THE CONCRETE JUNGLE: PANAMA’S CONSTRUCTION EXPLOSION

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Introduction

Known for nearly a century as just a home to the famous canal, Panama is fast becoming the economic dynamo of Central America. Over the last several years the country has experienced a GDP growth rate of over 6 percent, and in 2006 Panamanian GDP grew at an impressive 8.1 percent. (“President’s Letter, December 2006”) Over the same period of time the unemployment rate has dropped significantly, and as of May 2007 stood at 7.3 percent, the lowest in Central America, while per-capita income was the highest. (“Unemployment in Panama...”) Panama’s current success is attributable to the growth of a few historically vital industries, such as the canal and the Colón Free Trade Zone, but also to a booming real estate market. The construction explosion that is taking place all over the country is a recent phenomenon, having really taken off less than half a decade ago. In the short term, the canal will continue to have the greatest impact on the Panamanian economy, especially in view of the upcoming expansion project. However, in the longer run real estate development has the potential to have a considerable effect on the structure of Panama’s economy and society.

What follows is a socioeconomic analysis of the real estate boom. In the first section of the article I examine why the boom is occurring and continue with a discussion of the major players involved, as well as the main areas of development within Panama. Subsequently, I analyze the benefits of the construction and real estate sectors to the Panamanian economy. Finally, I explore the negative externalities and other risks associated with the booming real estate market, and follow with a discussion of how long the boom can last and how it will shape Panama in the long run.
Why Panama?

A number of factors have contributed to Panama’s becoming a hotspot for real estate development. Increased global interconnectedness has made the concept of retiring abroad more acceptable to the aging populations of the U.S. and of wealthy Western European countries. People are concerned with high real estate costs, high taxes, and a rising cost of living in their native countries and communities, and they are increasingly willing to relocate after they retire. With the anticipated retirement of the “baby boomer” generation, an unprecedented number of people will be looking for affordable and comfortable retirement havens. Panama has quickly become a viable destination for these retirees and has positioned itself to attract a sizeable fraction of the baby boomer exodus.

After witnessing Costa Rica’s success in attracting foreigners through its pensionado program, Panama has implemented a similar strategy to lure expatriates. The features of the Panamanian pensionado program are discussed in detail in Allison Warshaw’s article, entitled “Move Over Florida: Retirement in Panama,” but include significant discounts on almost anything imaginable, including healthcare, utilities, transportation, and even restaurants. (“Retiring and Living…”) Affordable healthcare is of particular importance since people are becoming increasingly skeptical of the U.S. Medicare program’s ability to meet the expectations of aging Americans. Another significant advantage that Panama offers to expatriates is transparency in property ownership rights. Property titles in Panama are standardized, accurately recorded, publicly available, and recognizable by the law. It is possible to get a mortgage of up to 80 percent of the purchase price of the property, and it is also possible to get a loan using property title as collateral. (“Tapping into…”) This practice is common for those living in the U.S., but it is atypical of developing countries, particularly in Latin America.

Panama is making a considerable effort to advertise its retirement opportunities. Its beautiful beaches were featured in the “Survivor Panama” reality TV show (“Survivor Panama”), and the AARP Modern Maturity magazine, with a circulation of over 20 million, has printed several articles on retiring in Panama. (“Retiring and Living…”) Panamanian real estate agencies, with an obvious interest in luring retirees, arrange special tours for potential buyers to introduce them to Panama and Panamanian real estate, and to persuade them to buy on the spot. These tours prove especially successful in attracting U.S. buyers.

Demand for new construction isn’t fueled by retirees alone. Astronomically high land and construction costs in both the United States and Europe have precipitated an outflow of investors eager to find new markets. (Gewaltig) In spite of the recent appreciation of Panamanian real estate, land values are still two to three times lower in Panama than in the United States. Beachfront property, particularly in areas with better developed infrastructure, has doubled and even tripled in price; however, it still sells at just a fraction of what similar property would cost in Ft. Lauderdale and Sarasota, or in European resorts such as Marbella and Palma de Mallorka. Construction costs, averaging $400–600 per square foot in Miami, are but $150–300 in Panama City. (Richardson) As usual, alongside the investors who seek to diversify their property portfolios are the speculators who are financing new construction projects with the intention of “flipping,” or reselling, the properties right away. The presence of speculators creates a certain risk to the real estate market that will be discussed below in more detail.

The final component of real estate demand in Panama is business development. Companies or individuals looking to expand their businesses into Central and South America are increasingly looking to Panama as a base of operations. They are drawn in by the sophisticated banking sector, consisting of over 100 international banks, as well as by the excellent communications infrastructure, including high-speed internet access. In addition, government efforts to encourage investment have resulted in a liberalized financial sector with few capital controls or regulations limiting financial flows. “Everything works,” claims one U.S. real estate investor, “and because it’s a

1During the baby boomer years (1946–1964), 75.8 million Americans were born. By 2011 this generation will begin to reach the age of retirement.
financial center for Latin America, it's easy to establish banking relationships and locate money managers and accountants.” (Markels) The country’s dollarized economy mitigates inflationary pressure and the government, while still battling petty corruption, is one of the most stable in Central and South America. Finally, Panama is outside of the hurricane belt and therefore is better protected from Katrina-like disasters.

Panama is making the most of its advantageous situation. The Tocumen international airport is currently undergoing a $75 million renovation and expansion to accommodate growing air traffic, much of which is coming from South America. (Simon) Panama’s aim in this and other projects is to establish itself as a regional financial, communications, and transportation hub, with domestic industries such as real estate receiving the obvious benefits. With a buoyant real estate market not entirely dependent on U.S. retirees and investors, growth potential is very high.

Chief Areas of Development

Panama City remains the center of real estate development in the country. One need only take a drive down Balboa Avenue and examine the city’s skyline to appreciate the magnitude of the construction explosion. The city boasts over 120 high-rises with about 107 more currently under construction. The majority of the upcoming projects are residential developments, including the $260-million Trump Ocean Club, the 104-story Ice Tower, the Pacific Village, and the E Tower. (“Featured Panama…”) The total value of these projects is over $3 billion, or one-fifth of Panama’s annual GDP. (Lakshmanan)

Recently, all eyes have turned to Casco Viejo, the old quarter of Panama City. Historically the cultural and political center of Panama, it was left to decline while the rest of the city modernized in the 20th century. A government restoration policy has been in place for a number of years, but it is only now coming to fruition. The policy provides for a 30-year property tax exemption, a 10-year income tax exemption for any income made from the sale or rental of property, and exemption from import duties for materials used to complete the renovation. As a sign of commitment, the Panamanian government has recently invested millions of its public funds into the neighborhood for the renovation of the National Theater, the Ministry of Government and Justice, and the La Salle Parochial School. (“Panama Real Estate”) The pace of construction is staggering and is likely to continue as more investors jump on this new opportunity.

While Panama City is a much-cited example of the construction explosion, substantial investment is being made in other regions of the country. The Chiriqui and Bocas del Toro provinces are popular among people seeking a second home, both for the temperate climates in the highlands and the beachfront property on both oceans. Boquete, once a small town in Chiriqui, has been transformed by the influx of expatriates into a thriving community and an ideal retirement location. Another popular destination is El Valle de Anton, less than an hour’s drive north of Panama City. This resort area sports villas and condominiums and is located on the caldera of an extinct volcano. The destination’s unparalleled biodiversity makes it a perfect location for ecotourism as well.2

Economic Impact and Positive Externalities

It is not surprising that the real estate boom is having a significant effect on the Panamanian economy. According to Business Panama, the fastest growing sectors of Panama’s economy in 2004 were mining, which rose by 33.7 percent over the previous year, and construction, which rose by 16 percent over the previous year. The growth rates of these development-driven sectors compare quite favorably with the growth rates of manufacturing and agriculture, increasing by 2.6 percent and 3 percent respectively. (“Growth of Key Sectors”) CAPAC, the Panamanian Construction Chamber, maintains that the construction sector accounted for about 4 percent of GDP in 2005, a slight dip from 4.6 percent in 2004, which was likely due to a construction workers’

2The volcano’s eruption nearly 5 million years ago created the ideal conditions for plant and animal life to flourish.
strike in early 2005 and the near-completion of a number of large projects. Nevertheless, building permit sales in the Panama City metropolitan area rose by over 120 percent in the first nine months of 2005 to about $706 million. (“Building Boom”) CAPAC believes this to be an important measure of private-sector real estate demand.

Perhaps the greatest benefit from the construction boom is an indirect one. Real estate and construction are connected to a number of other industries in Panama, including transportation, services, and communication. The growth in real estate expenditures is expected to create a multiplier effect that causes a concurrent growth in a number of these other sectors. Intuitively this argument is persuasive, as real estate investors need well developed infrastructure around their property as well as utilities such as electricity and running water. Recent data also support this argument, as construction-driven industries all grew at above-average rates, with transportation and communications growing at 11.6 percent in 2004, hotels and restaurants growing at 10.9 percent, and electricity and water supply at 8.8 percent. (“Growth of Key Sectors”) Another beneficiary of the construction boom is the traditionally strong Panamanian banking industry, where mortgage lending grew by 23 percent between 2003 and 2005. (“Building Boom”) Retirees or those who frequently do business in Panama demand all the amenities that they are accustomed to receiving in their home countries. Consequently, the retail and services industries are expanding to provide foreigners with food, clothing, and entertainment. Panama is widely recognized for its excellent communications infrastructure, and this is likely to improve even further and expand into less developed regions of the country as foreigners move in. (“Infrastructure”)

It is important that many retirees or owners of a second home are engaged in activities that benefit their new communities. Many of these people feel a certain responsibility to improve Panama and use their human and financial capital to do so. Expatriates in Boquete and Chiriqui are already injecting funds into the local economy and are organizing civic projects ranging from building orphanages and providing medical services to planting trees and recycling. (“Expats Love…”) The magnitude and effectiveness of these efforts will undoubtedly continue to increase. These indirect effects resulting from the expansion of the real estate industry are referred to as positive externalities, and they will keep the Panamanian economy churning at a pace far beyond that indicated by the construction figures alone.

The real estate boom has also contributed to the marked reduction in unemployment. As of 2003, the construction industry in Panama employed about 45,000 people, as compared to 26,000 in 1994. (“Characteristics of…”) Rising demand for labor has strengthened the hand of the construction workers union, SUNTRACS, in its negotiations with CAPAC over standardization of wages and safety conditions at construction sites. (“RFBC, CAPAC…”) The few strikes that have occurred were resolved rather quickly; it appears that CAPAC will be forced to give in to most of SUNTRACS’ demands to prevent the union from stifling industrial growth. This may mean higher labor costs for construction projects and more financing from investors.

**Economic, Social, and Environmental Risks**

The benefits of a booming real estate market to the Panamanian economy, as well as to investors and retirees, need to be weighed against the potentially large risks to all the parties involved. Despite a fairly well regulated real estate market and a wide network of legitimate real estate agencies, investors still face some risk of losing their investment to swindlers looking to take advantage of foreigners. Furthermore, while property ownership rights are well established, there is still some confusion regarding the titling of land. There are currently a number of lawsuits pending over land that was illegally sold to foreigners by municipal governments or untitled land that was bought under an assumption of full ownership where such rights did not actually exist.

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3For information on how swindlers operate and the types of scams they attempt, the *Panama News* article “Anatomy of a Scam” provides useful information. It can be found at: www.thepanamanews.com/pn/v_10/issue_07/business_02.html.
(Jackson, “Law 132…”) This is rarely a problem in Panama City, but is an issue when looking at coastal areas like Bocas del Toro. To protect investors’ rights, the U.S. embassy provides American investors with the names of lawyers and real estate agents who can guide them through the investment process and ensure that their money goes where it’s supposed to. (“Panama Information”) The Panamanian government is also clarifying and strengthening existing regulations to prevent con-artists from damaging the investment climate and to gradually phase out any remaining problems with property titles. (“Panama Real Estate: Important Information”)

While the real estate market may pose a danger to some investors, investors can likewise pose a very large threat to real estate market stability. Speculators are financing a large portion of new construction, particularly in Panama City, with little intention of holding on to the investment for long. This was the situation in the United States from 2001 to 2005, where a speculative frenzy drove real estate prices to record levels. High prices coupled with rising interest rates pushed buyers out of the market, and in late 2005 the inventory of unsold homes began to rise as prices dropped. (Koenig) Two years after the bursting of this so-called “bubble,” housing prices in the United States continue to fall. Ironically, the decline of the U.S. housing market may have repercussions for real estate in Panama. Due to falling prices in the U.S., the price differential that makes Panamanian real estate such a good investment is becoming smaller. In addition, U.S. retirees often sell their property prior to buying new homes in Panama. If they are unable to sell their homes here, demand for new real estate in Panama will likely go down. (“Panama Real Estate Flipping”)

As was mentioned earlier, one of the reasons why Panama is such an attractive place to invest is its liberalized financial sector. This is a double-edged sword, however, as investment may flow out of the country as quickly as it flows in. There are telling precedents of destructive “herd behavior” by investors. The 1997 East Asian Financial Crisis was precipitated by large capital outflows. Currency and real estate speculation was rampant, and when international investors found more attractive opportunities elsewhere (the U.S. economy was in an expansion, leading the Federal Reserve to raise interest rates), billions of dollars quickly fled from these “Asian Tigers.” (“The East Asian…”) Many analysts note that the herd behavior leading to a capital outflow was also the result of a weak banking sector. (Gochoco-Bautista) A lack of transparency in bank lending and a large number of non-performing loans worried investors, who quickly decided to pull their funds out. There is no doubt that the Panamanian banking sector is fundamentally sounder than those of the Asian Tigers at the time of the crisis, but around 50 percent of Panamanian bank assets still come from international sources. According to the Banking Superintendency, the body that oversees Panama’s international banking sector, most banks are recovering their construction loans in a very short time and consequently don’t feel overexposed. (Superintendencia de Bancos…) However, should the real estate market overheat and slow down, bank lending and liquidity could become serious concerns.

The construction boom is also putting a strain on Panama City’s municipal services. Vielka Tunon, director of planning and budgeting at the Public Works Ministry, had her budget increased by 54 percent from $136.9 million in 2005 to $210.8 million for 2006. “The city is growing so quickly that it’s difficult to meet demands for infrastructure.” (“Building Boom”) Ricardo Riba, a former top official with the National Planning Office, likewise worries about the sustainability of development: “It’s a time bomb — you cannot meet the demand of all these high-rises with the infrastructure that exists. What happens when people start to live there?” (Lakshmanan) In response to growing concern, the government has promised a new bridge and waste-water treatment plant, and has also earmarked substantial funding toward building and repairing roads and improving public transportation. (Lakshmanan)

Outside of the city, construction companies have their hands full with environmentalist groups who are lobbying hard to prevent the government from selling contracts for the development of what is supposed to be protected land. Most recently, the Panamanian National Assembly went ahead with plans to sell a 15.2 hectare lot on Fort Clayton, a former U.S.
military base, “to the horror of environmentalists” who maintain that the land is part of the Camino de Cruces National Park and therefore a protected area. (“For Sale…”) However, an April 2006 report from the Department of Environmental Protection confirms that the land is outside of the Camino de Cruces National Park; unless evidence is presented to the contrary, the sale of this land will likely go through. Much of Clayton’s 843 hectares has already been developed since it was returned to Panama in 1999. (“The Conquest of Clayton…”)

A similar battle is taking place over a law approved at the beginning of 2006 that would allow the government to grant “long-term private concessions for the use of beaches and islands.” (Jackson, “Law 132…”) The aim of this legislation is to override Panama’s constitution, which regards beaches as public property. Environmentalists fear that the construction of large resorts and the subsequent influx of too many tourists will destroy coral reefs and other natural features that make Panama unique. Environmentalists are not the only ones complaining. In July 2006, Eligio Bins, the mayor of Bocas del Toro, expressed his apprehension about increased residential tourism and possible overdevelopment. He fears that without a development plan that minimizes environmental impact and ensures the creation of local jobs, the archipelago will turn into “towns of elites surrounded by misery.” (“Bocas del Toro…”)

Environmental degradation is certainly a serious concern, as business interests often trump environmental ones. However, the environmental lobby has a surprisingly loud voice and considerable clout in the administration of President Torrijos. The government has erected fences around a number of proposed construction sites and halted construction at others. Under the exceptionally corrupt government of former President Mireya Moscoso, businessmen made a habit of bribing government officials from the necessary departments to ensure that their construction projects went along unhindered. (Jackson, “Companies Belonging…”) Now these same businesspeople are locked up in legal disputes over the status of the land. While not all land is escaping development, the Torrijos administration should be applauded for its efforts to curtail further encroachment into protected areas.

The above mentioned economic, environmental, and other risks associated with the rapid pace of development need to be monitored and mitigated. The government must continue to be diligent in its protection of the environment and must invest heavily in infrastructure and utilities to accommodate growth. Furthermore, the banking industry, although well developed, must still be prepared to deal with the vagaries of financial flows. However, it is clear that these risks do not outweigh the palatable benefits of real-estate-induced growth. If Panama is not lacking in foresight and the proper steps are taken, the country can benefit tremendously from the real estate boom.

**Prospects for Continued Growth**

The question on everyone’s minds is how long will this unprecedented rate of development last. At the time of this writing the market looks healthy enough, with a record number of projects under construction in 2006. According to the American Chamber of Commerce and Industry of Panama, there has been a 150 percent increase in planned new projects in each of the last three years. In 2006 alone, Panama received $3 billion in foreign direct investment with about $2 billion of that going into real estate. Estimates indicate that the total dollar amount of projects to be built and delivered by 2012 is $3.2 billion, and the total number of residential units to be built between 2006 and 2012 is 25,000. (“President’s Letter, December 2006”) This building frenzy is so tremendous that many construction companies are starting to reach the limits of their operational capacity. Some contractors are causing delays by moving equipment and resources from one project to another, and in a few instances the Panamanian Ministry of Public Works has had to take legal action to ensure the completion of a project. (“Panamanian Construction…”)

There is certainly no shortage of investment opportunities and it seems, at least in the short run, that there is no shortage of buyers either. As was previously mentioned, Panama is currently the top retirement destination in the
world and offers a variety of benefits to induce retirees. As of December 2006, there were approximately 100,000 foreigners living in Panama, 15–20 percent of them Americans. (“President’s Letter, December 2006”) This number is sure to increase in the coming years, especially with the upcoming retirement of the baby boomer generation. Money is also flowing in from South America. Panama is processing a large number of immigration visas for Colombians and Venezuelans, among others. Turbulent political and economic atmospheres in their home countries are causing many to relocate. (“Dictators May Save…”) Most of these immigrants are well off and instantly contribute to real estate demand. As for investors seeking to make money, Panama looks to remain an investment hotspot for at least another few years. Construction prices are still low while properties continue to appreciate in value, and the country’s beautiful real estate is getting more attention than it ever has.

With the expansion of the Panama Canal and continued negotiations between the Panamanian Construction Chamber and the SUNTRACS union, the cost of construction materials and labor is likely to go up. As construction costs go up, there is the possibility of a slowdown in demand for new projects. However, this may not be a bad thing. Increased speculative activity and strained resources due to overbuilding are some signs of an overheating market. Perhaps Panama would benefit from a slight slowdown in real estate activity, rather than possibly have the rug pulled from under it like real estate in the United States. However, even if such a slowdown does occur, Panamanian real estate development is likely to continue to be a significant engine of growth for the country.
REFERENCES


