

The Jamaican Construction and Real Estate Industry
and the Impact of the Global Economic Crisis
 By Dean Burrowes (BSc, MRICS, Partner Burrowes & Wallace)

The construction and real estate industry in Jamaica make up approximately 15 percent of the Gross Domestic Product of this beautiful island nation. Between 2002 and 2007 this ranged from J\$34 billion to approximately J\$39.7 billion dollars. The industry also impacts significantly on labor, accounting for approximately 17 percent of the total labor force.

In Jamaica, the government is the largest contributor to industry spending on residential buildings, infrastructure and public buildings, as well as the maintenance of the existing stock.

Table 1: Contribution of Construction and Real Estate to GDP (J\$ in million)

Industry	2002	2003	2004	2005	2006	2007
Construction	22,305	22,636	23,863	25,596	25,271	26,629
Real Estate	11,761	11,971	12,224	12,462	12,774	13,110
Total Contribution	34,066	34,607	36,067	38,058	38,045	39,739
Total GDP	229,984	235,190	237,475	240,864	246,798	249,645
% Contribution to GDP	14.8	14.7	15.2	15.8	15.4	13.5

Source: Statistical Institute Of Jamaica

The majority of government involvement in the construction industry is carried out by several ministries and state agencies, some of the largest being The Ministry of Works, which concentrates on infrastructure, and The Ministry of Water and Housing, which concentrates on low- and middle-income housing solutions. The Urban Development Corporation, the National Housing Trust and the Port Authority of Jamaica are also significant participants in the construction industry working on a variety of projects across the island.



The demand in the lower and middle socio-economic groups for affordable housing solutions resulted in the Ministry of Water and Housing employing innovative methods to augment supply. One such method was encouraging joint venture partnerships with private developers and providing incentives to ensure affordable houses were constructed and sold to middle-income purchasers. In 2009 this was stated to be within the J\$7 to J\$10 million range.

A major government program designed to enable people to afford a home is The National Housing Trust, a statutory body funded from the combination of corporate and individual contributions. This organization was set up in 1976 to address the housing shortage at the time by making loans to borrowers at a rate lower than the commercial institutions, which enabled these borrowers to purchase, build or improve their homes. The Trust is the largest provider of residential mortgages in Jamaica and since its inception the trust has made 81,434 loans benefiting 92,810 people at a value of J\$31.4 billion while at the same time J\$1.53 billion has been expended to construct housing units for sale. The rates charged by the Trust range from 2 percent to 11 percent, and these compare very favorably to rates offered by the banks and building societies, which range between 16 percent and 25 percent.

Table 2: Performance of the National Housing Trust (J\$ in millions)

	2004	2005	2006	2007
Annual Housing Expenditure	13,171,808	7,710,150	5,735,970	5,773,574
Mortgages created since inception	116,527	108,233	101,084	94,830
Individual benefits provided since inception	128,010	119,695	112,514	106,246
Average interest on loans	5.8%	6.5%	7.9%	8.2%

Source: National Housing Trust

Private sector developers currently tend to prefer constructing houses where the effective demand ensures that upon completion they can maximize profits - if left on their own they would invest in the suburbs and most desirable neighborhoods and cater only to the upper income earners.

In 1971 the government established the Jamaica Mortgage Bank to encourage developers to construct affordable housing by offering financing at a concessionary rate of interest. Financing from the mortgage bank is given for 80 percent of the development cost. To qualify for funding the developer must convince the bank that the project is marketable and has a high probability to be presold.

Table 3: Value of mortgages by Major Institutions (J\$ in millions)

	2002	2003	2004	2005
National Housing Trust	3966.0	4261.8	4382.7	4147.0
Building Societies	3994.4	5645.5	7630.4	10,115.2
Credit Unions/Insurance Companies	263.0	459.6	1136.9	242.8
National Housing Development Corporation	237.1	267.6	121.8	20.0
Total	8460.5	10,634.5	13271.8	14,525.0

Source: Bank of Jamaica Economic Data

Short-term bridging finance is available from banks, insurance companies and credit unions, and currently the cost of these funds ranges from 18 percent to 26 percent. These loans are not always easily obtained because of the high level of collateralization required. In many cases the finance houses require that the loans be fully collateralized. Despite these restrictions the loans by commercial banks for land acquisition and construction reached J\$8,524,940,000 in 2006.

Table 4: Value of loans by Commercial Banks for Land purchase and Construction (J\$ in thousands)

	2003	2004	2005	2006	2007
Construction & Land Development	J\$6,694,696	5,875,725	5,512,311	8,045,537	8,977,370
Construction (only)	J\$6,535,436	5,525,451	5,149,328	7,586,534	7,881,569
Land Development	J\$112,516	127,764	136,490	204,380	783,482
Land Acquisition	J\$46,744	222,510	226,493	254,623	312,319

Source: Bank of Jamaica Economic Data

The conservatism of local lenders is not without cause. In 1996 and 1997 Jamaica experienced a banking crisis as a result of high interest rates on loans; many investors defaulted after being unable to service their loans. This resulted in a few financial institutions going bankrupt and others coming under severe strain. In order to protect depositors the government purchased the bad debts, resulting in an increase to the country's debt-to-GDP ratio by 44 percent. By 1999 the ratio of debt to GDP reached 140 percent. By adopting a policy of high interest rates in an attempt to mop up the liquidity in the economy, government securities became a more attractive option compared to what was [offered by the commercial banks, thus the private

investors opted to purchase the government bonds rather than risk their capital in business ventures. This resulted in a slowdown in the economy and in the construction sector.

Since 2000 a few private investors with funding from overseas - and encouraged by attractive incentives from the government - made substantial investments in several large-scale hotels on the northern coast of the island. These hotels include the Bahia Principe, The Grand Palladium, the Ibero-star and the Palmyra. In 2008 the value of these investments from Spanish-based investors was estimated to be approximately US\$550 million, providing some 5,000 hotel rooms.

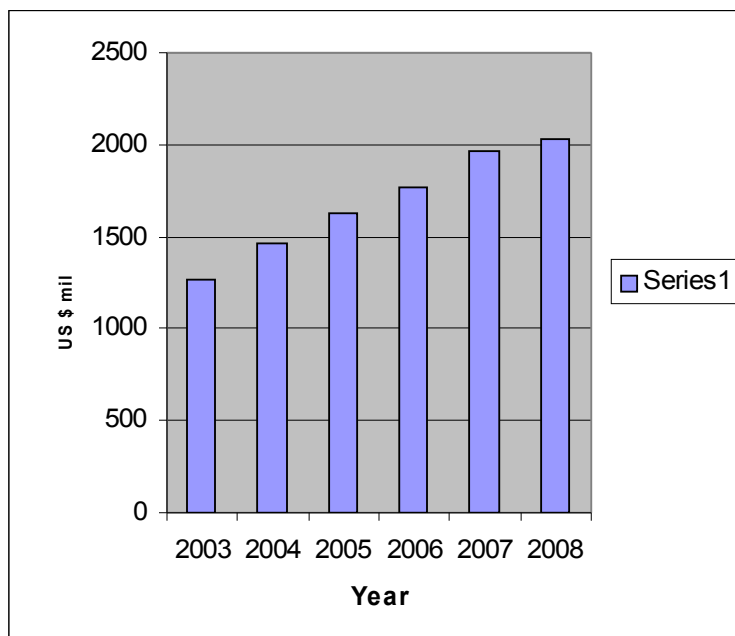
The Hotel Incentive Act, under which many hotels were built, provides varying incentives depending on the size of the investment. For example, a hotel developer constructing 350 new rooms or more is entitled to:

- Duty free importation of capital items required in the construction of the hotel.
- 15-year tax holiday.

Incentives are also offered to developers refurbishing existing properties.

Another significant source of funding is via remittances from Jamaicans living overseas. This comes as a supplement to the income of many Jamaicans who would normally be unable to afford a mortgage or a construction loan. Jamaicans living overseas find it easier to purchase property in Jamaica because of the higher purchasing power of the U.S. dollar vis-à-vis the Jamaican dollar, which at March 2009 exchanged at rate of US\$1 to J\$88.5 and which has been continuously devaluing during the last several years. The monies from remittances are often used to fund new construction or execute repairs to existing buildings and are evident especially in marginal or rural communities often overlooked by local private developers. The value of remittances reached US\$1.97 billion in 2007.

FIGURE 1: Remittance to GDP Ratio



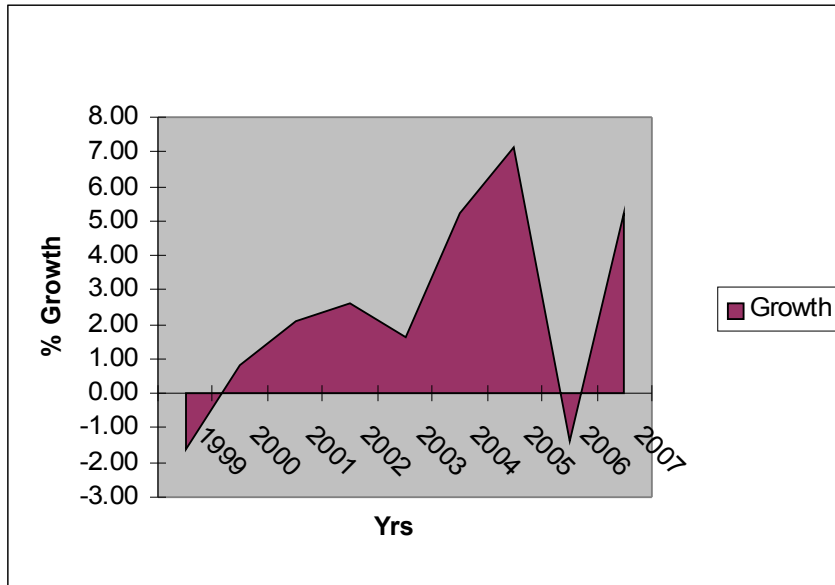
Source: Bank of Jamaica Economic Data

In 1999 the government initiated several large infrastructure projects namely:

- Sector 11A and 111 of the North Coast Highway.
- Venues for the staging of the Cricket World Cup.
- Rehabilitation works as a result of Hurricane Dean.

By 2000 the real gross domestic product for the construction industry began to show some positive growth. This growth was sustained by the commencement of other major projects, such as major telecommunication installations across the island and the commencement of several new hotels and resorts and the rehabilitation of others.

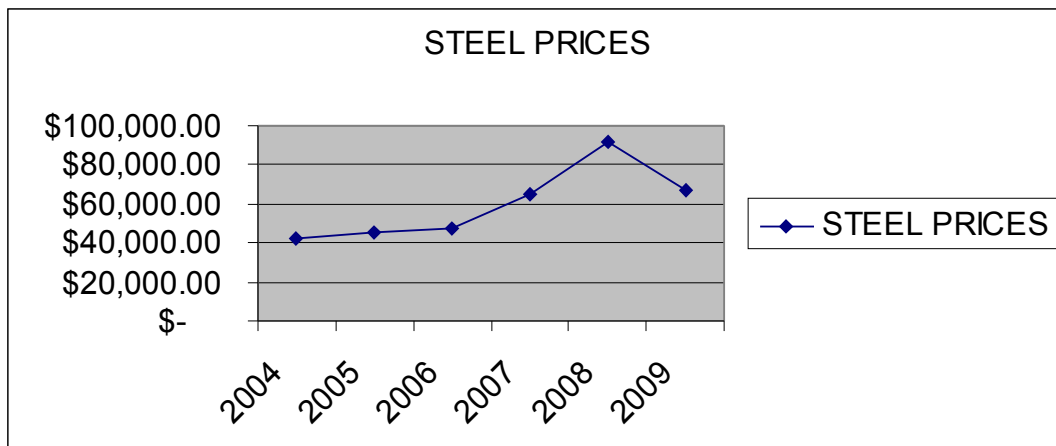
Figure 2: Construction Sector GDP Growth Rates



Source: Statistical Institute Of Jamaica

The growth trend was only interrupted by inclement weather in 2003 and in 2006 and a major problem with quality control at the only local cement plant, which resulted in a literal shutdown of the industry until supplies from overseas became available. Recovery from this downturn was again affected in 2008 by sharp increases in the price of oil, which resulted in an increase in the prices of critical construction materials, transportation and energy. For example, the price of reinforcing mild steel bars rose from approximately J\$64,657 per ton in December 2007 to J\$92,035 by July 2008. The massive escalations resulted in increases in house prices and with it a fall off in sales.

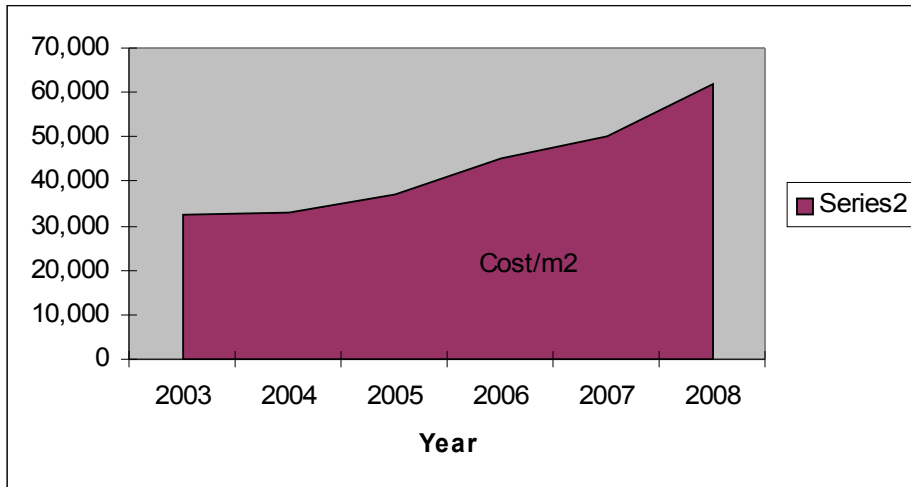
Figure 3: Construction Material Price Increases



Source: Burrowes and Wallace Cost Information

Although since the last quarter of 2008 there have been reductions in the price of oil, devaluations in the Jamaican dollar combined with inflation that has trended upward have ensured that house prices have remained high.

Figure 4: Average House Prices

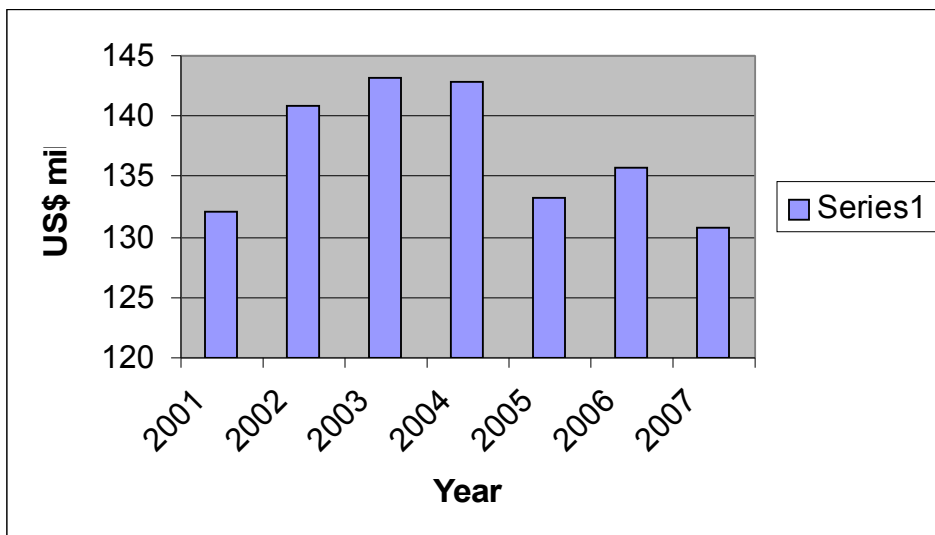


Source: Burrowes and Wallace Cost Information

The recent financial crisis has impacted the Jamaican economy in several critical areas. The credit squeeze resulting from the subprime mortgage meltdown and subsequent bankruptcy of several major financial houses in the United States precipitated an almost immediate reduction in liquidity in the local banking industry, resulting in a drying up of funds available for construction projects. The reduction in demand on the international markets for our major exports also impacted the national income and the government's ability to meet the budgeted expenditures.

Jamaica's high debt-to-GDP ratio effectively restricted the government's ability to accessing external funding from the international capital markets. This, coupled with the fallout in demand for bauxite and alumina (the industry that contributes 60 percent of Jamaica's annual export earnings) further exacerbated the dire economic situation.

Figure 5: Jamaica's Debt to GDP Ratio



Source: Bank of Jamaica Economic Data

The new government that took office in September 2007 turned to accessing funds through the multi-lateral lending agencies such as the Inter-American Development Bank (IDB) and the World Bank at much lower interest rates than the rates on the private capital markets in an attempt to reduce the debt-to-GDP ratio and to generate some economic growth. The funds from these multi-lateral agencies, however, are always earmarked for financing infrastructure in an attempt to encourage private development and cannot be used for funding the budget. For example; a US\$6 billion emergency liquidity fund was created in October 2008 by the IDB to provide support to banks for lending specifically to companies who find themselves experiencing liquidity problems.

Despite this lifeline several major companies continue to struggle to survive, among them are some in critical industries like bauxite extraction and export. In one case the employees at one of the largest bauxite plants opted to take a 40 percent cut in their wages to keep the plant open. Any widespread increase in job losses will definitely result an increased inability of prospective buyers to conclude house sales, leaving some developers with unsold units on their hands. Fearing this, some private developers that had already commenced projects are obviously scaling back or suspending the works in an attempt to mitigate losses. Those who have not commenced with their projects are taking a wait-and-see posture until the economic prospects improve.

The government is continuing with its infrastructure and housing projects and although this will provide some buoyancy to the industry there will definitely be some decline in the rate of growth. As long as critical elements of the economy remain vulnerable to the impact of the global financial crisis, the cost to the country and the full impact on the economy will depend on the duration of the crisis.