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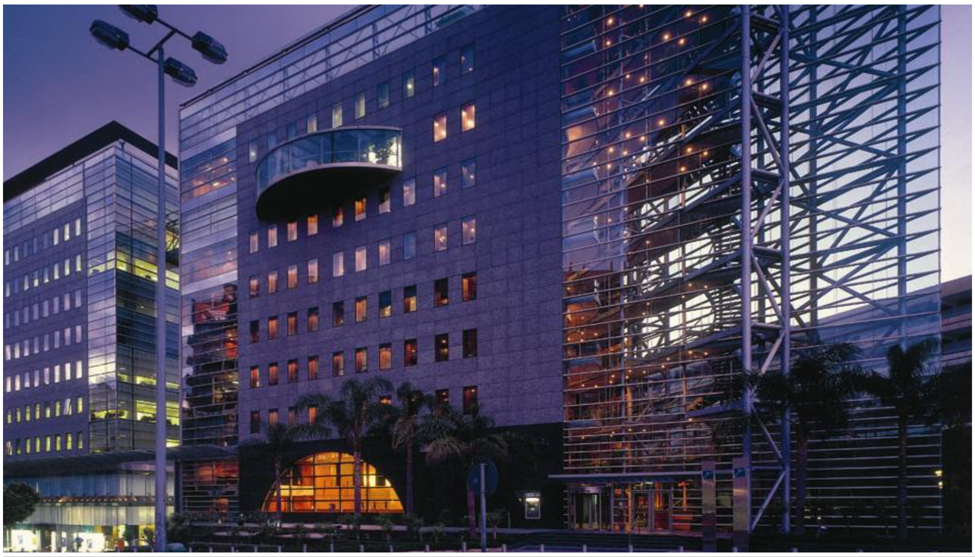

ECONOMIC RESEARCH DEPARTMENT
Rashid Karame Street, Verdun Area
P.O.Box 11-1540 Beirut, Lebanon
T (01) 747802 F (+961) 1 737414
research@blominvestbank.com
www.blom.com.lb

FOCUS IN BRIEF

The End of Rent Control in Lebanon: Impact Analysis

After remaining a dormant issue for several decades, rent contracts signed before the 23rd of July 1992 are set to be freed from rent control as stated by the new law passed by Parliament in April 2014. Not shy of controversy, this matter was yet another source of social outcry opposing the Syndicate of Owners of Leased Property on one hand and the Committee Supporting the Rights of Tenants on the other. Owners are protesting against the dismal rental fees they receive, which have long stopped reflecting true market value while tenants are voicing their concern over their inability to pay higher rents.

Providing a supply of affordable housing was the main intent of the Lebanese law implemented in the 1940s, according to which rents are fixed by the state. Indeed, further down the road in the 1950-1970s, renting apartments in the city allowed a large portion of the low to middle income population to move away from rural areas. However, the real value of these fixed rents was slashed drastically as the civil war and the deteriorating public finances led to the large depreciation of the Lebanese Pound between 1985 and 1987. Ever since, the owners of these properties were left with mediocre rental income which fails to cover maintenance costs.

In 1992, law number 160 stipulates that no amendments shall be made to rent contracts signed before 1992 while law number 159 states that rent contracts concluded after July 1992 will be free from any rent control. Today, lawmakers believe it is sound for all rent contracts to abide by the market's supply and demand dynamics. This new order will generate social, demographic and surely economic change, which will be discussed after delving into the most relevant articles of the law.

First of all, the law is **not applicable** on commercial rents, agricultural rents, seasonal rent contracts, rent contracts according to which an employer offers housing to its employee (free or against a fee), land owned by the government or municipalities and for tenants residing in villas endowed with the following characteristics: 1 or more floors, rented for one tenant which incurs the costs of the property's insurance, with garden, garage, heating system and hot water supply.

All other rent contracts for housing purposes and signed before July 1992 are concerned by the new law. For the properties leased for housing and commercial purposes under one contract, they are treated as properties leased solely for housing. According to the new legislation, rent contracts shall be extended for a period of 9 years, during which rents will gradually increase, with the fair lease price being reached by the sixth year. The fair lease price has been set at 5% of the apartment's estimated value.

The law envisages two means of estimating the apartment's value. First, through an agreement between the owner and the tenant (although this value can be revised by the authorities if the tenant will benefit from government assistance to pay the new monthly rent). If an agreement fails to be reached within three months of the law's official start date, the owner must designate two local experts, one being a civil engineer and the other being an architect. Once an estimate is reached, it will be presented to the tenant, which either accepts the estimate or designates two other experts which will draft an estimation of their own. If the two estimations differ, the case will be brought up to a special committee[1] which will make the final decision.

For the first, second, third and fourth years of the extension, the rent increase represents 15% of the difference between the fair lease price and the old rent. For the fifth and sixth year, the rent increase represents 20% of the above mentioned difference. For the seventh, eighth and ninth year, the yearly rent will be equal to the determined fair lease price. By the end of the ninth year, all form of rent control is lifted off the property.

[1] Committee is made up of: retired or active judge, two representatives one for the tenants and one for the owners, a representative from the ministry of finance and another from the ministry of social affairs.

Assistance Mechanism for those who wish to stay

The law has also established an assistance fund for the tenants who lack the means to finance the rent increases. The fund, which partially or totally covers the rent upturn, is to be financed by annual state contributions and/or donations which will be deduced from the donator's taxable income. The level of assistance has been determined in light of the household's average income (where the revenue of each active member is taken into account) compared to the minimum wage of $450.

	Assistance Fund		
	Scenario A	Scenario B	Scenario C
Household's Average Monthly Income	Less than $900	Between $900 - $1,350	Above $1,350
Assistance	100% of the rent increases	Difference, if any, between 30% of the income and the new monthly rent	No Assistance

In the words below we attempt to draw an estimate of the cost incurred by the government in each scenario.
We have determined the **number of total households** residing in properties governed by the pre-1992 law as **125,000**, the average between two figures:

- 80,000 which is the figure adopted by the owners and derived from a study conducted by the Ministry of Social Affairs.
- 170,000 which is the figure adopted by the tenants

Our hypothesis states that **80% of the households are in scenario A**, **10% in scenario B** and 10% in scenario C. scenario C will be left out since it does not entail any government assistance.

Since some of the old rent contracts are present in Beirut and others in the outskirts of the city, scenarios A and B have been examined in Beirut and Outside Beirut. We have estimated that 60% of the households reside in Beirut while the remaining 40% reside outside the city.

The analysis detailed below showed that by the end of the sixth year the government would have incurred a cost of $1.13B[2] for all the households in Beirut and outside Beirut. The reasoning is explained below.

[2] This figure is the net present value of the total cost

Beirut Area

Number of Households	75,000
Households in scenario A	60,000
Households in scenario B	7,500
Households in scenario C	7,500
Apartment Area (In sqm)	120
Cost of 1 sqm (In $)	2,300
Apartment Value (In $)	276,000
Fair Lease price (5% of apartment value) (In $)	13,800
Old Rent (0.3% of apartment value) (In $)	828

For the Beirut region, 75,000 households are present: 60,000 in scenario A and 7,500 in scenario B.

The cost of 1 square meter is equal to $2,300. This price is quite low because we assume that the apartments are old and have witnessed few renovations.

With a cost of $2,300/sqm and an area of 120 sqm, the apartment's value would be $276,000.

Since the tenants pay only a dismal portion of the apartment's value, we settled on the old yearly rent being equal to 0.3% of the apartment's value or $828.

The fair lease price represents 5% of this apartment's value, as stated by the law and is equal to $13,800.

After calculating the rent increases, we found that by the end of the 6th year the assistance fund would have disbursed a total of $963.75M in Beirut, divided as $778.32M for the households in scenario A and $185.43M for households in scenario B.

For more precision, the **net present value** of these costs (calculated with a 4% discount rate) would be:

- Total Cost in Beirut: $860.92M
- Cost for Scenario A: $701.75M
- Cost for Scenario B: $159.17M

Beirut Area

Scenario A: Average Household Income below 2x the minimum wage = below $900

80% of 75,000 households in scenario A = 60,000 households

	Tenant Yearly Payments (1 household)	Government Yearly Payments (all households)
Year 1	$2,774 = 828+**1946**	1946*60,000 = 116,760,000
Year 2	$4,720= 2774+**1946**	116,760,000
Year 3	$6,666 = 4720 +**1946**	116,760,000
Year 4	$8,612 = 6666 +**1946**	116,760,000
Year 5	$11,206 = 8612 +**2594**	2594* 60,000 = 155,640,000
Year 6	$13,800 = 11206+ **2594**	155,640,000
Total		$778,320,000

- Rent Increase (Year 1 to 4) = 15% (Fair Lease Price – Old Rent)
- 1946 = 15 %(13,800- 828)
- Rent Increase (Year 5 ,6) = 20% (Fair Lease Price – Old Rent)
- 2594 = 20 %(13,800-828)

Scenario B: Average Household Income between 2- 3 times the minimum wage = between $900 - $1,350

10% of 75,000 households in Scenario B =7,500

Assuming household income as the average between $900-$1350 = $1,125

If the new monthly rent is higher than 30% of $1,125 = $338, the government covers the difference

	New Monthly Rent	Difference Between 30% of income and New Monthly Rent	Assistance for all households, monthly	Assistance for all households, yearly
1st year	$231	-	-	-
2nd year	$393	$55	$415,000	$4,980,000
3rd year	$556	$218	$1,631,250	$19,575,000
4th year	$718	$380	$2,847,500	$34,170,000
5th year	$934	$596	$4,468,750	$53,625,000
6th year	$1,150	$812	$6,090,000	$73,080,000
Total				$185,430,000

- New monthly Rent = New Yearly Rent / 12
- 231 = $2,774 / 12
- Government Monthly Payment = New Monthly Rent – 30% (Income)
- 55 = $393 - $338

Outside Beirut

	Outside Beirut
Number of Households	50,000
Households in Scenario A	40,000
Households in Scenario B	5,000
Households in Scenario C	5,000
Apartment Area (In sqm)	120
Cost of 1 sqm (In $)	1,200
Apartment Value (In $)	144,000
Fair Lease price (5% of apartment value) (In $)	7,200
Old Rent (0.3% of apartment value) (In $)	432

Outside Beirut, 50,000 households are present: 40,000 of them fit in scenario A and 5,000 in scenario B.

The cost of 1 sqm is of course lower than that in Beirut, estimated at $1,200.

The 120 sqm apartment's value is then equal to $144,000.

The tenants pay only 0.3% of the apartment's value as rent = $432.

The fair lease price, representing 5% of the apartment's value = $7,200.

After calculating the rent increases, we found that by the end of the 6th year the assistance fund would have to disburse a total of $297.57M, divided as $270.72M for the households in scenario A and $26.85M for households in scenario B.

For more precision, the **net present value** of these costs (calculated with a 4% discount rate) would be:

- Total Cost Outside Beirut:$266.59M
- Cost for Scenario A: $244.08M
- Cost for Scenario B: $22.51M

Outside Beirut

Scenario A: Average Household Income below 2x the minimum wage = below $900

80% of 50,000 = 40,000 households in scenario A

	Tenant Yearly Payments (1 household)	Government Yearly Payments (All households)
Year 1	$1,447 = 432 + **1015**	1015*40,000 = 40,600,000
Year 2	$2,462 = 1447 + **1015**	40,600,000
Year 3	$3,477 = 2462 + **1015**	40,600,000
Year 4	$4,492 =3477 +**1015**	40,600,000
Year 5	$5,846 = 4492 + **1354**	1354* 40,000 = 54,160,000
Year 6	$7,200 = 5846+ **1354**	54,160,000
Total		**$270,720,000**

- Rent Increase (Year 1 to 4) = 15% (Fair Lease Price – Old Rent)
- 1,015 = 15 % (7,200 - 432)
- Rent Increase (Year 5,6) = 20% (Fair Lease Price – Old Rent)
- 1354 = 20% (7,200 - 432)

Scenario B: Average Household Income between 2- 3 times the minimum wage = between $900 - $1,350

10% of 50,000 = 5,000 households in scenario B

Assuming household income as the average between $900-$1350 = $1,125

If the new monthly rent is higher than 30% of $1,125 = $338, the government covers the difference

	New Monthly Rent	Difference Between 30% of income and New Monthly Rent	Assistance for all households, monthly	Assistance for all households, yearly
1st year	$121	-	-	-
2nd year	$205	-	-	-
3rd year	$290	-	-	-
4th year	$374	$36	$181,667	$2,180,000
5th year	$487	$149	$745,833	$8,950,000
6th year	$600	$262	$1,310,000	$15,720,000
Total				**$26,850,000**

- New monthly rate = New Yearly Rent / 12
- 121 = 1447 / 12
- Government Monthly Payment = New Monthly Rent – 30% (Income)
- 36 = 374 - 338

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Compensation Mechanism…

1. For tenants who wish to leave

For tenants who wish to leave the premises, the same benchmark of the household's average income against the minimum wage is applied to determine the amount of compensation owed to tenants. The tenant must inform the assistance committee of his decision within two months after having informed the landlord. The tenant also has the option to defer his monthly compensation to any credit institution in exchange for a housing loan.

In the compensation scheme, the total average household income takes into account only the income of the two spouses as opposed to the assistance scheme where the revenue of each household member is included in the total computation. Most probably, the legislator wants to encourage tenants to vacate the property as they will receive a higher compensation, especially since only the two spouses' income is taken into account in this case.

2. Upon the owner's request

The law gives the owner[3] the right to claim back his property under two main circumstances: family purposes or demolition of the property in order to build a new one.

The first case is when the landlord shows that the property is needed for family purposes (housing his kids or other family members) upon proving that there is no other unoccupied and eligible place to house them.

In this first case when the landlord claims his property for family purposes during the first extended year, he will have to pay the tenant 4 times the fair lease price. This compensation is cut by half if the tenant's household income exceeds 3 times the minimum wage. If the apartment is deemed a luxurious one (elevator, concierge, central heating system), the compensation is also slashed by half.

In the second case where the landlord claims his property in order to demolish or build a new one during the first extended year, he will have to pay the tenant 6 times the fair lease price, also reduced by half for the households with an income higher than 3 times the minimum wage.

Hence, where the landlord is entitled to claim his property, the tenant will receive monthly installments from the assistance fund. The government's assistance fund will compute what the tenant would have received if he were to stay in the property for the whole extended period (9 years) and then deduce from that amount what has already been paid by the fund for the tenant in addition to the compensation paid by the landlord. The balance would be divided into equal monthly installments that will be paid to the tenant.

In both cases mentioned above, if the landlord claims back his property between the second and ninth year, the compensation he will have to pay for the tenant will be reduced by 1/9 for each year. For example, if the landlord claims back his property during the third year, he will pay the tenant: [4 times the fair lease price] * (1 – 2/9). (Reduction of the compensation by 1/9th each year).

[3] Only landlords who own at least ¾ of the property or that get a written consent from their partners to take over at least ¾ of the property have the right to ask for the tenant's exit

Economic, Social and Fiscal Impact of the New Rent Law

First, a portion of the old tenants will not have the necessary funds to rent another apartment in Beirut at the current market value and will relocate to a more affordable area outside Beirut. This could enhance the "shifting out of Beirut" trend that has been witnessed in 2013. The Orders of Engineers in Beirut and the North data showed that Mount Lebanon remained the top location for new constructions in 2013 capturing 43.1% of total activity in terms of projects number, while the lowest was Beirut reporting 4.7% of total projects.

Meanwhile, the now vacant apartments in Beirut will most likely be renovated or demolished in order for new apartments to be built. Therefore, the prices of the old leases, long below market value, will finally witness an upward correction in prices.

If the renovated or newly built apartments are small sized apartments, the new supply is more likely to be absorbed by the market since demand for smaller sized housing units is on the rise. The Construction area Authorized by Permit (CAP) plummeted by 12.8% to 12.82M sqm in 2013 following a 10.8% fall in 2012, underscoring the spreading of projects over lower sized investments. Accordingly, the average area per permit has decreased by 5.1% to 765.40 sqm/permit in 2013 compared to 806.78 sqm/permit recorded a year earlier.

On the fiscal front, finding proper means of financing for the proposed assistance fund, especially at a time where the fiscal balance is in the red, is a must. The cost of this new law on the government, which we estimated at $1.13B by the end of the 6th extended year, comes in a context where the ratio of the fiscal deficit to GDP is on the rise (around 10%), where economic growth is below potential and where social uproar regarding the salary scale is getting louder by the minute. This is why structural reforms such as eliminating corruption, reducing tax evasion and a better organization of Electricité du Liban need to be put on the table for immediate discussion. Once these issues are addressed, they can offer a significant boost to government revenues.

Finally, evaluating the real repercussions of the new rent law requires further statistical data regarding the exact geographical location of the old rent leases and a more thorough breakdown of the concerned households (age, income… etc.)

Research Department:

Lana Saadeh lana.saadeh@blominvestbank.com
Riwa Daou riwa.daou@blominvestbank.com
Mirna Chami mirna.chami@blominvestbank.com
Marwan Mikhael marwan.mikhael@blominvestbank.com

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