence a re-allocation
of resources. Whereas construction of luxury buildings will
be adversely affected, construction of popular small houses
will be stimulated. Theoretically, these two effects are
most welcome at a time when luxury buildings are over-abundant
while popular habitats are lacking. On balance, however, the
law will tend to affect total expenditures on construction
adversely as on the whole, more taxes - that cannot easily be
shifted forward due to the rent laws - will be levied from the
sector in question leaving landlords with less incomes and
scaring away rich potential investors who will probably be
inclined, for psychological reasons, not to construct at all
rather than build popular habitats. At the same time, there
will be a tendency, on the part of owners of more than one
building, to sell part of their properties in order to
decrease the progressivity of the tax and, thus, earn more
income on the remaining estate. This would, incidentally,
lead to a more even distribution of real estate ownership
among the population.
3. **The Currency and Credit Draft Law**

In December, 1962, the Monetary and Credit Board released a draft law, for the purpose of regulating the Lebanese currency, setting up a Central Bank and regulating banking practices in Lebanon. The release of that law led to both praises and outcries from leading financiers and economists. On the whole, most of the criticisms were aimed against specific articles of the law and sometimes against the whole idea. Mr. Bassile Meguerdiche, President-Director of the "Banque de l'Economie Arabe" felt that the legislation was indispensable but should be slightly modified. Mr. Joseph Saab, President-Director of the "Development Bank" stated that the law could very well scare capital out of Lebanon. Dr. M. Azhari, Director of the "Banque du Liban et d'Outre-Mer", declared that the fundamental principles of the law were acceptable. Professor Samy Chamas of the Law Faculty considered the powers given to the Central Bank as incompatible with the liberal traditions of Lebanon. Finally, Mr. Sami Shoucair, a brilliant banker and businessman, made a prediction that should the law be enacted in its present form, it would be the equivalent of a death penalty for Lebanon.

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Amidst such a controversy, the only aim in this section is to mention and comment upon the main clauses which are believed to affect construction, should the law be enacted without any modifications at the end of 1963.

Article 132 states that the minimum paid-up capital of commercial banks has to be five million Lebanese pounds.1 Needless to say, many banks would have to close down. Aside from the fact that a climate of insecurity would prevail in the country, depositors would be forced to channel their funds into the vaults of a few privileged banks that might create trusts and prejudice the economy. No matter how the picture is looked at, such a stipulation will, most probably, be detrimental to growth in general and, hence, to the construction sector.

If article 132 would affect construction somewhat indirectly, articles 149, 152, and 154 would doubtless have direct impacts on the sector under study. To begin with, article 149 states that bank secrecy will be preserved, but it stipulates that banks are under obligation to provide

sworn officers of the Central Bank with their accounting books as well as any related documents. Although these officers are required to abide by the bank secrecy law of September 1956 and will therefore not divulge any information, the article also provides that these officers have to report to the Governor of the Central Bank who in turn owes loyalty to the Minister of Finance. Clearly, the article is a threat to the proper functioning of bank secrecy. Mr. Sami Shoucair, who was already referred to, argued forcefully in a talk given at the Alumni Club of the American University of Beirut, on January 23, 1963, of the need to abolish any article that could endanger bank secrecy: "Should bank secrecy be abolished or weakened, or even inspire less confidence, there would definitely be an immediate haemorrhage of funds that would go abroad. In the last few months, there have been two instances where bank secrecy has been threatened or shaken. In both instances, capital has fled from the Lebanon." 1 Extending this argument elsewhere, 2 he writes: "It is absolutely inconceivable to believe that the mere fact of swearing (not to divulge bank secrets) should entitle


central bank employees to know of commercial banks secrets. Clients do trust the bank in which they deposit their money, but do not have confidence in employees of other banks. Should there be any leakage, how would the Banker know whether his own employees or those of the Central Bank are to blame?" The argument is indeed sensible. It is very difficult to believe that bank secrecy will be adequately preserved, if the present draft law is enacted. The consequences are many. For the sake of the present discussion, it would be sufficient to point out the fact that foreign capital which would have in part helped finance construction in Lebanon, would be scared away.

Next, Article 152 of the Currency and Credit Draft Law stipulates that it is forbidden for commercial banks to undertake any commercial industrial or other activities considered as not belonging to the banking profession. This, of course, makes real estate ownership by commercial banks impossible. Almost all commercial banks in Lebanon own and/or are in the process of constructing buildings that appear in their balance sheets as income producing fixed assets. Whether such a


2. Actually, article 153 of the law provides that only up to 75% of the capital of a bank can be used to acquire real estate, stocks, furniture etc...
portfolio distribution is wise or not, is of little relevance here. What has to be pointed out, is the fact that article 152 will, if enacted, provoke a forced selling of real estate which, undoubtedly, will be detrimental to the construction sector of the Lebanese economy.

Article 154 of the same law, provides that a commercial bank is entitled to acquire buildings belonging to their debtors, in the event such clients default on their loans. However, article 154 also stipulates that any building acquired on that basis, has to be sold within two years. Here again, being forced to dispose of the property, the flexibility of the commercial banker is reduced and the sale, being imposed by law, will tend to reduce the sale value, a fact that would tend to reflect itself on construction activity.

4. The Popular Housing Draft Law.

Taking into consideration that the private sector has not adequately responded to the housing demands of low income groups of the population, the Lebanese Government has recently promulgated a law (subject to approval by the Chamber of Deputies), "for the establishment of an organization in the Ministry of Works and Social Affairs called the 'Housing Council' (that would) formulate a general policy for the provision of housing accommodation to limited and low income groups .... establish the necessary conditions for selling the or renting such houses .... work for setting up of mixed companies

1. Ibid.
(i.e. owned by the private and public sectors) to be created for the sole purpose of constructing houses for limited and low income groups. ....encourage the execution of projects intended to facilitate housing accommodation, ....supervise and control the operations of all organizations and companies working under the provisions of this law". The law provides that the contribution by the Lebanese Government will not exceed 40% of any single company's capital. Such companies will have to devote their activities exclusively towards the construction of houses which are within the reach of limited and low income groups. The Government would also guarantee these companies in the event bank loans are required and applied for "provided such loans do not exceed L.L. 30 million at any one time".¹

Undoubtedly, if the above project is realized as intended, part of the problem currently faced by the construction sector would be solved as more popular habitats would become available. It is doubtful, however, that the project will completely succeed if approved by the Chamber of Deputies in its present form. One criticism is that the feasibility of the scheme as a whole, rests on one major assumption made by the legislator, that private enterprise would accept the Government as a partner for such a venture. Indeed, it is very difficult to conceive that any entrepreneur with 60% of the capital, would forego

¹ "A New Housing Council for Lebanon", Middle East Express, (April 1, 1963), p.3.
his managerial freedom and flexibility to a rigid partner with only a minority interest in the concern. The contrary might have been true only if the entrepreneur in Lebanon had been badly in need of capital for his investment projects. This, however, is not the case. (Kindly refer to the discussion on the "Availability of Local Funds for Construction", on page 39.)

On the whole, therefore, the project is probably bound to failure prior to its launching, unless the Government decides to assume its execution on an exclusive basis. It is believed here that still a better way to make popular habitats available, would be through fiscal policy. The analysis and justification of such an alternative is deferred to the last part of this paper, under the title "General Conclusion - A Suggested Model".

5. Conclusion

In the first three sections of this chapter, three laws that are believed to have an immediate impact on the volume of construction in Lebanon, were discussed. The fourth law regarding the popular housing project was not considered as a factor that would affect construction, for the reason that it would probably not be implemented, due to its impracticability.

To begin with, it was demonstrated that the 1962 Rent Law would not discourage the construction of luxury buildings, but would affect the general
level of construction adversely. Half way in opposition to the Rent Law, the Tax on Rent Law of 1962 would stimulate the construction of popular habitats but would discourage construction of luxury buildings, with, on balance, a loss in total volume. Finally, the Currency and Credit Draft Law would probably, if enacted in its present form, affect the level of construction adversely, without discriminating between various classes of real estate.

Clearly, if the effects of the three laws are totalled up, it can easily be seen that the sector under study is bound to face, in the short run, a recession if not a depression. Some of these laws would also affect construction in the long run, unless replaced or amended in the future. Other factors than those outlined above, will also affect the sector under study in the long run. These will be analysed in the following section.

B. LONG RUN PROSPECTS

It is obviously far easier to foresee the short run than the long run prospects of the construction sector. This is simply because the long run, even if it is defined as a period covering only ten years cannot be forecast with great accuracy, especially in this part of the world where political uncertainties prevail.
In spite of the fact that among the factors that would affect construction in the long run some are in the process of a definitely known evolution, the conclusions drawn in this section will essentially be speculative in nature.

1. **Changes in Population, Culture and Income**

It has already been stated in Chapter II that the Lebanese population is expected to double every 30 years. The yearly increase of around 2.2% is not likely to change over the next decade. Theoretically speaking, and other things remaining equal, construction has to increase by the same percentage. True, this percentage will tend to fall as more birth control and family planning become widespread, but their effect will be more than offset by the increase in the average life span of the population, as medical care becomes more efficient, and by the drop in the rate of emigration as foreign countries become less needy of manpower to exploit their resources. This last fact has already been discussed earlier, when it was stated that from 15,000 departures a year, as between 1900 and 1914, emigration has dropped to 2,850, as between 1951 and 1959, and will probably become most insignificant in a few years. The increase in population will not only affect construction directly, but indirectly as well. This is because an increasing number of
crumbling buildings, which had been constructed in the past at an increasing rate as a result of population growth, will have to be replaced with an increasing number of new ones, year after year.

Another factor that will undoubtedly boost construction in the long run, is cultural change. Newly wed couples are refusing to share their parents' houses; the improvement in the level of education, coupled with the increasing number of attractions that the cities offer, are spurring an exodus from rural regions to centres where more remunerative jobs are available and where life seems more attractive. True, the authorities are trying to slow down such a migration in their planning programs, but it is doubtful whether they will succeed to stop it altogether.

The increase in national income has been 4.4% yearly up to very recently. With the population expanding at a rate of 2.2% per annum, the Lebanese citizen has been, on average, better off by 2.2% yearly. Will this process continue in the future? At the time this chapter is being written, it seems that the Lebanese economy is not doing so well due to the uncertainties regarding the effects of future political events in the neighbouring countries on the integrity of
Lebanon as a free and independent political entity. In a mood of tension and general pessimism, it would be most difficult to sort out the lasting aspects of the present situation, from the temporary. However, if this is carefully done by referring back to history, it can be stated that Lebanon will remain independent and that the entrepreneurial genius that exists in this country, will once again emerge in the long run. There is an inclination on the part of the government nowadays to assist the business sector. The summoning of the I.R.F.E.D. Mission is one such example, that of the Central Bank is another. True, the Currency and Credit Draft Law seems to be detrimental to the economy, if enacted in its present form. But here again, flexibility which is another characteristic of individuals in Lebanon, will certainly prevail on the Legislator. The rise in per capita income seems a certainty in the long run and will consequently be accompanied with an expansion of the construction sector.

2. Changes in Tourism, Commerce and Industry

Recently, genuine efforts on the part of the Lebanese Government have been exerted to promote tourism in Lebanon. A semi-autonomous body called the National Council for Tourism and headed by Mr. Charles Helou, was founded in 1961 to plan...
and coordinate the execution of touristic projects, such as the re-organisation of beaches, winter and summer resorts. It also is endeavouring to make cheap hotels available to tourists with limited incomes and to encourage all sorts of festivals, international exhibits and congresses, etc..., in Lebanon. Although the number of tourists from neighbouring countries is expected to decline, there are indications that the loss will be more than offset, in the long run, by Europeans and Latin Americans, to whom the present advertising campaign is being directed.

In addition to the expected increase of tourists' demand for accommodations, many foreigners will continue to come and establish themselves in Lebanon semi-permanently attracted by both the geographical location of the country and its liberal economy which permits them to operate freely in any sector they like, with the assurance that they will be permitted to withdraw their funds any time. This assumes, of course, that the Lebanese economy will remain basically liberal, an assumption which is quite realistic.

As the population grows, commerce and industry are very likely to expand as well. True, political instability cannot be discounted altogether and it might constitute a threat to
the development of both these sectors. However, as long as the Government maintains its free foreign exchange policy under which all exchange transactions can be undertaken without any restriction or control and as long as the progressive income tax schedule remains mild and therefore attractive, both local and foreign capital will continue to be channelled into commerce and industry. By foreign capital, it is not meant here foreign Arab capital, since anyway such capital is not directly invested to a great extent in commercial or industrial concerns. Of course, withdrawals of Arab capital from its present forms of investment, could have adverse repercussions not only on the construction sector, but on the whole economy as well. This possibility is briefly discussed in the next section.

On the whole, therefore, tourism, commerce, and industry are expected to develop in the long run, bringing about a corresponding expansion in the construction sector.

3. **Inflow of Capital into Lebanon and the Availability of Local Funds**

It was said in Chapter II that the deficit in the balance of trade has been mainly offset by compensating items, the most important of which has been, on the one hand,
"Private Gifts and Emigrant Remittances", and, on the other, "Capital Movement". It was also demonstrated that these compensating items did occasion a boom in the real estate sector.

In the long run, "Private Gifts and Emigrant Remittances" will certainly fall. This is simply because the number of emigrants is dropping year after year which means that emotional ties with the mother country will slowly, but surely, fade out. A similar assertion cannot be made in respect to capital movement. It was stated earlier that the greater portion of this item came from oil producing neighbouring countries. The inflow of capital into Lebanon will depend on mainly two factors. First, the degree of instability in neighbouring countries and, second, the degree of stability in Lebanon itself. The more the political climate becomes insecure beyond the Lebanese borders, the more capital will flow into the relatively secure Lebanon. It has often been said that Lebanon's prosperity comes from the misfortunes of its neighbours, a highly vulnerable factor which cannot be depended on for the development of the Lebanese economy. However, if the situation is analysed objectively, it seems that history will keep on perpetuating itself, at least over the next decade, and that the factor under consideration is not that
vulnerable after all. This section is not a political essay and the above stated opinion will consequently not be defended here. The reader is left free to accept it or reject it. The next question to answer is as follows: Will Lebanon retain its present relatively stable political climate so that it would keep on attracting capital from its less privileged neighbours? It is believed here that the answer is positive. Again, if the situation is analysed impersonally, one has to see in the balance of power that exists in Lebanon a guarantee of security.

Capital from neighbouring countries is therefore expected to keep on flowing into Lebanon, maybe not as regularly, but nevertheless uninterruptedly. This, of course, assumes that bank secrecy will be preserved, a step that the legislator had better guarantee urgently to dissipate any doubt regarding its possible removal.

Will local funds be available for construction in the long run? The answer is yes, for the following reason. It was argued earlier that per capita income would most probably continue to increase in the future. If the marginal propensity to consume is not 100% (undoubtedly, it is not), then part of the increase in income will necessarily be saved
in form of bank deposits. In addition, beginning with 1964, the Central Bank will start functioning and through its manipulation of money supply and credit, will be in a position to insure the availability of funds for construction, as well as for other purposes, depending on the needs of the economy. In this aspect, as well as in a multitude of other economic aspects, the foundation of the Central Bank is most welcome. Other specialised banks, such as real estate banks are at present under establishment and will probably provide medium and long term capital. Additional real estate banks will most certainly be founded if the credit law prohibiting commercial banks from financing construction is enacted.

On the whole, therefore, both foreign and local capital will most probably be available in the long run to finance, in part, an expansion in the construction sector.

4. Conclusion

To repeat what has been said earlier, even if the long run is defined as a period covering only ten years, it cannot be forecast with great accuracy, especially in this part of the world where political uncertainties prevail. The preceding section consisted mainly of speculations in respect to the future. Most of the conclusions reached are based on
assumptions which can be challenged for their optimism. It was stated, for example, that entrepreneurial genius will always relieve the Lebanese economy from its stresses, that the legislator will be flexible and wise, that political disturbances will continue to prevail in neighbouring countries at least over the next decade, and that Lebanon will maintain its relative stability. It could be argued that it is doubtful whether all these predictions will prove to be correct in the future.

In spite of the subjectivity involved, it is believed here that the construction sector will resume its expansion in the long run, but that due to a rapidly changing environment, its growth will remain unstable, unless a solution is devised to smooth out the erratic factors underlying it. A suggested solution was discussed in the conclusion of the thesis.
GENERAL CONCLUSION - A SUGGESTED MODEL

A French saying goes as follows: "Lorsque le batiment va, tout va", which means that everything is well, when construction is well. Nowadays, it has become customary to hear local businessmen state: "The economic situation is deplorable; just have a look at the construction sector." From all that has been stated, the main problems facing the construction sector have to be briefly pointed out and adequate solutions suggested. First, it can be said that in the late fifties, an over-expansion in luxury buildings was the main factor that called for a period of adjustment, beginning with 1961. The consequent abrupt drop in construction activity has had adverse repercussions on the economy as a whole, and will continue to do so as long as the present trend is not reversed. Ideally, and in view of the multiplier effect, the construction sector should not be permitted to behave in a jerky manner, but should be induced to grow steadily, at that rate which would be beneficial to the community, both from the point of view of income generated and lodging. The second problem that has to be dealt with, is that in spite of the decline of construction in both 1961 and 1962, luxury buildings are still too abundant, whereas popular ones are scarce. The problem is therefore dual, both quantitative and qualitative.
The solution which is suggested below calls for two consecutive stages. In the first stage, the disequilibrium will have to be adjusted in such a way as to provide as many habitats in each of the classes, as demanded by various income bracket groups. From thereon, the expansion of the construction sector will have to be stimulated in such a way as to continuously reflect the housing needs of the various population groups. As these needs are presumably growing at a constant rate, the real estate sector will have to grow likewise. Obviously, the next question is, how could this be done in practice? Below is a suggested procedure presented in an outline form. It is by no means the only workable one and improvements on it are most welcome.

To begin with, a construction research department could be set up and staffed with econometricians, statisticians, public finance experts and researchers. Such a department could be directly attached to the Ministry of Finance or to the Ministry of National Economy, preferably to the former. The task of that department would be both technical and advisory. In the first stage, it would have to determine the degree of the present over-expansion in luxury buildings, and that of under-expansion in popular habitats. Simultaneously, it would have to establish clear correlations between, say, the progressivity of a tax on construction or on rent, and the resulting volume of construction in each of the classes in the real estate sector.
Having arrived at the necessary data, it would submit its recommenda-
tions to the Ministry it is attached to, on the basis of which a new
tax law would be enacted, the effect of which would adjust the
disequilibrium.

Once this is achieved, the scheme would enter in its second
phase. The task of the department would then be to recommend a
modified tax schedule that would permit the construction sector to
expand at a rate which would satisfy the demands of various income
groups. Of course, on the advice of the department, the schedule could
be revised if and when the need arises. The construction of the tax
schedule is not an easy task, but the difficulties can be surmounted
provided an adequate approach is used. Assuming the first stage of
disequilibrium is removed in 1966, the department will have to forecast
what the additional demand on the part of each of the income bracket
groups would be, say, in 1968. To take an example, assume the
additional demand for luxury apartments in 1968 is forecast at \( x \) square
meters. The department will then have to determine, on the basis of a
sound study, what is the average length of time required for a luxury
building to be constructed. If the time lag is computed to be, say,
two years, it would obviously mean that construction of luxury
buildings has to start two years in advance, if it is to meet demand in
due course. The next task of the department would be to find out the
volume of investment needed to make \( x \) capacity available two years
hence. When this is done, the department would finally have to
determine the tax rate that would be just high enough (or low enough)
to channel an amount of V Lebanese pounds into luxury buildings.
To put it differently, the department will have to determine that tax
rate that would channel V Lebanese pounds into luxury buildings, making
just enough capacity available to meet the demand of one income bracket
group of the population, two years hence. Below, is an illustration
adapted from John P. Lewis' book, "Business Conditions Analysis,"
revealing graphically the outlined procedure:

---

In the above graph, CT stands for the total expenditures which would hypothetically be incurred by the nation over a series of years, less what is invested in construction which appears as AC in 1966 and DE in 1968. It is assumed that the total capacity needed will be OB in 1966. The graph also assumes that the increase in the capacity of 1968 will have to be BF. What is revealed in this graph is the fact that to be able to provide an increase in capacity that would amount to EF in 1968, an amount equal to AC will have to be invested in 1966. Similarly, an amount equal to DE will have to be invested in 1968 so that capacity increases by FG in 1970 and satisfies demand.

What the department should aim at, is precisely what the graph reveals, i.e. a dynamic equilibrium whereby aggregate demand is equal to aggregate supply, the benefits of which are innumerable. True, the model as it is presented, is still in a very crude form. The best way to improve on it would be to criticise it in a constructive manner. Thus, it could be argued that the mere manipulation of the tax schedule need not necessarily stimulate a specific type of construction which is needed by the community, even if the tax rate is reduced to zero. The obvious counter argument is that the department could recommend subsidies in such cases. Where would the Ministry of Finance be able to provide sufficient funds for such a project? This is the sort of problem that the public finance expert would have to solve. He could choose, for instance, to recommend a
decrease in government expenditures for the construction of popular houses and use the savings thus obtained as subsidies to the private sector, which most probably could do the job more efficiently.

Another criticism against the proposed model could be that it would involve frequent revisions of the tax (or subsidy) schedule and would, among other things, discourage the entrepreneur from investing in a sector in which uncertainties prevail. The answer is that constant revisions of the schedule would have to be made only in the initial stage. Later, on the basis of the acquired experience, the department would be in a position to devise more effective schedules that would be applicable over longer periods. But, even if these schedules are constantly readjusted to a changing environment (which is a possibility), it does not follow that the entrepreneur will necessarily be discouraged. Indeed, rent laws have succeeded one another in the fifties without discouraging real estate entrepreneurs, and foreign exchange rates have been free to float without depressing trade. It could be argued that the scheme remains essentially inflexible, and by the time the tax law is enacted, the whole sector might run out of control. Instead of manipulating tax rates, why not manipulate the number of construction licenses? In reply, the critic will have to be reminded that one of the aims of setting a specialised construction research department, is to make sure that an evaluation of the situation is made frequently enough, and to recommend immediate action before the "whole sector runs out of control." In respect to
the second suggestion, that of manipulating the number of licenses, the answer is that such a policy would not only give way to favouritism, but it would increase the corruption of government employees as well.

The final charge against the whole concept of the model would be made by the liberal economist who will hold that government interference in the Lebanese economy would stand against the basic philosophy of this country. His belief is that the market forces will automatically restore dynamic equilibrium in the long run, without the necessity of "performing a major surgical operation," the outcomes of which are unpredictable. The extremely liberal economist would add that once the government is allowed to interfere in one aspect of the economy, the road becomes open for more controls and nationalisation that would, in turn, lead to totalitarianism and communism. Such economists do actually exist and would certainly oppose the proposed scheme.

It is the belief here that to abide by the above mentioned recommendation, would amount to sacrificing material benefits for an ideal which cannot be easily justified. This does not mean that liberalism is a wrong concept, but the excess of it is not advisable. First of all, what is the guarantee that the market forces will adjust the disequilibrium in the long run? How long is the long run? Isn't the present part of the long run, from the standpoint of earlier short runs? Could it not be true that such a disequilibrium is not entirely
conditioned by market forces, in which case, there is no reason to believe with certainty that dynamic equilibrium will finally prevail? Furthermore, why is it assumed that any government interference in the economy would necessarily lead to totalitarianism? Clearly, the reasoning of the extremely liberal economist does not stand to reason, but is probably motivated by fear, fear of losing one's liberty. If this is true, then it could be said – to allay his doubts – that in the proposed scheme, there is no danger of being deprived of one's liberty. True, the tax (or subsidy) schedule would motivate entrepreneurs, but it would not force them to abide by the governmental policy. It would guide them, but would not impel them, and it is here that the difference lies.

In Lebanon, construction activity fulfills two major roles: It is one important measure of the performance of the whole economy, but also provides necessary energy for proper growth. Vital as it is, its management is indeed one pre-requisite for a healthy Lebanese economy.
GENERAL APPENDIX

CASE STUDIES OF SELECTED CONSTRUCTION PROJECTS

A. THE METHOD

As mentioned in Chapter II, the case studies discussed hereafter will try to explain why real estate investors have been channelling their funds into construction in such a way as to cause simultaneously an over-expansion in one sub-sector and an under-expansion in another.

In addition, this chapter will attempt to discover the efficiency of capital invested. Over and above the analysis that will be made, therefore, to reveal, first, the motives behind investment in real estate, second, the modes of financing, and third, the types of ownership and the role of key money, a computational analysis will try to determine, as scientifically as possible, the rate of return on such investments.

The determination of the rate of return necessitates first the determination of the asset value. In all the cases discussed, accounting records did reveal the book values of the assets. However, these book values needed adjustment prior to the computation of the rate of return. To give an example, although accounting records might have revealed that the land cost LL.10,000 in 1945, and that the building erected in 1955
necessitated an outlay of LL.100,000, the total value of the asset is not as might be expected, LL.110,000.

By now, the reader must have realised that "value", as used in this text, means "adjusted cost". If this is so, what are the adjustments that have to be made if the value of the asset is to be computed?

To begin with, land that cost LL.10,000 in 1945, most probably had a different value in 1955 at the time of construction. If the market rate of return is to be computed, the market value of land at the beginning of 1955 has to be determined first. Assuming such market value is found to have been LL.20,000, would it be correct to add it to the cost of construction incurred in 1955 and compare the total to revenues received in 1956 and in each of the following years up to 1962? The answer is no, simply because the value of the Lebanese pound has not remained stable. Adjustments have therefore to be made to express the value of the asset in a monetary unit prevailing in each of the years during which the rents were received.

The determination of the extent to which the Lebanese pound has depreciated in value, is a necessity at this point. Inflation can be traced at least as far back as 1939, when the first price
index was computed. All the case studies that will be discussed involve buildings that were constructed later than 1950. Consequently, the yearly rate of inflation increase will have to be computed beginning with this date. Ideally, a real estate price index should have been used, but, since this is not available, the next best alternative, i.e. the general price index, was adopted.

In 1950, the general price index was 425 and in 1959, 520. The problem consists in determining the average annual compounded rate that would permit the 425 index number of 1950 to accumulate to 520 in 1959. Using a logarithmical table, the rate can be computed as follows:

\[
A = \frac{520}{425} = 1.22353
\]

\[
\log A = \log 520 - \log 425 = 2.7160033 - 2.6283889 = 0.0876144
\]

Therefore, \( A = \frac{520}{425} = 1.22353 \)

\[
R^9 = 1.22353
\]

\[
\log 1.22353 = 9 \log R = 0.0876144
\]

Therefore, \( \log R = \frac{0.0876144}{9} = 0.00973493 \)

Hence \( R = 1.02267 \)

Therefore, \( r = 2.267\% \), say 2.25\%

---

To summarise, the method that will be used to compute the rates of return in the subsequent case studies, will be as follows:— The focal date is chosen to be the year during which rents are received for the first time. Then, both the market value of the land and the costs of construction are compounded at 2.25% yearly, to account for inflation. These values obtained at the focal point are added, the total representing the value of the whole asset. Rents received in the first year being expressed in the same unit as the adjusted value of the asset, a comparison can be made, determining the first rate of return. Next, the value of the asset is compounded for one year at 2.25% and compared to the net revenue of the second year. The same process is carried over until 1962.¹

The rates thus obtained will reflect the efficiency of capital that potential investors would have earned, i.e. the market rate of return on investment in real estate. This is because, as a basis for arriving at the total cost of the asset, the market value of the land and not its original cost is used.

It was mentioned earlier that the computation of the rate of return consisted in comparing the net revenue in any one year to the adjusted value of the asset in the same year. But, what is exactly meant by net revenue? Does it include or exclude key

¹ Ideally, capital appreciation (if any) should have been taken into account in the determination of the rate of return. Such a procedure was discarded as it would have involved subjectivity to a great extent. It is tremendously difficult to appraise meaningfully the market value of buildings today, let alone their market values over a series of past years.
money, depreciation charges and interest paid on the loan to finance construction and the acquisition of land? These questions will be answered as they arise and along with the solution of the case studies. In addition, each of the steps constituting the method outlined above, will be briefly justified.

The owners of the buildings under study were kind enough to reveal the necessary data in their accounting records. For simplicity's sake, figures were rounded to the closest thousand.

B. **FIRST CASE STUDY - PROPERTY NUMBER 1374 OF THE PORT DISTRICT - BEIRUT**

1. **Historical Aspects**

   The property under study is situated in Riad El-Solh Square, Beirut. It is adjacent to the Pan American Building and faces the "Palais de Justice".

   The land on which a six-storey building was to be later erected, was purchased from the Beirut Municipality at a public auction in 1950 for LL.487,000.

   The new owners, three brothers and partners in a trading concern, thought that the mere fact of acquiring such an asset in the heart of the commercial and banking district,
would enhance their prestige. In addition, they considered that the erection of an office building would be remunerative, as it would yield a rate of return on their investment of 12 to 14 percent.

To finance the construction that started early in 1952, the three brothers had to use part of the line of credit allowed by two commercial banks. Out of the total monetary cost of both land and construction, almost 40 percent was financed with bank credit, the remainder with personal funds. In 1954, the building was finished. But, prior to its completion, key money was received for the ground level stores. The following table reveals the monetary costs incurred as between 1950 and 1954.
TABLE CI - 1

MONETARY COST OF LAND & CONSTRUCTION

PROPERTY NO. 1374 – PORT DISTRICT

(in LL.)

<table>
<thead>
<tr>
<th></th>
<th>1950</th>
<th>1952</th>
<th>1953</th>
<th>1954</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>487,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction</td>
<td>96,000</td>
<td>321,000</td>
<td>75,000</td>
<td></td>
</tr>
<tr>
<td>Minus Key Money</td>
<td></td>
<td>82,000+</td>
<td></td>
<td>10,000+</td>
</tr>
<tr>
<td>Net Cost</td>
<td>487,000</td>
<td>96,000</td>
<td>239,000</td>
<td>65,000</td>
</tr>
</tbody>
</table>

*The reason why key money is deducted from the cost of construction and is not considered as revenue, will be discussed in the next section under the title "Computational Analysis".*

The building, as it is today, has both elevators and central heating, but does not have an expensive finish. By virtue of the standards set in the research that was published in Al-Rā'id al 'Arabi, of October, 1962, the Building is of a third class quality.¹

As of the end of November, 1962, when all the rents for that year had been received, the books of the partners revealed the following data in respect to the building under

1. A building with an elevator, central heating, air conditioning and expensive finish, would belong to the first class.
study.

**TABLE CI - 2**

**REVENUES & EXPENSES EXCLUDING DEPRECIATION CHARGES**

**FROM 1953 - 1957 (in LL.)**

**PROPERTY NO. 1374 - PORT DISTRICT**

<table>
<thead>
<tr>
<th></th>
<th>1953</th>
<th>1954</th>
<th>1955</th>
<th>1956</th>
<th>1957</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues from Rents</td>
<td>110,000</td>
<td>118,000</td>
<td>128,000</td>
<td>128,000</td>
<td>110,000</td>
</tr>
<tr>
<td>Expenses Excluding Depreciation</td>
<td>22,000+</td>
<td>19,000+</td>
<td>15,000+</td>
<td>18,000+</td>
<td>16,000+</td>
</tr>
<tr>
<td>Net Cash Receipts</td>
<td>88,000</td>
<td>98,000</td>
<td>113,000</td>
<td>110,000</td>
<td>94,000</td>
</tr>
</tbody>
</table>

**TABLE CI-2 (Cont’d.)**

**FROM 1958 - 1962 (in LL.)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues from Rents</td>
<td>124,000</td>
<td>153,000</td>
<td>144,000</td>
<td>144,000</td>
<td>146,000</td>
</tr>
<tr>
<td>Expenses Excluding Depreciation</td>
<td>27,000</td>
<td>17,000</td>
<td>19,000</td>
<td>18,000</td>
<td>19,000</td>
</tr>
<tr>
<td>Net Cash Receipts</td>
<td>97,000</td>
<td>136,000</td>
<td>125,000</td>
<td>126,000</td>
<td>127,000</td>
</tr>
</tbody>
</table>

*Excludes interest paid on loan. The justification is given in the following section.*
Historically, the yearly net cash receipts have not been stable. Fast and irregular turnovers of tenants are attributed to costly incidents caused by the poor quality of the building materials and equipment installed (pipes bursting in walls, inefficient central heating, breakdowns and ill-functioning of elevators, responsible for the death of an office boy, etc.).

One of the three partners estimates the market value of the land at the time of construction, i.e. in early 1952, at no more than LL.575,000.

2. Computational Analysis and the Rate of Return

At the end of this chapter, a special section is devoted to analysing those aspects of the five case studies that are not directly related to mathematical formulations, i.e. motives behind investment, modes of financing and the type of ownership. The aim here, and in the corresponding section in each of the case studies, is the computation of the rate of return. To do so, the first task is to determine the total value of the asset at one focal point which has been chosen to be the year in which the first rents were received.
As was mentioned earlier, the market value of the land at the beginning of construction was estimated by one of the partners to be approximately LL. 575,000. The yearly expenditures on construction are revealed in table CI-1 as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>1952</td>
<td>LL. 96,000</td>
</tr>
<tr>
<td>1953</td>
<td>LL. 239,000</td>
</tr>
<tr>
<td>1954</td>
<td>LL. 76,000</td>
</tr>
</tbody>
</table>

Although rents were received for part of the property one year before the construction was completely finished, the focal date is chosen to be in 1954 and not in 1953. This is due to the fact that rents received in 1953 were not representative of the normal earning power of the asset. By ignoring these first receipts and by considering 1954 as the focal date, the average rate of return would consequently be more realistic. To be more precise, the focal date has to be at the middle of 1954, as on the whole, rents are received in quarterly instalments and not in a lump sum at the beginning or end of the year. In view of this, it would be more accurate to determine the value of the asset at the middle of each year before a comparison between the two values is made.
The amount spent in 1954 on construction, need not be adjusted for inflation, as it was spent during the focal year and can safely be assumed that as much of it was spread after the sixth month as before. The LL.239,000 spent presumably uniformly in 1953, can be considered as a lump sum payment at the middle of that year and will be subject to a 2.25 percent increase for one period. Similarly, the LL.96,000 spent in 1952, will be compounded at 2.25 percent for two years and the land market value (LL.575,000) whose original cost was LL.487,000, will be compounded at the same rate for two years. The computations referred to, as well as an explanatory diagram appear below:
TABLE CI - 3

ADJUSTMENT OF COSTS OF CONSTRUCTION & LAND MARKET VALUE TO

1954 PRICES

PROPERTY NO. 1374 - PORT DISTRICT

1. Cost of Construction in 1954  LL. 76,000
2. Cost of Construction in 1953
   \[ S = P(1 + r)^n = 239,000 \times (1 + 0.0225)^1 = LL. 244,377 \]
3. Cost of Construction in 1952
   \[ S = P(1 + r)^n = 96,000 \times (1 + 0.0225)^2 = LL. 100,369 \]
4. Market Value of Land in 1950
   \[ S = P(1 + r)^n = 550,000 \times (1 + 0.0225)^2 = LL. 601,162 \]
   Value of Asset at Focal Date  LL.1,021,908

\[ \begin{matrix}
575,000 \rightarrow 601,162 \\
500,000 \rightarrow 100,369 \\
96,000 \rightarrow 244,377 \\
76,000 \rightarrow LL.1,021,908 \\
\end{matrix} \]

1952  53  54  6 months
The value of land and the cost of construction are expressed in the same unit of currency. Their total, i.e. LL.1,021,942 represents the value of the whole asset at the focal date.

Now that the total value of the asset is known, various approaches could be used to determine the rate of return. One method would be to determine that rate which would discount all future net receipts to the focal date in such a way as to equate the present value of the stream to the value of the asset determined above. This, however, is not recommended, as the rents of only the first ten years are known. Looking into the distant future and assuming a series of hypothetical values would amount to presenting the reader with a theoretical model.

The most practical method that would give a close approximation of the real rate of return would consist in comparing each year's net cash receipts with the value of the asset re-adjusted to inflation. First, why should the asset value be re-adjusted at all? Simply so that the ratio would consist of both a numerator and a denominator expressed in the same unit of currency. The next question is why should the net cash receipts and not the net profit (net cash receipts minus depreciation) be
the amount in the numerator? Because the procedure of
discounting through which the rate of return is determined
takes care of capital recovery. The determination of the
rate of return through dividing the yearly net cash
receipts by the initial investment approximates the true
rate of return - obtained through discounting - very closely,
since it implies the presence of a perpetual annuity. The
presumption of the presence of a perpetual annuity in the
real estate sector is safely warranted because the average
productive life of residential buildings extends, in general,
beyond 50 years. But, are the receipts constant, and does
the value of the asset remain the same so that the use of
the perpetual annuity formulae be justified? The answer
is that one has to visualise the problem placing himself in
each of the successive years accounted for in the case study
without allowing himself to anticipate the data pertaining
to the next year. To give an example, taking any one year
would reveal that the value of the asset is $V$ and that the
net cash receipts are $C$. By ignoring the actual changes in
$V$ and $C$ in the subsequent year, it can be assumed for the
time being that these values will remain constant therefrom,
that $C$ is a representative receipt in a perpetual series,
and that $V$ is the capital invested, not subject to any change.
In the subsequent year, the former assumption is relaxed,
V is adjusted to inflation and becomes \( V_1 \) and the receipt becomes \( C_1 \). Again, by placing one's self in the year and ignoring the \( V_3 \) and \( C_3 \) of the following year, the same reasoning could be carried over again. It would assume that \( V_2 \) is the capital not subject to change and that \( C_2 \) is one receipt in a series of similar receipts.

Such a method will not solve for just one rate of return but for a series of rates, one for each year. Of course, an average can then be computed, revealing the efficiency of capital invested as from the first year of receipts and up to the last year under study.

Before going into the final computations, a justification pertaining to an assumption taken earlier has to be made. In a small table appearing in the historical section of the present case study, under the title "Monetary Cost of Land and Construction", the key money amounts received in both 1953 and 1954 were deducted from the cost incurred in each of these years and were not considered as revenue. The reasoning is that, treating key money as revenue would involve spreading such an amount over the useful life of the asset. Even if it is assumed that the difficulty, involving the choice of the pattern over which key money should be allocated, is removed, it would still
be very difficult to settle for an appropriate rate (in the event the increasing method of distribution is adopted) and even more difficult to assess objectively the useful life of the asset. Adopting such a course in spite of these disadvantages, would permit sheer speculation. Instead, if key money is looked upon, not as an addition to yearly income but as a saving in cost, the solution to the problem would become simpler and much less subjective.

Another justification concerning the treatment of interest paid to the owners of the property to finance their investment has to be made. As seen in Table CI-2, interest was deducted from the yearly expenditures simply because the purpose of the case study is to compute the market rates of return on such property. Had interest been added to the yearly expenditures, the resulting rates of return would reflect what the owners have been realising on their equity and not the earning power rate on the total capital invested in the property.

Now that all the pending obstacles to the solution of the final stage have been removed, the rates of return can be computed by adjusting the value of the asset to inflation, in each of the years, at 2.25%, and comparing it consecutively to the net cash receipts in the corresponding period.
TABLE CI - 4

DETERMINATION OF THE RATES OF RETURN

PROPERTY NO. 1374 - PORT DISTRICT

(in £.)

<table>
<thead>
<tr>
<th>Year</th>
<th>Adjustment of Asset Value to Inflation</th>
<th>(a)</th>
<th>Net Cash Receipts fr. Table CI - 2</th>
<th>(b)</th>
<th>Rate of Return b/a</th>
</tr>
</thead>
<tbody>
<tr>
<td>1954</td>
<td>From Table CI-3 1,021,908 1,021,908</td>
<td>1,021,908</td>
<td>1,021,908</td>
<td>98,000</td>
<td>9.6%</td>
</tr>
<tr>
<td>1955</td>
<td>1,021,908 (1+0.0225)(^1) = 1,044,936</td>
<td>1,044,936</td>
<td>1,044,936</td>
<td>113,000</td>
<td>10.8%</td>
</tr>
<tr>
<td>1956</td>
<td>1,044,936 (1+0.0225)(^1) = 1,068,447</td>
<td>1,068,447</td>
<td>1,068,447</td>
<td>110,000</td>
<td>10.3%</td>
</tr>
<tr>
<td>1957</td>
<td>1,068,447 (1+0.0225)(^1) = 1,092,487</td>
<td>1,092,487</td>
<td>1,092,487</td>
<td>94,000</td>
<td>8.6%</td>
</tr>
<tr>
<td>1958</td>
<td>1,092,487 (1+0.0225)(^1) = 1,117,068</td>
<td>1,117,068</td>
<td>1,117,068</td>
<td>97,000</td>
<td>8.7%</td>
</tr>
<tr>
<td>1959</td>
<td>1,117,068 (1+0.0225)(^1) = 1,142,202</td>
<td>1,142,202</td>
<td>1,142,202</td>
<td>136,000</td>
<td>11.9%</td>
</tr>
<tr>
<td>1960</td>
<td>1,142,202 (1+0.0225)(^1) = 1,167,906</td>
<td>1,167,906</td>
<td>1,167,906</td>
<td>125,000</td>
<td>10.7%</td>
</tr>
<tr>
<td>1961</td>
<td>1,167,906 (1+0.0225)(^1) = 1,194,184</td>
<td>1,194,184</td>
<td>1,194,184</td>
<td>126,000</td>
<td>10.5%</td>
</tr>
<tr>
<td>1962</td>
<td>1,194,184 (1+0.0225)(^1) = 1,221,052</td>
<td>1,221,052</td>
<td>1,221,052</td>
<td>127,000</td>
<td>10.6%</td>
</tr>
</tbody>
</table>

Note: In this table, it is assumed that the rate of inflation remained 2.25% after 1959.

The average rate of return on capital invested as from 1954 and up to 1962 is 10.1%, or 2 to 4% less than was anticipated by the partners.
C. SECOND CASE STUDY - PROPERTY NO. 2213 OF THE RAS BEIRUT DISTRICT

1. Historical Aspects

The owner of the property under study is a well established businessman representing many internationally known office equipment producing firms, such as typewriters, calculating and photocopying machines, etc. He is the sole proprietor of the business concern which has expanded very fast after the second World War.

In 1947, he purchased a plot of land, "Rue Arts et Métiers" (Sanā'i'), opposite the recently built radio transmitting station, for which he paid LL.115,000 out of his own savings. His purpose was to construct a luxurious apartment building, which, he believed, could be easily rented, as very few such buildings existed at the time and as many families, enriched during the war, could afford paying relatively high rents. He believed his investment would yield not less than 12%, his planned costs being LL.400,000 (including the land) and his estimated yearly revenue being around LL.50,000.

In this way, he thought he would be diverting some of the business funds whose returns would, he anticipated, fall as competition increased, into a more remunerative type of asset.
At the beginning of 1950, almost 3 years after the acquisition of the land, the construction was started. Although a great deal of planning had preceded the ground works, constant modifications retarded the growth of the building, involving much higher costs than forecast. Only at the beginning of 1954 was the asset ready to be rented.

Below is a table revealing the monetary costs involved as between 1947 and 1953.

**TABLE C2 - 1**

**MONETARY COSTS OF LAND AND CONSTRUCTION**

**PROPERTY NO. 2213 - RAS BEIRUT DISTRICT**

(in LL.)

<table>
<thead>
<tr>
<th></th>
<th>1947</th>
<th>1950</th>
<th>1951</th>
<th>1952</th>
<th>1953</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land Cost</td>
<td>115,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction Cost</td>
<td></td>
<td>49,000</td>
<td>148,000</td>
<td>264,000</td>
<td>56,000</td>
</tr>
<tr>
<td>Total</td>
<td>115,000</td>
<td>49,000</td>
<td>148,000</td>
<td>264,000</td>
<td>56,000</td>
</tr>
</tbody>
</table>

The five storey building, as it stands today, is equipped with both central heating and an elevator and has an expensive finish. In the classification of buildings in
order of quality, it belongs to the second class, as it is not equipped with air conditioning apparatus.

As of the end of October, 1961, the books of the owner revealed the following data in respect to the building under consideration.

**TABLE C2 - 2**

**REVENUES & EXPENSES EXCLUDING DEPRECIATION CHARGES**

**FROM 1954 - 1958 (in LL.)**

PROPERTY NO. 2213 - RAS BEIRUT DISTRICT

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues From Rent</td>
<td>51,000</td>
<td>51,000</td>
<td>51,000</td>
<td>51,000</td>
<td>51,000</td>
</tr>
<tr>
<td>Expenses</td>
<td>6,000</td>
<td>6,000</td>
<td>7,000</td>
<td>6,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Net Cash Receipts</td>
<td>45,000</td>
<td>45,000</td>
<td>44,000</td>
<td>45,000</td>
<td>46,000</td>
</tr>
</tbody>
</table>

**TABLE C2-2 (Cont'd.)**

**FROM 1959-1962 (in LL.)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues From Rent</td>
<td>62,000</td>
<td>62,000</td>
<td>62,000</td>
<td>62,000</td>
</tr>
<tr>
<td>Expenses</td>
<td>8,000</td>
<td>7,000</td>
<td>6,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Net Cash Receipts</td>
<td>54,000</td>
<td>55,000</td>
<td>56,000</td>
<td>57,000</td>
</tr>
</tbody>
</table>
The owner estimates that the market value of the land at the beginning of 1950 might have been around LL.155,000, as he recalls having been offered this price at the time.

2. **Computational Analysis and the Rate of Return**

Subjecting the data made available in the previous section to the same treatment as in the first case study, the first step would be to adjust the costs of construction and the land market value to 1954 prices, i.e. the first year during which the owner started earning income from rents.
TABLE C2 - 3

ADJUSTMENT OF COSTS OF CONSTRUCTION & LAND MARKET VALUE TO

1954 PRICES

PROPERTY NO. 2213 - RAS BEIRUT DISTRICT

1. Cost of Construction in 1953
   \[ S = P(1 + r)^n = 56,000 \times (1 + 0.0225)^1 = \text{LL. 57,260} \]

2. Cost of Construction in 1952
   \[ S = P(1 + r)^n = 264,000 \times (1 + 0.0225)^2 = \text{LL. 276,013} \]

3. Cost of Construction in 1951
   \[ S = P(1 + r)^n = 148,000 \times (1 + 0.0225)^3 = \text{LL. 158,216} \]

4. Cost of Construction in 1950
   \[ S = P(1 + r)^n = 49,000 \times (1 + 0.0225)^4 = \text{LL. 53,561} \]

5. Market Value of Land in 1950
   \[ S = P(1 + r)^n = 155,000 \times (1 + 0.0225)^4 = \text{LL. 168,651} \]

\[ \text{LL. 713,701} \]

\[ \text{150,000} \]
\[ \therefore = 53,561 \]
\[ \text{49,000} \]
\[ \therefore = 158,216 \]
\[ 148,000 \]
\[ \therefore = 276,013 \]
\[ \begin{array}{c|c|c|c|c|c}
   1950 & 51 & 52 & 53 & 54 & 6 months \\
   \hline
   204,000 & 56,000 & & & & \\
\end{array} \]

\[ = \text{LL. 713,701} \]
Having determined the value of the asset at the middle of 1954, the rates of return can be computed by adjusting such value to inflation in each of the subsequent years at 2.25% and comparing it subsequently to the net cash receipts in the corresponding period.

**TABLE C2 - 4**

**DETERMINATION OF THE RATES OF RETURN**

**PROPERTY NO. 2213 - RAS BEIRUT DISTRICT**

*(in LL.)*

<table>
<thead>
<tr>
<th>Year</th>
<th>Adjustment of Asset Value to Inflation</th>
<th>Net Cash Receipts fr. Table C2 - 2</th>
<th>Rate of Return b/a</th>
</tr>
</thead>
<tbody>
<tr>
<td>1954</td>
<td>From Table C2-3 ... = 713,701</td>
<td>45,000</td>
<td>6.3%</td>
</tr>
<tr>
<td>1955</td>
<td>713,701 (1+0.0225)^1 = 728,736</td>
<td>45,000</td>
<td>6.1%</td>
</tr>
<tr>
<td>1956</td>
<td>728,736 (1+0.0225)^1 = 745,132</td>
<td>44,000</td>
<td>5.9%</td>
</tr>
<tr>
<td>1957</td>
<td>745,132 (1+0.0225)^1 = 761,897</td>
<td>45,000</td>
<td>5.9%</td>
</tr>
<tr>
<td>1958</td>
<td>761,897 (1+0.0225)^1 = 779,039</td>
<td>46,000</td>
<td>5.9%</td>
</tr>
<tr>
<td>1959</td>
<td>779,039 (1+0.0225)^1 = 796,567</td>
<td>54,000</td>
<td>6.8%</td>
</tr>
<tr>
<td>1960</td>
<td>796,567 (1+0.0225)^1 = 814,489</td>
<td>55,000</td>
<td>6.7%</td>
</tr>
<tr>
<td>1961</td>
<td>814,489 (1+0.0225)^1 = 832,815</td>
<td>56,000</td>
<td>6.7%</td>
</tr>
<tr>
<td>1962</td>
<td>832,815 (1+0.0225)^1 = 851,553</td>
<td>57,000</td>
<td>6.7%</td>
</tr>
</tbody>
</table>
The average rate of return on capital invested as from 1954 and up to 1962 is 6.3%, or around 6% less than anticipated by the owner.

D. THIRD CASE STUDY – PROPERTY NO. 4168 OF THE ACHRAFIYEH DISTRICT

1. Historical Aspects

The owner of the building under study is a rich manufacturer of leather. He owns both the means of production and the distribution outlet. Similarly to most proprietors of tanneries, he has been witnessing the decline of the leather industry over the last decade, both because of increased local competition and the introduction to the market of substitutes such as plastics and synthetic fiber materials.

When in 1950 he purchased a plot of land at LL.55,000, his primary aim was to diversify his assets. Two years later, he decided to construct an apartment building that, according to his forecast, would yield him at least 10% per annum. His philosophy was against going into debt, and as he was illiquid at the time, he sold one of the leather mills and thus was able to finance construction. The cost of such a venture was estimated by the engineer in charge at LL.400,000. Although no modifications had taken place,
actual monetary costs exceeded those planned by more than a fifth. Below are the monetary amounts spent as from the year in which land was purchased.

\[
\text{TABLE C3 - 1}
\]

\[
\text{MONETARY COSTS OF LAND AND CONSTRUCTION}
\]

\[
\text{PROPERTY NO. 4168 - ACHRAFIYEH DISTRICT}
\]

\[
\text{(in LL.)}
\]

\[
\begin{array}{ccc}
\text{Year} & 1950 & 1952 & 1953 \\
\text{Land Cost} & 55,000 & \_ & \_ \\
\text{Construction Cost} & \_ & 220,000 & 304,000 \\
\_ & 55,000 & 220,000 & 304,000 \\
\end{array}
\]

As it stands today in Zahrat al Ihsān (where a big ground level store has been rented to Dfouni), the building has five storeys, is equipped with an elevator and central heating, and is finished luxuriously. Being a second class building, its apartments could have been rented in a more remunerative manner. As it came out, the owner behaved in a paternal manner and leased most of his property to relatives and close friends of his at very low rents. Apparently, he has not been aware of the fact that this would mean a drop in the value of his property. He maintains that
he was successful in shifting part of his holdings into real
estate, worth, roughly, more than half a million Lebanese
pounds.

As of the end of 1962, when all the rent for that
year had been collected, the books of the owner revealed
the following:-

| TABLE C3 - 2 |
| REVENUES & EXPENSES EXCLUDING DEPRECIATION CHARGES |
| FROM 1954 - 1958 (in LL.) |

| PROPERTY NO. 4168 - ACHARAFIYEH DISTRICT |
| Revenues | | | | |
| From Rent | 44,000 | 44,000 | 44,000 | 44,000 | 44,000 |
| Expenses | 4,000 | 4,000 | 5,000 | 5,000 | 6,000 |
| Net Cash Receipts | 40,000 | 40,000 | 39,000 | 39,000 | 38,000 |

| TABLE C3-2 (Cont'd.) |
| FROM 1959-1962 (in LL.) |

| Revenues | | | | |
| From Rent | 44,000 | 44,000 | 44,000 | 45,000 |
| Expenses | 6,000 | 6,000 | 6,000 | 6,000 |
| Net Cash Receipts | 38,000 | 38,000 | 38,000 | 39,000 |

1. The owner occupies an apartment which could be
rented at LL.7,000 per annum. This amount is
included in the yearly revenues.
Rents amounting to LL.16,000 were received for the last two months of 1953, when part of the building was completed. These receipts do not appear in table C3-2 so as not to take them into account when rates of return are computed in the following section.

Key money was not received for the ground level store, as the area in which the building stands is not a commercial centre. Rent laws that left the owner perfectly free to increase his revenues were not enforced, most probably for personal reasons. This explains the absence of leaseholders' turnover and the stability of revenues. Only at the beginning of 1962 did one family leave its apartment making it possible for the owner to charge for the vacant apartment an extra thousand pounds.

Over the period of time during which the land was kept idle before construction took place, the owner received no offer to sell the property. This makes it impossible for him today to estimate the market value of the land at the time. However, he believes that putting such value at LL.60,000 during 1952, is safe enough.
2. **Computational Analysis and the Rate of Return**

The data made available in the previous section follows the same pattern as in the first two case studies. Hence, the solution is to be computed along the same lines as before.

**TABLE C3 - 3**

**ADJUSTMENT OF COSTS OF CONSTRUCTION & LAND MARKET VALUE TO 1954 PRICES**

**PROPERTY NO. 4168 - ACHRIFIYEH DISTRICT**

*(in LL.)*

1. **Cost of Construction in 1953**
   \[ S = P(1 + r)^n = 304,000 \times (1+0.0225)^1 = LL.310,840 \]

2. **Cost of Construction in 1952**
   \[ S = P(1 + r)^n = 220,000 \times (1+0.0225)^2 = LL.230,011 \]

3. **Market Value of Land in 1952**
   \[ S = P(1 + r)^n = 60,000 \times (1+0.0225)^2 = LL.62,730 \]
   \[ LL.603,581 \]

<table>
<thead>
<tr>
<th></th>
<th>1952</th>
<th>1953</th>
<th>1954</th>
<th>6 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>1953</td>
<td></td>
<td>230,011</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1954</td>
<td></td>
<td></td>
<td>310,840</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>LL.603,581</td>
</tr>
</tbody>
</table>
Knowing the value of the asset at the middle of 1954, the rates of return can be computed by adjusting such value to inflation in each of the subsequent years at 2.25% and then comparing it to the net cash receipts in the corresponding period.

**TABLE C3 - 4**

**DETERMINATION OF THE RATES OF RETURN**

**PROPERTY NO. 4168 - ACHRAFIYEH DISTRICT**

*(in LL.)*

<table>
<thead>
<tr>
<th>Year</th>
<th>Adjustment of Asset Value to Inflation</th>
<th>Net Cash Receipts fr. Table</th>
<th>Rate of Return (\frac{c}{a})</th>
</tr>
</thead>
<tbody>
<tr>
<td>1954</td>
<td>From Table C3-3 (\ldots) 603,581</td>
<td>40,000</td>
<td>6.6%</td>
</tr>
<tr>
<td>1955</td>
<td>603,581 ((1+0.0225)^1) = 617,161</td>
<td>40,000</td>
<td>6.4%</td>
</tr>
<tr>
<td>1956</td>
<td>617,161 ((1+0.0225)^1) = 631,047</td>
<td>39,000</td>
<td>6.1%</td>
</tr>
<tr>
<td>1957</td>
<td>631,047 ((1+0.0225)^1) = 645,245</td>
<td>39,000</td>
<td>6.0%</td>
</tr>
<tr>
<td>1958</td>
<td>645,245 ((1+0.0225)^1) = 659,763</td>
<td>38,000</td>
<td>5.7%</td>
</tr>
<tr>
<td>1959</td>
<td>659,763 ((1+0.0225)^1) = 674,607</td>
<td>38,000</td>
<td>5.6%</td>
</tr>
<tr>
<td>1960</td>
<td>674,607 ((1+0.0225)^1) = 689,785</td>
<td>38,000</td>
<td>5.5%</td>
</tr>
<tr>
<td>1961</td>
<td>689,785 ((1+0.0225)^1) = 705,305</td>
<td>38,000</td>
<td>5.4%</td>
</tr>
<tr>
<td>1962</td>
<td>705,305 ((1+0.0225)^1) = 721,174</td>
<td>39,000</td>
<td>5.4%</td>
</tr>
</tbody>
</table>

The average rate of return on capital invested as from 1954 and up to 1962 is 5.8%, or around 4% less than anticipated by the owner.
E. FOURTH CASE STUDY - PROPERTY NO. 209 - RAS BEIRUT DISTRICT

1. Historical Aspects

The owner of the building under study is a rich, intelligent and self made businessman. He is the sole proprietor of a firm that imports and distributes office equipment apparatus ranging from computers to telephone units. His personality is such that he resents delegating any authority to his employees. Consequently, the firm is highly centralised and rests on just one man. It can be said about him that he has a "computer mind", as he has always been after efficiency and likes things to be properly done.

In 1956, the person referred to purchased a piece of land in Ras Beirut (Rue de Rome) for LL.410,000 which he paid out of his business retained earnings. It took him approximately two and a half years to approve the final plans of the luxurious apartment building he planned to construct and which he estimated would yield not less than 15% annually. His theory is that the more luxurious a building is, the higher is the profit on investment, i.e. the revenue curve increases at a faster rate than the cost curve, the more costs are incurred.
Excavation began early in 1960 but had to be postponed because the earth was too sandy and further excavations could be made only at the risk of causing a landslip that would in turn, most probably, destroy the building on the adjacent land. This technicality was solved by building a parapet wall at the boundary of the land, starting from the ground level into the earth, for a depth of 10 meters. Huge and unforecast amounts were spent just to prevent any accident from happening.

As it stands today, the building is still unfinished and it will take at least until the end of 1963 to become ready for habitation. The delay is not only due to the above mentioned technical problem, but also to the mentality of the owner who has constantly made modifications to realise his hope, that of constructing a building that would "last eternally". Not even the smallest detail escapes his attention, and whenever he is not completely satisfied with the work done, he has it repeated.

Since the building is not finished yet, some of the figures made available are nothing but estimates. Below, is a table showing the amounts spent as from the year in which land was purchased, as well as an estimate of the
amount still to be spent for the completion of the building.

<table>
<thead>
<tr>
<th>TABLE C4 – 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>MONETARY COSTS OF LAND &amp; CONSTRUCTION</td>
</tr>
<tr>
<td>PROPERTY NO. 209 – RAS BEIRUT DISTRICT</td>
</tr>
<tr>
<td>(in LL.)</td>
</tr>
<tr>
<td>Land Cost</td>
</tr>
<tr>
<td>Construction Cost</td>
</tr>
<tr>
<td>Estimated Cost of Completion</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

In Table C4-1, it can be seen that the estimated cost of completion is LL.200,000. This relatively high figure is justified, as it includes two elevators, central heating and air conditioning installations. Once the building is ready to be rented, it will be a first class quality asset, by virtue of the classification discussed earlier.

The owner feels sure that beginning with 1964, he will start earning LL.210,000, representing the gross yearly revenues of the property, from which LL.20,000 will have to be deducted as yearly expenses excluding depreciation.
He also believes that the value of his land in 1960, when excavations began, was approximately LL.500,000.

2. **Computational Analysis and the Rate of Return**

The data made available in the previous section is dissimilar to those in the previous case studies in that here, it involves a lot more subjectivity in respect to the planned cost of construction in 1963 and the forecast net cash receipts beginning with 1964 and on. However, if the rate of return is to be determined, it will have to be assumed that the estimated amounts are close to what they will be in reality.

The approach here is basically similar to that used before. The first step consists in adjusting the costs of construction and land market value to the assumed 1964 prices, i.e. the first year during which the owner will start earning income from rents.
<table>
<thead>
<tr>
<th>Year</th>
<th>Value (in LL.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>73,000</td>
</tr>
<tr>
<td>1961</td>
<td>314,000</td>
</tr>
<tr>
<td>1962</td>
<td>365,000</td>
</tr>
<tr>
<td>1963</td>
<td>200,000</td>
</tr>
<tr>
<td>6 months</td>
<td>546,541</td>
</tr>
<tr>
<td>Total</td>
<td>LL. 1,548,121</td>
</tr>
</tbody>
</table>

**TABLE C4 - 2**

ADJUSTMENT OF COSTS OF CONSTRUCTION & LAND MARKET VALUE TO 1964 PRICES

PROPERTY NO. 209 - RAS BEIRUT DISTRICT

(in LL.)

1. Cost of Construction in 1963
   \[ S = P(1+r)^n = 200,000 \ (1+0.0225)^1 = \text{LL. 204,500} \]

2. Cost of Construction in 1962
   \[ S = P(1+r)^n = 365,000 \ (1+0.0225)^2 = \text{LL. 381,610} \]

3. Cost of Construction in 1961
   \[ S = P(1+r)^n = 314,000 \ (1+0.0225)^3 = \text{LL. 335,675} \]

4. Cost of Construction in 1960
   \[ S = P(1+r)^n = 73,000 \ (1+0.0225)^4 = \text{LL. 79,795} \]

5. Market Value of Land in 1960
   \[ S = P(1+r)^n = 500,000 \ (1+0.0225)^4 = \text{LL. 546.541} \]

\[ \text{LL. 1,548,121} \]
Knowing the value of the asset at the middle of 1964, the rate of return can be computed by comparing such value to the net projected cash receipts in that year. Here, it is assumed that in the subsequent years, the net cash receipts will remain constant and that the estimated rents of 1964 will represent one receipt in a perpetual annuity. Thus, the rate of return is obtained by dividing the annual net cash receipt by the value of the property:

\[
\frac{\text{Net Cash Receipts}}{\text{Property Value}} = \frac{190,000}{1,548,121} = 12.2\%
\]

If everything goes from here on according to plans, (this case study is being written in February, 1963) the rate of return on investment will amount to 12.2%, or close to 3% less than originally anticipated.

F. FIFTH CASE STUDY – PROPERTY NO. 545 – 'AIN AL-MRAYSEH DISTRICT

1. Historical Aspects

The building under study belongs to the three brothers and partners who own the asset analysed in the first case study of this chapter.
Their land on which the British Embassy building stands today, was purchased in 1940 at LL.30,000, and remained idle until 1958 when excavations began. One year earlier, British Embassy Officials approached the partners and after one month of negotiations, the following agreement was reached: The owners would build a five storey building according to specifications and would rent the asset for a period of ten years, the contract being automatically renewed if neither party is notified by the other at maturity, of the desire to discontinue it. The rent was set at LL.125,000 per annum, payable in two equal instalments at the beginning and middle of each fiscal year. Two years rent were received in advance upon signing the contract at the end of February, 1958.

The owners felt at the time that they would realise on their investment close to 20% yearly, as they made their estimate by adding the original cost of land to that of construction and comparing the total to the yearly LL.125,000 revenue. Construction started at the beginning of 1958 in spite of the fact that the country was at the edge of civil war. Being illiquid, they managed to convince their bankers of the necessity to help them finance part of the construction cost, over and above the LL.250,000 received in advance for
two years rent.

A third class engineer was hired to plan and execute the work and, as a consequence of his inefficiency, the building was in danger of collapsing at one stage, and additional pillars were quickly devised to prevent an accident from happening. Nevertheless, the building was ready for rent by the end of 1959. Below, are the monetary amounts spent as from the year in which the land was purchased.

TABLE C5 - 1
MONETARY COSTS OF LAND & CONSTRUCTION
PROPERTY NO. 545 - 'AIN AL-MRA'YSEH DISTRICT

(in LL.)

<table>
<thead>
<tr>
<th></th>
<th>1940</th>
<th>1958</th>
<th>1959</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land Cost</td>
<td>30,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction Cost</td>
<td>30,000</td>
<td>160,000</td>
<td>413,000</td>
</tr>
</tbody>
</table>

1. Excluding interest paid on loan.
The building was occupied at the beginning of 1960. As of that year, revenues and expenses incurred have been as follows:

**TABLE C5 - 2**

**REVENUES & EXPENSES EXCLUDING DEPRECIATION CHARGES**

**FROM 1958 - 1962 (in LL.)**

**PROPERTY NO. 545 - 'AIN AL-MRAYSEH DISTRICT**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Receipts</td>
<td>250,000</td>
<td></td>
<td></td>
<td>125,000</td>
</tr>
<tr>
<td>Expenses</td>
<td>16,000</td>
<td>21,000</td>
<td>20,000</td>
<td></td>
</tr>
</tbody>
</table>

The building as it is today is of a second class quality, for, although it is equipped with two elevators, central heating and air conditioning installations, it is far from having an expensive finish. The outside and even part of the inside are just whitewashed; the floorings and toilets are of a poor quality and the white marble that covers only a limited area, is of a very common type. In addition, from just looking at the building, one has the impression that the work was done hurriedly and by inexpert hands.
It is fortunate that the market value of the land on which the building was erected is a fact objectively determined, not by the owners as in most of the preceding cases, but by the tribunal. Indeed, when the license was given by the municipality of Beirut in 1958, experts were appointed to determine the land market value on the basis of which a tax had to be paid. This was made because the land had remained idle for approximately 18 years and the original cost was no longer satisfactory for tax purposes. The estimated market value, at the time, was LL.320,000.

2. **Computational Analysis and the Rate of Return**

   Basically, the determination of the rate of return here is similar to those in the preceding cases. However, the fact that rents that would have been collected in 1960 and 1961 were received in a lump sum in advance at the beginning of 1958, brings an additional complication, the solution of which makes this case study more interesting.

   The question to be answered is: how will the rent received in a lump sum in advance be treated? Looking at the picture from one point of view, it could be argued that the interest earned as from 1958 and up till 1960 and 1961 will have to be added to the LL.125,000 that would have
normally been received in form of rent in each of the latter two years. But then, why should only the first two years during which the building was rented, receive all the benefits of pre-payment? After all, when the British Embassy Officials accepted to pay LL.250,000 in advance, their purpose was to help the landlords finance the construction which they had agreed to rent for a period of 10 years. The fact that the amount paid in advance was made to correspond to two years rent does not mean that the resulting benefit should be allocated only to the first two years.

The problem, therefore, consists in determining the monetary gain resulting from the LL.250,000 received in advance, and spreading such gain over the ten years covered by the contract. Two assumptions have to be made. The first is that over the whole period in question, money is worth 6 percent annually, or 3 percent semi-annually. Secondly, it will be assumed for simplicity’s sake, that the LL.250,000 were received exactly one year and three quarters before the building was occupied (in reality, the amount was received approximately one year and ten months before). Knowing that until the very beginning of 1962 no amount other than the LL.250,000 was received, and knowing that beginning
with that date, LL.62,500 has been and will continue to be received every six months until July 1, 1969, a single amount representing all these revenues can be computed as of one focal date, which has been chosen to be at the beginning of 1960. Once this is done, the problem would consist in spreading the amount arrived at, over the 10 years or 20 periods (of 6 months each), covered by the rent contract.

Money being worth 3% semi-annually, the first computations will therefore compound LL.250,000 for 3.5 periods (representing one year and three quarters) as follows:

\[ S = P(1+r)^n = 250,000 \times (1+0.03)^{3.5} \]

Therefore, \( S = \text{LL}.277,249 \)

Since rents for the first two years were received in advance, the landlords will still be receiving a total of sixteen payments of LL.62,500 each, covering the remaining eight years of the contract. The computations below, will determine the present value of an annuity due of LL.62,500, at the beginning of 1962, payable at 3% semi-annually over eight years:–
\[ PV = R \left[ \frac{1 - (1+i)^{-n}}{i} + 1 \right] \]

\[ PV = 62,500 \left[ \frac{1 - (1+0.03)^{-16}}{0.03} \right] + 1 \]

Therefore, \( PV = \text{LL.} 808,619 \)

To obtain the value of the above annuity at the beginning of 1960, the LL.808,619 will still have to be discounted for 4 periods at 3\% as follows:

\[ S = P(1+r)^{-n} = 808,619 \times (1+0.03)^{-4} \]

Therefore, \( S = \text{LL.} 718,458 \)

Since both rents received in advance and periodic rents are at the same focal date, their total would represent the gross profit on investment over the first ten years, thus:

\[ 277,249 + 718,458 = \text{LL.} 995,707 \]

Before going into the final stage, i.e. that of spreading the LL.995,707 over ten years, it is advisable to clarify what has already been said in a diagrammatical illustration:
Present Value of an annuity due of LL62,500 for 16 periods at 3%.
The diagram reveals in the first place that the amount of LL.250,000 is compounded at 3% semi-annually for three periods and a half (representing one year and three quarters). Next, the present value (as of the beginning of 1962) of an annuity due of LL.62,500, is computed for 16 periods at 3%. The result, i.e. LL.808,619 is further discounted for four periods at 3% and the value thus obtained as of the beginning of 1960, is added to the LL.277,249, computed in the first stage above. The total, i.e. LL.995,707 is therefore a lump sum that represents, as of 1960, all the amounts already received and to be received in lieu of rents, over the ten year contract. Put differently, the LL.995,707 is simply the present value of a 20 periods annuity due, money being worth 6% annually (3% per period). To compute the amount of such an annuity, the same formula that was used in the second step above will again be used:

\[
PV = R \left[ \frac{1 - (1+i)^{-n}}{i} + 1 \right]
\]

\[
995,707 = R \left[ \frac{1 - (1+0.03)^{-(20)}}{0.03} + 1 \right]
\]

\[
R = \frac{995,707}{15.3238} = 65,043
\]
Therefore, the semi-annual rent amounts to LL.65,043, which consists, in addition to the periodic LL.62,500 cash receipt, of LL.2,543 representing an additional profit which originates from the accumulated interest realised on the LL.250,000 received in advance.

Since LL.65,043 are being realised by the landlords twice a year, on the first of January and on the first of August, it would almost be the same thing to say that rent amounting to LL.130,086, \( (2 \times 65,043) \) is being received in a lump sum for the whole year, on the 31st of March. In order to compute the rate of return on investment, the value of the asset will therefore have to be determined as of the 31st of March, 1960, the year in which the building was occupied. To arrive at such value, the following computations have to be made. At a rate of inflation increase of 2.25% per annum, the construction cost of 1959 is compounded for three fourth of a period, that in 1958 is compounded for one and three fourth of a period, and the land market value is compounded for one period and three fourth as well.
<table>
<thead>
<tr>
<th>Year</th>
<th>Cost of Construction in 1959</th>
<th>Cost of Construction in 1960</th>
<th>Land Market Value in 1960</th>
</tr>
</thead>
<tbody>
<tr>
<td>1958</td>
<td>S = P(1+r)^n = 413,000 (1+0.0225)(^{1.25}) = LL.424,648</td>
<td>S = P(1+r)^n = 160,000 (1+0.0225)(^{2.25}) = LL.168,214</td>
<td>S = P(1+r)^n = 320,000 (1+0.0225)(^{2.25}) = LL.336,428</td>
</tr>
<tr>
<td>1959</td>
<td>160,000</td>
<td>320,000</td>
<td>168,214</td>
</tr>
<tr>
<td>1960</td>
<td>413,000</td>
<td>336,428</td>
<td>424,648</td>
</tr>
</tbody>
</table>

Having arrived at the asset value as of the first quarter in 1960, the rates of return can be obtained by adjusting such value to inflation in each of the subsequent
years at 2.25% and then comparing it to the net cash receipts in the corresponding period.

### TABLE C5 - 4

**DETERMINATION OF THE RATES OF RETURN**

**PROPERTY NO. 545 - 'AIN AL-MRAÝSEH DISTRICT**

*(in LL.)*

<table>
<thead>
<tr>
<th>Year</th>
<th>(a) Adjustment of Asset Value to Inflation ( S = P(1+r)^n )</th>
<th>(b) Rents Realised fr. Table C5 - 2</th>
<th>(c) Expenses ( (b - c) )</th>
<th>(d) Net Receipts</th>
<th>(e) Rate of Return ( d/a )</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>929,290(1+0.0225) (^1) = 950,210</td>
<td>130,086</td>
<td>16,000</td>
<td>114,086</td>
<td>12.0%</td>
</tr>
<tr>
<td>1961</td>
<td>950,210(1+0.0225) (^1) = 971,589</td>
<td>130,086</td>
<td>21,000</td>
<td>109,086</td>
<td>11.2%</td>
</tr>
<tr>
<td>1962</td>
<td>971,589(1+0.0225) (^1) = 993,449</td>
<td>130,086</td>
<td>20,000</td>
<td>110,086</td>
<td>11.1%</td>
</tr>
</tbody>
</table>

Since the yearly rental is fixed, the effect of adjusting capital value for inflation will lead to lower rates of return in the future for all of the 10 years, unless the monetary increase in the asset value is offset by a drop in yearly expenses.

The average rate of return on capital invested as from 1960 and up to 1962 is 11.4%, or around 11% less than anticipated by the owners.
CONCLUSION

A partial analysis of five cases was made in the preceding sections. When it is revealed that in 1960, 1220 construction licenses were granted for the Beirut area alone, it is evident that any generalisation resting upon the observations made in respect to only five assets, would be of limited use. First, the ratio of the buildings studied to the existing ones is indeed very small. Second, these assets were not picked up in a random sample, but were consciously chosen. Third, their geographic distribution is confined to the city of Beirut. Fourth, the owners are all traders and their buildings are of the luxury or semi-luxury class.

Does this mean that these are absolutely not representative of the existing buildings? This question cannot be answered without first reminding the reader that the aim of this chapter is to try and find out why investors in real estate have insisted on constructing first and second class buildings, in spite of the fact that the sub-sector in question had over-expanded. This being the aim, it obviously would not have been as useful to study the under-expanded popular habitats. Second, and to argue tautologically, in view of the commonly observed fact that mainly rich businessmen can afford constructing luxury and semi-luxury buildings, it is perfectly normal that the owners of the
analysed assets be businessmen. Third, since it is mainly in Beirut that over-expansion in the sub-sector under study exists, it would not have been as useful to analyse buildings outside the capital. Lastly, the reason why a random sample was not taken, is as follows:— since in Lebanon, income from rent is subject to a real estate tax and is not subject to income tax, most businessmen do not see much benefit in keeping accounting records for their buildings. Even when they do, they are generally reluctant to provide anyone, even prospective buyers, with the figures on their books. In view of these facts, taking a random sample would have been an extremely burdensome, time consuming, and often useless task. The writer preferred going to acquaintances of his, from whom he could secure the needed information.

It appears from the above that, if the five cases studied in the previous section are not absolutely representative of the whole sub-sector—especially in view of the paternalistic attitude of the owner of the Achrafiyeh building—generalisations are nevertheless, and to a certain extent, acceptable. With this reserve in mind, the analysis can proceed.

First, it seems that the decline of some businesses is partly responsible for the shift of capital into real estate.
The conservative businessman has often been forced into diversifying his assets and, for his prestige, has sought to construct luxury buildings that would bear his name. Some have not been so much after self publicity as after satisfying their ego by aiming at perfection, almost as artists do. In any case, it is a certainty that the psychological element has not been altogether absent among the factors that have induced the businessman to construct luxury buildings. Another motive behind such investment rests on a very refined assumption which some constructors seem to have adopted. It is held that the higher the cost of construction (implying better finish), the higher the rate of return. Put differently, it would mean that as the building is better finished, the demand for rent becomes extremely price inelastic. This assumes that a category of the population is both ready and able to pay almost any rent, the more the building is outstanding in its comfort and finish. Such an assumption could be challenged. However, no matter whether it is justifiable or not, it still acts as an inducement to some entrepreneurs to construct expensive buildings.

While on the subject of profitability, the projected rate of return on investment in real estate remains the most important factor encouraging construction. A 10% return is generally considered to be attractive. Not one single owner
of the buildings analysed in the case studies, believed that he would get less on his investment, even when he had to finance construction from bank credit. It seems that, quite erroneously, seldom do owners of plots of land consider the market value of their asset at the time of construction as an element to be taken into account. Instead, they tend to regard the original cost as the true cost and compute, on this basis, the projected rate of return. Needless to say, such a resulting rate is over-inflated and its attractiveness often misleads the businessman into investing in real estate.

The most important reason why the realised rate of return is almost always lower than that anticipated, stems from the fact that planning is often not properly made. The consequent modifications involving more time to complete construction, increase total expenditures. Some engineers are either not sufficiently qualified or dishonest and sometimes both. Consciously or unconsciously, they often make erroneous cost estimates. In addition, and though not always relevant paternalism on the part of the landlord – as reflected in one of the cases studied – is sometimes the cause behind a drop in the rate of return.
What is the market rate of return on investment in luxury and semi-luxury buildings? If the average rate is computed on the basis of those determined in the case studies, it will amount to 9.1%. Such a rate might not be representative of the average rate of return on all similar buildings in Lebanon, especially in view of the fact that the unrealistic 5.8% return on the Achrafiyeh asset was taken into account, thus understating the general average. As it is, however, the rate is lower than that for industry, determined by the I.R.F.E.D. Mission to range from 10% to 18%.

In his determination of the rate of return realised on his property, the landlord does not go into the trouble of making the necessary adjustments precisely because he is not aware of their necessity. First, and to repeat what has been said, he almost never considers the market value of the land at the time of construction as representing its real value but rather looks at the cost incurred upon acquiring it. Second, he never adjusts the value of his asset for inflation, which means that he does not realise that the replacement value of his asset tends to rise year after year. Consequently, the rate of return which he believes is being realised, is higher than that computed on the basis of adjusted figures. It is irrelevant to demonstrate here, in what respect his method is erroneous.
However, what has to be pointed out is the effect that such an unconsciously accepted higher rate of return has on construction. Indeed, it induces investment in real estate on the basis of an assumed profitability.
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