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2014

Online at <http://mpa.ub.uni-muenchen.de/44770/>

MPRA Paper No. 44770, posted 25. February 2014 08:28 UTC

REAL ESTATE BUSINESS IN PAKISTAN AND ITS ECONOMIC IMPLICATIONS

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December 2012

Abstract:

The real estate Business has been one of the most attractive businesses in Pakistan during the last decade. This business minimizes the investment risk and offers high profit margin simultaneously. Therefore this business attracted lot of investment. However, this business has very important implications for several socio- economic indicators. The real estate business demands huge amount of investments and earns high profit margin than the ordinary investment, therefore leads to increased income inequality. The real estate investment reduces the velocity of money leading toward lower level of production. The attraction of industrial investment reduces because of this business. However, no scientific study on the consequences of real estate business exists for Pakistan. This study discusses the economic consequences of real estate business and proposes some reforms to reduce the undesirable consequences of this business.

Keywords: Real Estate, Capital Intensive, Investment, Remittances

JEL Classification: R21, R31, R38

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1. INTRODUCTION

The real estate business has been one of the most attractive businesses in Pakistan in the recent past. Many of top twenty businessmen are engaged in this business, including Hashwani group which is considered to be second richest business group of Pakistan. Malik Riaz Hussain which has been very influential in national politics is a legendary businessman of real estate.

The real estate business offers low investment risk and high profit margin simultaneously; therefore this business attracted lot of capital. Looking at the high returns, many of retired top military and civil bureaucrats adopted this business for their remaining career. Because of high rate of return and very low amount of entrepreneurial job, real estate business became a big attraction for overseas workers. A huge amount of remittances was being invested in the real estate.

The real estate business has some features which other businesses do not have. These features have very important implications for many indicators of social and economic welfare. For instance, the real estate business requires huge investments and the return on these investments is also higher than the ordinary investment. This implies rapid growth in the income of individual which is already at higher level of income. This will lead to expanding income inequality pushing away from the Millennium Development Goals.

However, despite these obvious impacts of real estate business on many socioeconomic indicators, no research could be found to analyze the consequences of this business.

The purpose of this study is to initiate the debate on economics of real estate business to produce a policy which can reduce the harmful effects of real estate business and can align the business in accordance with the national needs.

2. THE ECONOMICS OF REAL ESTATE

Economics of real estate has emerged as a separate discipline of knowledge during the past century. There are number of journals dedicated for research on the real estate economics and number of books has been written on the subject. However, the sole purpose of this field of knowledge is to advise the investors on the business related matters. For example, the Wikipedia definition of real estate economics is as follows:

Real estate economics is the application of economic techniques to real estate markets. It tries to describe, explain, and predict patterns of prices, supply, and demand. The closely related fields of housing economics is narrower in scope, concentrating on residential real estate markets as does the research of real estate trends focus on the business and structural changes impacting the

industry. Both draw on partial equilibrium analysis (supply and demand), urban economics, spatial economics, extensive research, surveys and finance.

The book 'Essentials of Real Estate Economics' by McKenzie et al. (2010) defines real estate economics as:

Real estate economics is a study that uses economic principles; macro and micro, to analyze the impact that national, regional, community, and neighborhood changes or trends have on real estate values and uses. In our society, our desire for goods and services frequently exceeds the supply available. When an object is scarce, people will give money to obtain it. Scarcity creates value. Real estate economics focuses on the economic principles that create and change real estate values.

The MIT course on the real estate economics describes the course contents as follows:

This course applies the latest economic thinking and research to the task of analyzing real estate market fundamentals, forecasting supply/demand, choosing locations.

Research Centre for Construction and Real Estate Economics describes its aims and objectives as follows:

To undertake internationally relevant multi-disciplinary research that supports the advancement of the construction and real estate industries in Hong Kong and China Mainland.

A future research strategy for the centre can be grouped under three related subheadings, namely:

- Policy analysis and formulation for Construction and Real Estate;
- Economic Analysis and Investment for Construction and Real Estate;
- Sustainable Development

All of these quotations from the respected texts in real estate economics reflect the fact that the effect of real estate on the socio economic indicators is no where the focus of the research. The real estate economics revolves around the solutions of the problems faced by real estate developers and to advise them on suitable investment plans. The impact that this business puts on the other economic indicators is out of the discussion in the real estate economics currently being taught.

On the other hand, this business have lot of implications for the other businesses, the overall economic functioning and several socioeconomic indicators but these impacts did not get due attention of the academic community. If we look at the history of economic crisis and recessions, we find that there is a strong linkage between real estate business and the economic crisis. There are number of documented evidences that the great depression of 1929 and the recent economic crisis of 2006 emerged because sudden changes in the real estate market. However, despite this strong relation of real estate business with the economic business cycles, the real estate economics did not focus on the consequences of real estate business. Despite lot of search, we did not find any

research on the socio economic impacts of this business. As described above, the discipline of real estate economics aims only to help the businessman.

Ignoring the welfare impacts of real estate business in study of real estate economics is not very surprising because the concept of welfare entered recently in the economics. The classical economics focused only on the GDP growth as a proxy of development without paying any attention to the welfare impacts of growth. It was the work of Amartya Sen and Mehboob ul Haq which made the economists realize the significance of welfare of masses while measuring the development of nations. The real estate economics still lags behind other disciplines of economics in realizing the significance of measures of human welfare.

We found only one research on the real estate written in Pakistan, This research is a part of series of research articles on 'State of Commerce in Pakistan', This research aims to develop information about real estate market and has nothing to do with the socioeconomic impacts of the real estate business.

3. SIZE OF REAL ESTATE BUSINESS AND ITS IMPORTANCE

According to World Bank, size of real assets constitute between half and two third of the total wealth for most of nations. In Pakistan, no reasonable guess about size of real estate is available. We will give just one example to make this point; if you explore the list of

top twenty richest people in Pakistan on the internet, you will find the Malik Riaz Hussain the owner of most popular land developers Bahria Town, listed at number 11², with wealth estimate of about 800 million dollars. But Malik Riaz Hussain offered 2 billion \$ as charity for the victims of 2010 flood, saying that he is offering 75% of his assets³. This implies the actual wealth as declared by Malik Riaz itself is more than 2.5 billion dollars. The recent advertisements by Bahria Town state that the total area of Bahria Town is about 66000 acres which is equal to 528000 Kanals. The price of land in this town varies between PKR 4000,000 and PKR 8000,000. If we take average price to be 6 million than the minimum amounts of assets will be about 3200 billion rupees. If this estimate is correct, than the wealth of Malik Riaz is more than collective earning of 56 million Pakistani over one year who are earning less than \$ 1.25 per day. This example clarifies that the actual worth of the assets of Malik Riaz is not known. Estimating the size of whole real estate market must be more difficult than estimating wealth of Malik Riaz Hussain. Therefore it is very hard to provide some reasonable figure about real estate sector, however it is so huge that it has attracted top civilian and military bureaucrats prefer to be engaged in this business. Similarly, out of the top twenty businessmen, many others are engaged in the business of real estate.

4. SOME SALIENT OF THE REAL ESTATE BUSINESS

4.1: CAPITAL INTENSIVE BUSINESS

² List of Pakistanis by net worth, http://en.wikipedia.org/wiki/List_of_Pakistanis_by_net_worth

³ Malik Riaz Hussain, an Exclusive Interview with CNN Chairman Bahria Town, http://bahriatown.com/index.php?option=com_content&task=view&id=281&Itemid=119

The real estate business is highly capital intensive. It requires lot of capital investment and very little amount of labor, especially when it comes to sale and purchase of land. The land investment even in millions does not create any permanent employment, and gives only one-shot opportunities except to the seller, buyer and the agent facilitating the deal. An amount of 10 million rupees if invested in agriculture can provide employment to hundreds of people on the farm marketing and management. But the same amount if invested in land purchase will provide permanent employment to nobody.

For the country where unemployment rate is very high, and the percentage of population entering into labor market in coming few years is highest in the world, this type of capital intensive investments are very undesirable.

4.2: RISK FREE BUSINESS

The real estate business is risk free in the sense that it does not have any fear of theft or dacoit. The property does not have chances of depreciation and there is no fear of loss due to spoiling of product. There is no cost of preserving the product. The bounded above amount of the land insures the consistent rise in prices of property. These properties make the real estate business sure to provide positive and high rate of return. The high return reduces the capital flow toward the agricultural and industrial investments which can create lot of employment opportunities.

4.3: ATTRACTS THE PEOPLE WHO DO NOT WANT TO WORK AS ENTERPRISE

For the individuals involved in the business the only requirement is to purchase a piece of land and then wait till the prices go up. Minimal labor and entrepreneurial spirit is needed for the real estate business. Therefore this business attracts who want to invest their earnings in a profitable business and have no opportunity of personally supervising the business. The overseas workers are therefore especially attracted to real estate. Therefore a big proportion of remittance goes into this business.

4.4: HIGH PROFIT MARGIN

The real estate is probably the business with the highest profit margin among the businesses where investors do not want to act as entrepreneurs. A plot purchased for one million can have a price of 10 million within few years. The high and certain profit in real estate reduces the charm of other businesses.

4.5: LOWER LIQUIDITY

The real estate is the slowest item to be sold or purchased. Plots once purchased will remain idle for years in hope of higher prices slowing down the velocity of money. The lower velocity of money leads to lower economic activity and lower growth rate.

5. CONSEQUENCES OF THE REAL ESTATE BUSINESS

The unique features of real estate business have unique consequences as well. There are lot of implications of real estate business for many socioeconomic indicators, some of them are discussed below:

5.1: DISTRIBUTION OF WEALTH

Real estate is a capital intensive business and carries a high profit margin, the earning of those who already have high level of wealth increase at higher rate. This leads to increased income inequality and wider gap between rich and poor, pushing the society away from the millennium development goals. The project of Malik Riaz Hussain is a leading example of the inequality created by the business. The area of Bahria Town surrounding Rawalpindi and Islamabad would not be less than 25% of the urban area of Islamabad. So the wealth (in terms of land occupation) of a single individual is more than the wealth of 25% individuals of the city. Therefore only one individual is capable of distorting any measure of income/wealth inequality of the city.

5.2: REDUCTION IN INDUSTRIAL INVESTMENT

The industrial sector in Pakistan is already facing big challenge of availability of essential inputs like electricity and gas. In addition, the high profitability and low risk in real estate business reduces the charm of industrial investment. Therefore the capital flow toward industrial investment decreases a lot. This reduction in industrial investment leads to lower productivity and unemployment. If the remittances that are being invested in real estate were invested in the energy sector solar or hydropower for financing, the energy crisis might have been finished. The world is now generating large scale solar power

plants generating upto 100 MW electricity from each plant. The desert areas of Sind and southern Punjab provide feasible location for the mega solar projects. The biggest hurdle in this type of projects is availability of capital for initial investment. If the remittance were being used to setup this type of power plants, the country can move toward solution of energy crisis.

5.3: PROVISION OF HOUSING

The ultimate justification for the land business is to facilitate in the provision housing and residential facility to the masses. But does the real estate business really create ease in access to housing? The answer is not as simple as the question looks.

The real estate business runs on the shoulders of those who want to earn profit by resale of the property. The proportion of people purchasing the land for their own residence or business has a small among all purchasers of property. Because of these investors, the demand for real estate increases leading to high prices and making the real estate out of the approach of middle income cohort of the society. Therefore the access to housing is negatively affected by the business. It is frequent observation that the price of a property increase manifold over a small interval of times. This increase is because of heavy demand of the land for investments. The effect of real estate on the access to housing can be tested by calculating the percentage of people who can afford to purchase a standard housing unit, however, the data is not available currently. The ordinary observation is, the housing is going out of the access of middle class in the large urban community.

5.4: REDUCTION IN AGRICULTURAL LAND

Fast growing real estate reduces the agricultural land rapidly as the agricultural land is being converted to residential land. Now it is very hard to find piece of agricultural land surrounding the Rawalpindi Islamabad because lot of residential schemes in its premises.

6. ADVANTAGES OF REAL ESTATE

Beside the undesirable consequences of real estate business, there are several advantages of the real estate as well. Some of these described are described below:

6.1: ACCESS TO NECESSITIES OF LIFE

The residential facilities created by real estate developers are usually well planned and it is being insured that basic facilities of life are available. The housing schemes usually have schools, hospitals, transportation, security parks and market facilities available. Moreover towns developed by real estate developers are not so congested. The unplanned traditional towns and colonies lack many of these facilities.

6.2: FLEXIBLE PAYMENT SCHEDULE

Many of the real estate developers offer their schemes on the easy installments so that the people, who are unable to pay price of a property in cash, can also have access to the housing facility. This is very big advantage for relatively lower income cohort of society.

6.3: EMPLOYMENT

The construction side real estate business creates employment opportunities, not only in construction but also in many other allied industries. The steel industry, cement industry, ceramics, furniture, communication and many other industries get the advantage of construction industry.

7. NEED OF INTERVENTIONS IN THE REAL ESTATE BUSINESS

As we have discussed in details beside its benefits, the real estate business, especially the land business brings some consequences which are quite undesirable for the society and resist the progress toward the millennium development goals. The extraordinary charm of real estate business reduces the attraction of investment of industrial and the agricultural investment, which can generate employment for many individuals. A huge investment in land did not create any permanent employment. The investment purpose demand of land raise the price of land and makes the access of middle class to housing more difficult. Therefore for a country with high rate of unemployment this type of capital intensive investments is quite undesirable. Therefore there is dire need of intervention in the real estate so that the business can be brought in accordance with the national needs and the harmful consequences of this business can be minimized.

Pakistan is one of the ten leading countries witnessing high inflows of remittances sent by its overseas workers from different countries. According to the world bank estimates, the

worker remittances inflow during 2002-2010 in Pakistan is more than 53 billion US\$⁴. This amount is sufficient to finance many projects of national importance, especially the energy projects, if the remittances were redirected to these investments. But most of this money is going to the real estate, creating an extraordinary price hike in the real estate and making the housing out of the approach of middle class. An intervention in this business is thus required which can reduce the extraordinary demand of real estate and can bring the real estate investment.

8. PROPOSED INTERVENTIONS

8.1: ANTI-LAND HOARDING MEASURES

Land purchase for the purpose of investment should be discouraged to keep housing approachable for the middle class. There must be some upper limit for the land purchase admissible to an individual or institution. There can be different limits for agricultural, industrial and residential land. Further purchase of land should be restricted if there is some un-utilized in occupation of an individuals. Plot resale per individual per annum should be bounded. The person selling more than one plots in some specified heavily. This will restrict individuals making land purchase a business. If someone selling more than one plots per annum, he should pay tax proportional to the difference between cost and sale values of the property.

⁴ Author's Calculation from the data on 'Worker Remittance Receipts' from WDI online data base.

8.2: HOUSING SOCIETIES

Housing societies provide access to housing with basic necessities of life. Therefore the housing societies should continue their business. However, a regulatory framework should be designed for these societies. Currently there is no regulation for the adjustment of property. Sometimes housing societies charge the price which is 3000-4000% of that of the cost of the property. This trend should be discouraged and an upper bound for the profit margin should be defined. For example, 60% of the land cost and development charges may be set as an upper limit of the margin of the land developer. This limit may be tied with the time so that a land developer is allowed to charge higher price if the land remain idle in his occupation for a larger interval of time.

8.3: PROVISION OF ALTERNATE INVESTMENT OPPORTUNITIES

The remitters and other investor should be provided some alternate investment opportunity, for which Government should insure the distribution of returns to the investors. Mega projects especially the energy projects can be financed by this investment channel. Financed should be insured appropriate share in the returns on maturity/completion of the project.

9. CONCLUSION

This paper described in details the desirable and undesirable consequences of real estate business. The real estate business reduces the charm of industrial and agricultural investments which can produce lot of employment opportunities and the output.

Similarly, this business widens the income inequality and makes the access to housing more difficult for the middle and lower middle class. This paper proposes some reforms which to reduce the undesirable consequences of this business. However we do not think that these are not ultimate words on the issue. We wish startup of a healthy debate ending up with a suitable policy to harmonize the business with the national needs.

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