**Opportunities and Challenges of Investing in Emerging Markets:
A Case Study of Panama**

by

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Submitted to the Department of Urban Studies and Planning in Partial Fulfillment of the Requirements for the Degree of Master of Science In Real Estate Development

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ABSTRACT:

Many Real Estate investment firms are looking to the world's emerging economies in their real estate investment strategies to seek optimal returns in opaque or inefficient markets. Although these investments carry increased political, regulatory and currency risk, cross-border real estate investment has been on the rise. This thesis will broadly explore the nature of investment in emerging markets and survey risks associated with deploying capital in these markets, from the perspective of a foreign investor

In order to assess explicit real estate opportunities and address the issues relevant to investors pursuing them, the scope of research was narrowed to focus on one Latin American country that has compelling opportunity for real estate investment: Panama. In recent years, this emerging market has seen extraordinary growth and expansion of its real estate sector, driven by domestic and international consumption related to trade, tourism, and the upcoming expansion of the Panama Canal. This paper will explore the real estate markets driven by these trends, analyze the specific risks associated with investment in these markets, and offer practical considerations for how the real estate "game" is played in Panama.

Thesis Advisor: Brian Anthony Ciochetti
Title: Professor of the Practice of Real Estate Development

TABLE OF CONTENTS

TABLE OF FIGURES

Chapter 1: Introduction

Many Real Estate investment firms are looking to the world's emerging economies in their real estate investment strategies to seek optimal returns in opaque or inefficient markets. Although these investments carry increased political, regulatory and currency risk, cross-border real estate investment has been on the rise. The purpose of this thesis is to broadly explore the nature of investment in emerging markets and to survey risks associated with deploying capital in these markets, from the perspective of a foreign investor.

In order to assess explicit real estate opportunities and address the issues relevant to investors pursuing them, the scope of research was narrowed to focus on one Latin American country that has compelling opportunity for real estate investment: Panama. As a relatively small market, Panama has not historically attracted a large amount of institutional real estate investment and is still considered to be relatively non-transparent to a foreign investor. At the same time, the country is experiencing tremendous growth, both in its economy and in the real estate sector. In 2006, Panama had the highest GDP growth in Latin America, and a historic referendum to expand the Panama Canal ensure that the country's economic expansion - and subsequent investment opportunities – will continue in the long term.

This thesis will begin by broadly examining investment in emerging markets, followed by a political and economic overview of Panama. The subsequent two chapters analyze the market and demand drivers of two real estate sectors that present a compelling opportunity for foreign investment, while the final chapter looks at real estate investment in Panama from an investment and risk management realm.

The research methodology for this thesis is predominantly qualitative. The research material is derived from industry-related books, journals, and articles, as well as data gathered from interviews with industry participants.

Chapter 2: Overview of Investment in Emerging Markets

2.1 What is an Emerging Market?

The term Emerging Market, coined by a World Bank economist in the 1980s, refers to the market activity in countries that are considered to be in a transitional phase between developing and developed status. Emerging markets are countries that are working to restructure their economies to interface with market-oriented globalization, providing opportunities in trade, technology transfers, and foreign direct investment via open door policies. These countries typically have a large population and resource base, and are abandoning traditional state interventionist policies to seek sustainable economic growth. Emerging Markets are the globe's fastest growing economies and play a part in contributing to the world's explosive trade growth; in time they are projected to become more significant buyers of goods and services than their industrial counterparts.

Although there is not a standard list of emerging markets, the most commonly tracked investment information sources in this arena are the Morgan Stanley Capital International (MSCI) Index, the Economist, and ISI Emerging Markets. The MSCI Index includes the following 25 emerging market country indices: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey. Additionally, other smaller markets including Estonia, Latvia, Lithuania, Romania, Slovakia, Costa Rica, Panama, Uruguay, Venezuela, Kazakhstan, Vietnam, and Nigeria are also considered to be emerging markets.

What defines an Emerging Market from a developing, or what many consider to be a "third world" nation? The distinction deals primarily with the nations' ability to have sustainable, market-oriented growth; foreign "investment" replaces foreign "assistance." Governments of developing countries rely heavily on borrowing from institutions like the IMF and World Bank, resulting in a debt overload and severe economic imbalance. When traditional government borrowing fails to fuel the development process, countries seek equity investment from private investors as a means of financing economic growth. In order to attract this foreign investment, the foundations of a market economy must be established to create a business climate that satisfies the expectations of foreign investors. India, a country that maintained strict government control over foreign trade and investment until 1991, provides an example of a country that has opened its markets to foreign capital and trade, and consequently experienced tremendous growth as an emerging world economy.

Further along the development process, many emerging markets have evolved to be considered "developed" or "first world" nations. According to the MSCI Country index, the change in the classification from an emerging to a developed market index is based on the country's relatively high level of economic and equity market development. Greece is an example of a nation that was recently upgraded to a "developed" status. Greece exceeds the GNP per capita threshold used by the World Bank to characterize high-income countries, and moreover, has enacted sound economic, fiscal and monetary polices to qualify for admission to the European Economic and Monetary Union (EMU). This has created a solid basis for increased economic and financial stability, including reduced currency risk and a lower cost of capital.

2.2 Emerging Markets in Real Estate

According to Jones Lang LaSalle (JLL), in 2006 cross border transactions represented 42% of total real estate investment volume, an 8% increase from the previous year. This clearly signifies the rapid globalization of real estate as an asset class much of which can be attributed to the growth in the emerging markets economies. As a result of rapid GDP growth, the emerging markets are expected to experience a disproportionate expansion in the real estate sector to accommodate a growing industrialized workforce and the increasing demand for larger quantity of assets. In 2006 alone, Russia's real estate market expanded 700%, and JLL reports strong deal flow in China, Turkey, Mexico and Brazil.[1] This section will examine what factors have contributed to the growth in this investment sector.

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[1] "Moving Further and Faster," *Jones Lang LaSalle Global Real Estate Capital Report* March 2007

Accessibility

The enormous real estate investment opportunity outside the US is not a new phenomenon, as US investors have long had a presence in Western Europe and Japan. What has changed is the increasing accessibility to emerging markets throughout the world. As the emerging economies are rapidly industrializing, they are developing strong service sectors and infrastructure necessary to facilitate international investment. Currently, emerging markets account for over half of world's output; by 2050, they will account for almost 78%. The enormous growth in these markets has not only fueled the development of infrastructure needed for investment, but also created investment vehicles that did not exist in the past to allow investment in these markets more freely. For example, as recently as the late 1990s, foreign investors could not invest directly in South Korea. A change in the legal structure has increased significant foreign capital inflows into the market. [2]

Perception

The Perceived Risk of a country has a strong effect on investor sentiment for that market. Investing in the emerging markets is no longer associated with the traditional notion of providing development assistance to poorer nations. As emerging markets increasingly sign trade agreements to enter the global economy, capital flows are directed more toward new market opportunities, and less by political consideration, reflecting the transition from dependency to global interdependency. In addition to the evolution of investment vehicles and markets, an evolution of investor attitudes is also shaping the real estate investment landscape, putting emerging markets on the radar of many opportunistic investors.

Globalization of Real estate Providers

Most of the world's "Global" real estate brands, including Hines, Jones Lang LaSalle, CBRE, and Tishman Speyer, in addition to the banks and funds who are financing them, have set up shop in many of the emerging markets. With an increase in cross-border

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[2] Conner, Philip; Liang, Youguo. "Ask Not Why International, Ask Why Not International," *Journal of Real Estate Portfolio Management*; May-Aug 2006; pg. 187

development and investment, and mergers of commercial real estate brokers, data reporting and other processes has become more standardized, making investment more plausible for may foreign firms.

Technological Advances and Increased Market Transparency

The global information exchange is integrating emerging markets into the global market at a faster pace, most notably through the aid of the Internet. This has a number of implications on investment from a real estate perspective. As research and brokerage firms have expanded their horizons, information on practically any market can be available within minutes. Advances in space imagery from satellites and aerial photography will provide additional research analysis tools. This has resulted in improving transparency across the globe. According to JLL's 2006 global transparency index, there have been steady improvements in transparency each year, with an increased pace of improvement over the last two years (2005 & 2006)[3] Generally speaking, the greater a country's transparency, the easier it is to do business in the real estate sector, therefore resulting in increased real estate capital flows.

Trade and globalization

The establishment of global trading blocs in North America, Europe, Pacific Rim, Asia, and the Regional Trade Agreement in Eastern and South Africa are having a significant impact on the development of emerging countries. Trade agreements not only open up emerging economies to global capital movements, but increasingly also set standards for labor, environmental, and fiscal policies. This contributes to the standardization of investment criteria and creates a more open market for real estate investment.

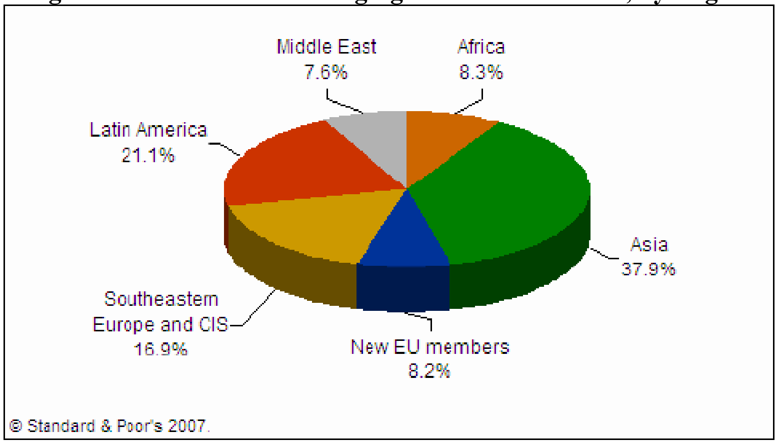
2.3 Emerging Market Investment in Latin America

The Latin America economies continue to expand and benefit from external capital flows, mainly through exports and Foreign Direct Investment (FDI). However, the growth of the Asian economies has caused the region to attract a smaller proportion of emerging

[3] "2006 Real Estate Transparency Index," *Jones Lang LaSalle Research*, 2006

market investment than it had in the past.[4] Currently, Latin America accounts for approximately 21% of all FDI invested in emerging market economies.

Figure 1: FDI Flows to Emerging Market Economies, by Region



Although the region's economies may not be growing as fast as those in China or India, Latin America presents real opportunities, and according to *The McKinsey Quarterly,* political risks in the region are often exaggerated. [5] Latin America's major economies have emerged from 2006 elections with governments committed to macroeconomic stability. For the most part, the region has seen sound economic growth and lower volatility in the past few years, as depicted in the chart below.

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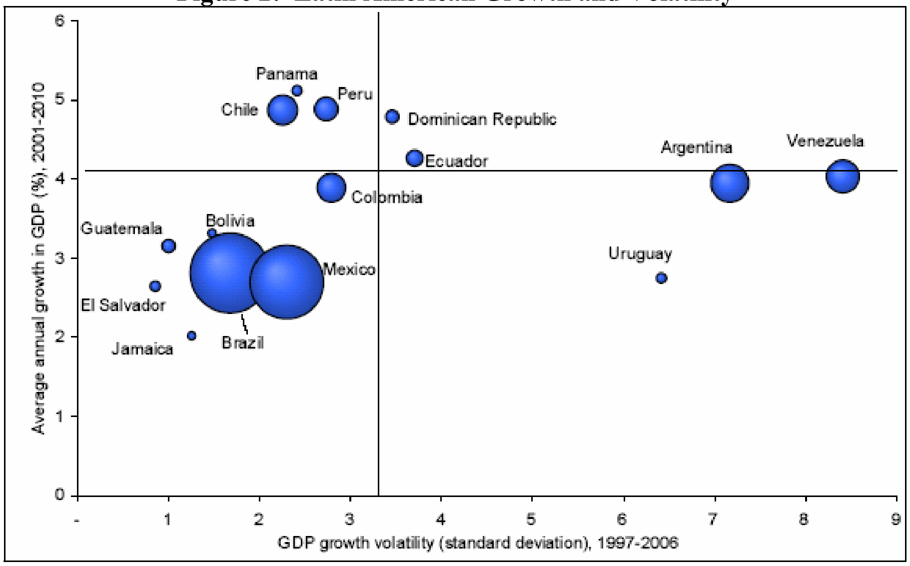
[4] "Foreign Investment in Latin America and the Caribbean, 2006," UN Economic Commission for Latin America and Caribbean, 2006.
[5] Elstrodt, Heinz-Peter. "What Executives Are Asking About Latin America," *The McKinsey Quarterly*. 2007

Figure 2: Latin American Growth and Volatility



The growth of cross-border real estate capital, in addition to the region's growth and relative stability are spurring real estate development throughout Latin America. While Mexico and Brazil are the leaders in this market, there are compelling opportunities that expand through most of Central and South America and into the Caribbean. New opportunities for real estate development continue to support key growth sectors, including trade, commodities, and tourism.

Despite its relatively small size, Panama is the fastest growing economy in Latin American, boasting 8% GDP growth last year with low volatility. The stable growth of this economy has resulted in an extraordinary expansion of its real estate sector, driven by domestic and international consumption related to trade, tourism, and the upcoming expansion of the Panama Canal. This paper will explore two real estate markets that are driven by these trends, namely, the industrial and residential tourism sectors. Although Panama currently has a small industrial real estate market, macro developments in this sector related to trade and logistics operations could present a compelling opportunity in this area. Accordingly, international demographics and trends driving more foreigners into Panama have fueled its Residential Tourism, or second home, sector. Each of these markets will be explored to determine if current supply and future demand will present a compelling investment opportunity for foreign real estate capital.

Chapter 3: Political and Economic Overview of Panama

3.1: Country Overview

The Republic of Panama occupies 78,200 square kilometers on the isthmus forming the land bridge between North and South America. The country's unique location between the 2 continents and as a passageway between the East and West has shaped both the political and economic situation throughout its history. Geographically, Panama is mainly mountainous, with lowlands along the Pacific and Atlantic coasts where the majority of the country's population of 3.4 Million residents reside.

Figure 3: Political Map of Panama

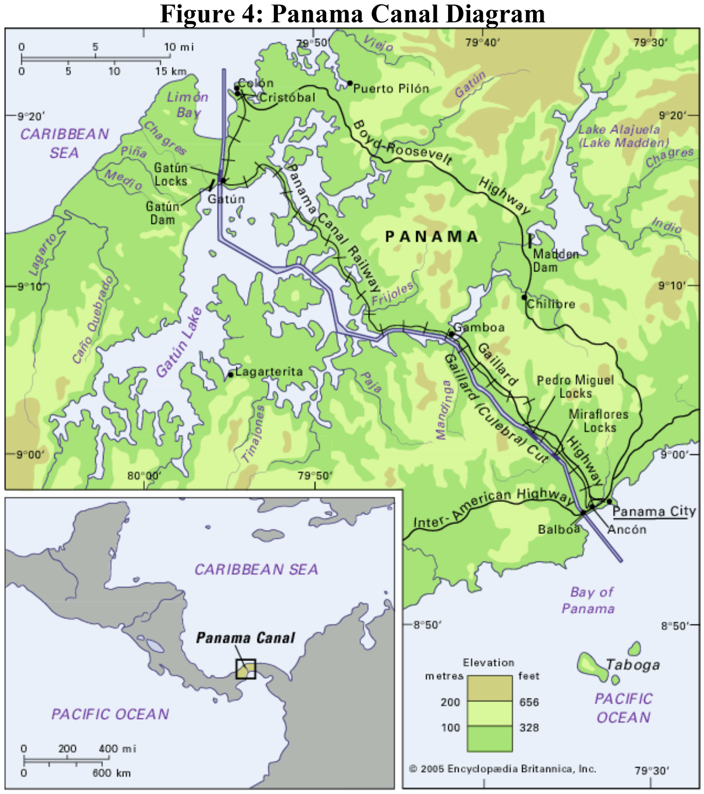
The Panamanian economy has been one of the most stable in Latin America, with a strong US and international presence due largely in part to the construction of Panama Canal in the early 1900s. Panama's Currency, the Balboa, has been pegged to the US dollar since the country's independence from Columbia in 1903, allowing the economy to avoid the currency fluctuations that have plagued other Central and South American Nations. The presence of the canal and the dollarized economy have endorsed Panama as an international trade and financial center.

Serving both as the political, cultural, and financial capital, Panama City benefits from its proximity to the Canal on the Pacific side, and is home to approximately 1.1 Million people. Although much smaller, a second city of strategic importance is Colon, located at the other end of the Canal on the Caribbean coast. Colon is home to the Colon Free Trade Zone, the largest free trade zone in the Western Hemisphere, a powerful engine in Panama's economy. Panama has the largest rainforest in the Western Hemisphere outside the Amazon Basin and is home to many unique tropical birds, plants, and animals, many of which are unique only to the isthmus.

3.2 History and the Canal

Modern Panamanian history has been shaped by the development of the canal, an idea envisioned by the Spaniards since colonizing the isthmus in 1538. In the 1800s, Panama gained independence from Spain but became part of Columbia, while the French were the first to unsuccessfully attempt the construction of the canal. Panama finally gained sovereignty in 1903 when declaring its independence from Columbia, with support from the US. In exchange, the US and Panama promptly signed a treaty granting rights to the US "as if it were sovereign" in a zone roughly 10 miles wide and 50 miles long, now known as the Panama Canal Zone. In that zone, the US would build, administer, fortify, and defend the Panama Canal in perpetuity.

Figure 4: Panama Canal Diagram



The Panama Canal was built by the US Army Corps of Engineers between 1904 and 1914, and is still considered to be one of the world's greatest feats of Engineering. In 1977, US president Carter and military leader Omar Torrijos signed an agreement which allowed for the full transfer and control of the Canal Zone to Panama by the end of the century, with the stipulation that the US could intervene to defend the neutrality of the Canal. In 1999, there was a smooth handover of authority, and today the Canal is governed an autonomous government agency, the Panama Canal Authority. Today, the canal transports 4% of world trade and 16% of US born trade; the US East Coast – Asia route is its principle trade route that accounts for almost half of canal transit. The charts below depict the Canal's principal trade routes and primary users by country.

Figure 5: Panama Canal Routes and Users

Top 5 Principal Trade Routes
1 U.S. East Coast - Asia
2 Europe - West Coast South America
3 U.S. East Coast - West Coast South America
4 U.S. East Coast - US West Coast
5 U.S. East Coast - West Coast of Central America

2006 Top 5 Origin and Destination of Cargo		
	Country	**Cargo** (measured in Long Tons)
1	United States	149,803,629
2	China	44,987,177
3	Japan	33,399,568
4	Chile	18,768,286
5	South Korea	18,323,085

3.3 Political Overview

Although Panama was governed as a constitutional democracy, it was dominated by a commercially oriented oligarchy until 1968, when the Panamanian military began to challenge power. In October 1968, the National Guard ousted the elected president, beginning a 20 year reign led by military regimes including Omar Torrijos (1968 – 1981) and Manuel Noriega (1981 – 1989). Although these regimes were harsh and marked with corruption, their populist social and economic reforms appealed to the rural and urban constituencies that were largely ignored by the oligarchy. In the late 1980s, Noriega was indicted with drug trafficking charges, and the US utilized the neutrality treaty to invade Panama and end the military leadership regime. Since Noriega's extradition from the country, Panama has moved to quickly rebuild their constitutional government and has made notable political and economic progress with four successful civilian governments.

Political Structure

Panama's government is a constitutional democracy consisting of elected executive and legislative branches, and an independent judicial system. The current president Martin Torrijos is son Omar Torrijos, the defacto military leader of Panama from 1968 – 1981, who's legacy includes the transfer of the Canal from the US to Panama in the Torrijos – Carter Treaties of 1977. Leader of the Partido Revolucionario Democratico (PRD), the younger Torrijos is a popular and charismatic leader who comfortably won the May 2004 election and began his five year term in September of that year. The PRD, which has a stated goal to achieve a social market economy, enjoys a firm majority in the Legislative Assembly which has smoothed the way for a number of agenda referendums. Public support for Torrijos is strong, further bolstered by weak political opposition and the recent "yes" vote in the referendum to expand the Panama Canal, the centerpiece of the PRD's agenda. Additionally, the administration pushed through an unpopular reform of social security and signed the much anticipated Free trade agreement (FTA) with the US. Other priorities of this administration include tackling corruption, accelerating export-led growth, increasing foreign investment, tackling unemployment and supporting the development of tourism.

Panama has nine provinces which are administered by governors appointed by the president. Within each province, a local government is organized into a smaller district, governed by mayors and councilors; in total Panama has 65 districts and 505 subdistricts. In the cities, mayors wield significant power, but in rural areas their influence is limited. Most government work and necessary permit approvals for typically happen at the federal level in Panama City.

Panama faces the challenge of shaking its reputation as a politically corrupt drug haven – a stigma that has especially plagued it since the Noriega era. Martin Torrijos won the 2004 election on a platform of "zero tolerance" for corruption, a problem rife in his own father's reign and endemic in recent administrations. Since taking office, the president has passed a number of laws making the government more transparent, including the creation of a National Anti-Corruption Council consisting of government, labor, religious, and civil leadership. With the canal referendum and FTA successfully passed, the government is expected to focus on the rest of its 2007 – 2008 agenda including anti-corruption measures, judicial and penal reforms, and rebuilding public confidence in state institutions damaged by scandals in recent years.

Despite its plagued past, Panama today is politically stable, with a popular president and increasing corruption reforms in place. According to the Latin American Monitor, Panama's political risk ratings are in very high standing, benefiting from an entrenched constitutional democracy and one of the safest crime situations in Central America.[6] The Torrijos administration has clearly been effective in instituting social reforms and passing major economic initiatives.

International Relations

For historical and economic reasons, Panama's most important and strategic international partner is the United States. Currently the two countries extensively collaborate on three main issues: counter-narcotics efforts, security of the Canal and the Columbian border, and negotiations on a bi-lateral Free Trade Agreement (FTA). The recent signing of the FTA will solidify relations between the two countries, increasing both foreign investment and trade volume. President Torrijos has made a number of official visits to the White House during his term, most recently in February 2007 when both presidents reinforced their commitment to reaching an agreement for the FTA.

Panama also has FTAs in place with its neighbors El Salvador and Honduras, and is seeking to execute agreements with the remaining three Central American countries in order to be included in negotiations towards a proposed regional trade agreement with the EU. Beyond the region, Panama recently signed an FTA with Singapore, who has been increasing ties with Panama through bilateral co-operation in ports and the maritime industry. [7]

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[6] "Ratings Update: Panama," *Latin American Monitor.* May 2007
[7] "Country View: Panama," *Economist Intelligence Unit,* June 15, 2007.

In November 2006, Panama was elected to hold a two-year rotating Latin America seat on the U.N. Security Council, unanimously winning the nomination from the member of the voting council. Panama's ascendancy to the 15-member National Security Council of the United Nations acknowledges not only its growing economic and political importance in Western Hemisphere and world affairs.

3.4 Economic Overview

Panama is experiencing an extraordinary economic boom, boasting the fastest growing economy in Latin America with impressive GDP growth of 8.1% in 2006. Despite economists' estimates that the growth would slow, the economy expanded 9.4% in the first trimester of the 2007, the highest GDP growth the country has seen in more than two decades.

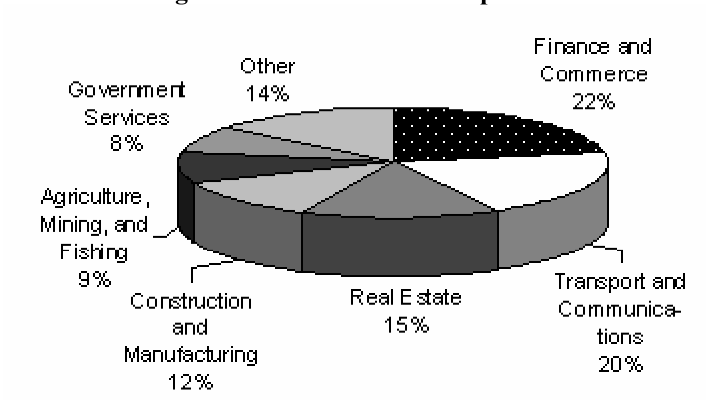
Figure 6: Panama Selected Economic Indicators, 2000 - 2008 F

	2000	2001	2002	2003	2004	2005	2006E	2007F	2008F
Population, national accounts and unemployment									
Population (mn)	2.9	3.0	3.0	3.1	3.2	3.2	3.3	3.3	3.3
Nominal GDP ($bn)	11.6	11.8	12.3	12.9	14.2	15.5	17.1	18.7	20.1
GDP per capita ($)	4,007	3,936	4,091	4,172	4,431	4,839	5,184	5,652	6,096
Real GDP growth (%)	2.7	0.6	2.2	4.2	7.6	6.9	8.1	6.9	7.1
Growth in real private consumption (%)	2.0	3.1	6.9	8.7	10.8	2.8	7.5	7.0	6.0
Growth in real fixed investment (%)	na	-25.7	-5.6	23.3	9.4	6.4	16.6	17.0	18.0
Fixed investment (% of GDP)	21.2	15.2	13.6	17.1	16.6	16.8	18.1	19.8	21.8
Unemployment (% of labor force, end-year)	13.5	14.7	14.1	13.1	12.3	9.6	8.5	8.0	7.0
Prices, interest rates and exchange rates									
CPI inflation (%, December over December)	0.7	0.0	1.8	1.7	1.5	3.5	2.2	2.0	0.7
CPI inflation (% change in average index for the year)	1.4	0.3	1.0	1.4	0.5	2.9	2.5	1.8	1.4
RER (% change, December over December)(1)	na	na	na	na	-2.1	0.0	0.3	0.0	2.3
One-year commercial lending rate (%, end-year)	10.9	10.4	8.7	9.3	8.4	8.0	8.1	8.5	10.5

Source: Credit Suisse

Panama's dollarized economy is dominated primarily by a well-developed services sector that comprises close to 80% of the Indice Mensual de Actividad Economica (IMAE), a rough proxy for GDP. Services include operating the Panama Canal, banking, the Zona Libre de Colon (Colon Free Zone, or CFZ), insurance, container ports, flagship registry, and tourism. Unlike its Central American neighbors, Panama's agriculture and fishing sector, as well as its industrial production sector are relatively insignificant. The chart below depicts Panama's components of GDP:

Figure 7: Panama GDP Components



Much of Panama's GDP growth is due to the expansion of some of its largest sectors. In 2006, the construction sector grew 17%, and growth in the transport, storage and communications sector has also been very dynamic. Exceptionally favorable external conditions are underpinning the strong performance of Panama's economy, with vigorous world trade growth benefiting the country's ports and Canal activity, and boosting trade in the Colon Free Zone. China's economic boom and export manufacturing base have pushed the country to emerge as the 2nd largest user of the Canal behind the US, and robust growth projections there will directly benefit Panama. Additionally, windfalls enjoyed by oil producers in the region are underpinning demand for CFZ exports in those countries. [8]

Role of Foreign Direct Investment

Panama encourages Foreign Direct Investment (FDI) and has seen a surge in activity since 2003. New foreign direct investment more than doubled in 2006 compared with the previous year, accounting for 16% of GDP—a share that is twice as big as that of any other country in the region. [9] Much of the growth in 2006 is linked to the acquisition of Panama's largest bank, Banistmo, by HSBC; however significant amounts of foreign capital flowed into infrastructure, property, and tourism. The widening of the Panama Canal is projected to have a significant impact on FDI in the coming years.

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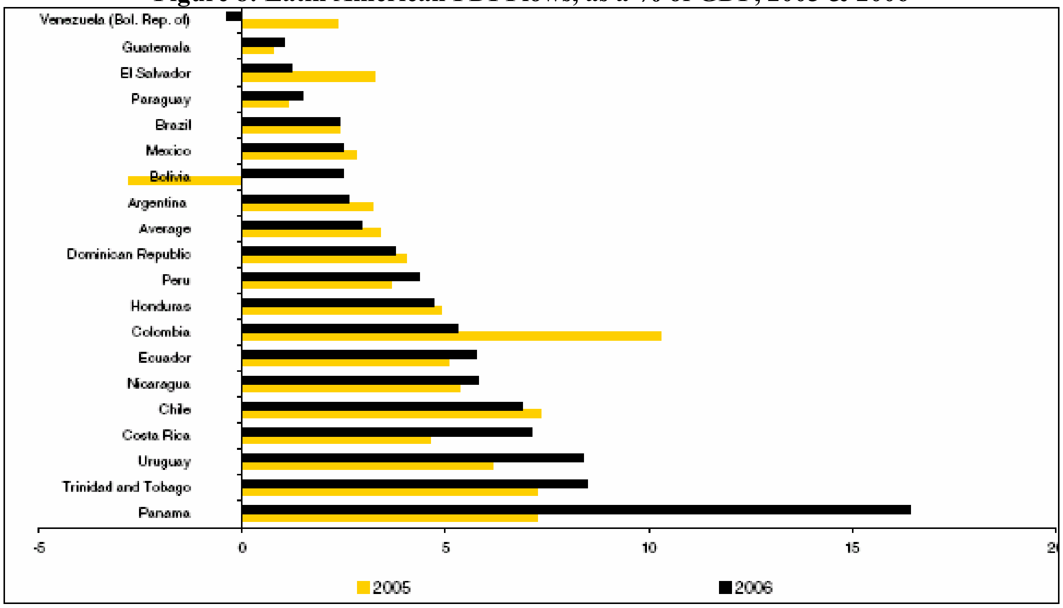
[8] "Country View: Panama," *Economist Intelligence Unit,* June 15, 2007.
[9] "Foreign Investment in Latin America and the Caribbean," *UN Economic Commission for Latin America and the Caribbean,* 2006.

Figure 8: Latin American FDI Flows, as a % of GDP, 2005 & 2006



Source: ECLAC

Inflation

Panama has a historically low inflation rate, averaging 1.1% over the past two decades. Given the absence of a central bank, Panama has created a completely market-driven money supply: the country must buy or obtain their US dollars by producing or exporting real goods or services. At the end of the Q1 2007, inflation stood at 2.7%, a factor of high oil prices and their effect on the price of good and services that make up the consumer price index. Inflation is expected to slow to 1.8% by the end of the year. [10]

Unemployment and Wealth Disparity

Although Panama claims the second highest per capita income in the region, unemployment and income distribution in Panama are among the worst in Latin America. A handful of families continue to control much of the country's growing wealth, and there has been recent concern that if the benefits of growth aren't better distributed, the resulting injustice could fuel an upheaval. The growth of employment therefore remains a priority for the Torrijos administration. Encouragingly, unemployment has decreased

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[10] "Country View: Panama," *Economist Intelligence Unit,* June 15, 2007.

significantly from its peak in 2001 of 14.7%. Economic growth has continued to generate jobs, and economists project that the unemployment rate will fall as low as 8% by the years end. [11]

3.5 Future Economic Expansion

Overall, Panama is enjoying strong economic growth fueled by foreign direct investment, global trade, and growth in tourism. However, the expansion of the canal and the signing of an FTA with the US are expected to trigger a structural shift of the economy that, if well administered, could catapult Panama onto a sustainable higher growth path in the long term.

Panama Canal Expansion

In April of 2006, President Martin Torrijos announced the heavily anticipated canal expansion plan which was overwhelmingly approved by Panamanian citizens in a national referendum six months later. Currently, The Panama canal functions as a set of locks – Gatun, Pedro Miguel, and Miraflores – each of which serve as lifts to elevate vessels 85 feet above sea levels from the Atlantic or Pacific oceans to Gatun Lake. The "megaproject," estimated to cost between $5 and $10 Billion, will effectively double the canal's capacity by creating a third set of locks alongside the existing ones. The economic benefits of the canal expansion are projected to be significant for Panama in both the long and short term. An increase in construction activity and as many as 50,000 jobs will be directly and indirectly created by the project, in addition to the increase in toll revenues and increased traffic to effect the Free Trade Zone and surrounding areas. The authority expects to raise existing tolls and tap debt markets for most of the project's financing. According to a 2006 report by Credit Suisse, the project has the potential to be the most important credit event in Panama in the upcoming decades.

US – Panama Trade Agreement

After four years of trade negotiations, the U.S. and Panama recently signed a highly

[11] Central America Insight, *HSBC Global Research*, Q2 2007

anticipated bilateral free-trade agreement that will eliminate tariffs on almost 90% of U.S. consumer and industrial exports to Panama. Total bilateral trade between the two countries totaled $3.1 billion in 2006, according to the USTR. Panama already has "broad duty free-access" to the U.S. because of several programs such as the Caribbean Basin Initiative (CBI) and the Generalized System of Preferences for developing countries. However, only a quarter of U.S. industrial exports and 34% of agricultural exports entered Panama duty-free in 2006; all other exports to Panama paid a 7 percent tariff on average. By eliminating tariffs immediately on most goods, the agreement will further stimulate trade and provide a level playing field for US companies in Panama. The pact also guarantees US construction firms at least 10 percent of the contracts in the $5.25 billion canal expansion.

In anticipation of the canal expansion, other big projects have recently been announced that will increase foreign investment in Panama. Occidental Petroleum, in partnership with Qatar Petroleum, plans to develop an oil refinery that will inject $7 billion into the economy. A consortium of port operators have plans to turn Balboa, on the Pacific Coast, into the largest port in Latin America, while bids are being accepted for the construction of a second mega-port, on the Caribbean coast.

The overall economic outlook is strong for Panama. The Canal’s contribution to the economy (roughly 10% of GDP), indicate that the $6 Billion project will strongly contribute to growth between now and the project’s completion in 2014. Furthermore, strong global trade will ensure a steady flow of cargo traffic, and private investment into the financial sector, construction, and Canal-related activities will make an increasingly important contribution to growth in the next 5 years. This economic outlook, coupled with low levels of inflation, a dollarized economy, declining unemployment, and a stable political platform provide strong fundamentals for foreign investment in the market.

Chapter 4: Panama's Industrial Real Estate Market

Unlike other emerging markets that rely on a strong manufacturing and industrial base to fuel GDP, Panama is not an industrial country. This is due to a heavy reliance on the services-based economy, which comprises close to 80% of GDP. Additionally, Panama has a smaller population and higher per capita wages than other Latin American markets, which has prevented companies from setting up a manufacturing base there. The industrial areas therefore are limited, mainly focused on the small agriculture sector, and do not meet the typical building standards that are common in other emerging markets. Despite the lack of traditional manufacturing demand, however, Panama has unique advantages that are driving a growing logistics-based industrial market to capitalize on the demands driven by global trade. Trade is an increasingly important part of this economy, with exports of goods and services composing 29% of GDP.[12] Panama has placed a strong emphasis on increasing exports, or re-exports, as a driver of economic growth, pointing to the expanding Colon Free Zone, the new Panama Pacific Special Economic Area, and to a lesser extent, the small export, processing zones as opportunities to execute this vision. The recent signing of the US-Panama Free Trade agreement, as well as the expansion of the Panama Canal, solidifies the country's position as a global shipping and export hub, highlighting its potential for logistics development. This chapter will explore the existing industrial market and to derive the drivers that will extrapolate growth for future industrial real estate development in Panama.

4.1 Existing Industrial Market

Notwithstanding the small agricultural market, existing industrial product in Panama is characterized by users that typically import goods, repackage them, and export them for sale. In this sense, Panama (mainly in the Colon-Free Zone), serves as a major distribution center for trade from Asia to the US and the Latin America. There is an increasingly strong market demand for this type of tail end manufacturing and packaging that utilizes Panama's location and proximity to large ports. A typical example of this

[12] Hornback, J.F. "The Proposed U.S.-Panama Free Trade Agreement," Congressional Research Service, August 23, 2004.

would involve a large container shipment of manufactured goods imported from China (i.e. textiles, dog food, electronics) that would be packaged, labeled, and sorted in Panama, and re-exported, destined for east coast ports in North and South America. Panama law recognizes this demand for value-add import/export opportunities and provides tax benefits that give companies 2 main incentives to base their logistics operations in Panama: operate in the Colon-Free Zone, or set up a company in an Export Processing Zones (zona processsadoras). Additionally, a third emerging area for industrial development is the former Howard Air Force Base on the Pacific Coast near Panama City, which has been recently been designated a Special Economic Area to further incentivize light industrial and logistics development.

This industrial real estate model in Panama can be characterized as follows:

- Development is executed by owner-occupied developers and users of the space
- Historically, individual end-user companies will purchase land outright, hire a design/construction firm to build, and self fund development
- There is a limited leasing market in Panama, although a small sub-leasing market has emerged in the past few years for industrial space. Given demand for product, space is typically only leased to multi-national companies with excellent credit who are willing to sign long-term leases
- Speculative building of industrial property is almost non-existent

Although the market is mainly dominated by local firms, the high demand for logistics services has produced an increased interest of foreign companies looking to enter the market. Industry participants note that there is a great need for US-style large scale industrial development and investment to add needed expertise to the logistics market.

Colon Free Trade Zone - overview

Panama's Colon Free Trade Zone (CFZ) serves as the largest free trade zone in the Western Hemisphere and second largest in the world after Hong Kong. Although most free trade zones are typically defined as labor intensive manufacturing centers that involve the import of raw materials and the export of manufactured products such as clothing or shoes, the Colon-Free zone is mainly dedicated to re-export of already manufactured goods. Quite simply, the free trade zone is a segregated, walled area in Colon where most companies establish for the purposes of importing, storing, assembling, re-packing, and re-exporting products without being subject to import duties or quotas, with a minimum of taxes. The products most often imported in the CFZ are electric appliances, clothing, watches, perfumes and cosmetics, textiles, gold jewelry, liquors, and cigarettes.

Established in 1948, the free trade zone occupies abandoned land utilized by the US during the Second World War. Today, the 400 hectare zone is completely developed; it serves as a home to 1,750 merchants and receives more than 250,000 visitors each year from all parts of the globe. It is a major contributor to the large service sector in the Panamanian economy.

The CFZ is located at the Atlantic mouth of the Panama Canal, with access to three ports in the Atlantic (MIT, Evergreen, Panama Port) and one in the Pacific (Balboa) via the intercoastal railway. The largest importer into the CFZ in 2004 was Hong Kong, followed by Taiwan, United States, Japan, and Korea; Colombia, Venezuela, and the United States are the largest exporters. The Free zone is mainly a decentralized market, with no large corporate presence that dominates trade.

There are four basic ways of doing business in the CFZ:

1. Leasing lots on which the user can build a warehouse or other facility as designed by the owner. Land leases are granted for a 20 year period.
2. Purchasing an existing facility from the CFZ Administration.
3. Subleasing from a company already established in the CFZ, subject to the approval of the CFZ Administration.
4. Leasing public warehouse space operated by the CFZ Administration. The firm receives its goods and stores them like any other company of the zone. There are no fixed costs and payment is based on the weight or volume of the goods stored.

Existing Real Estate Supply in the Free Trade Zone

The FTZ is segregated into two sectors: the original FTZ dating from the 1950s in Colon City, and the relatively new zone in the abandoned France Field area. The original Colon commercial sector consists of old warehousing buildings left by the US forces. Many of the buildings are old and unimproved from their original condition, making the space antiquated for current distribution and logistics needs. A guarded wall separates the FTZ from the Colon City, but given the lack and quality of space within the actual zone, many companies have extended the wall to expand the zone, an effort that the government has allowed assuming that the company also pays for the new infrastructure.

Figure 9: Arial View of the Colon Free Zone and Adjoining Ports

There have been a number of expansion efforts of the Colon Free zone since its original walled 94 acres had been filled with warehouses and showrooms since 1978. Since then, parts of Manzanillo Bay has been filled, and the zone was extended to include 131 acres of Old France Field. The quality of real estate in this area is newer and is exclusively intended for import-export business and not for heavy industry. Although France Field is located outside the port area, it is on the Kansas City Railroad Terminal which connects Colon with the port of Balboa on the Pacific Coast, facilitating port to port transshipment.

There is little to no space available to buy or rent in the old free trade zone; in fact, limited supply has driven leasing rates to double in the past 2 years[13]. There is some space available in the France Field area, and incoming occupants, if approved by the committee (jointly comprised of the government and former investors) can lease land and build for themselves. Land costs in this area are estimated to be between $30 and $100 dollars per square meter, and companies are obliged to follow the master plan (i.e. zoning) for the concession area. [14]

The following summarizes estimated costs to acquire or develop property in the Free Trade zone:

Figure 10: Colon Free Zone real estate cost estimates

Industrial space	$ Cost / Sq. Meter
Acuqisition Cost	$300 - $600
Est. Constuction cost	$200 - $500
Est. Land Cost	$30 - $100
SubLease Rate	$3.50 - $7

*info from Jones Lang LaSalle and CBRE

Zona Procesadoras

In an effort to replicate the success of the Colon Free zone, as well as to stimulate maquila – type export oriented industry, Panama created Zona Procesadoras (Export Processing Zones, or EPZ) in November 1992. Exporting companies (defined as exporting at least 60% of goods) located in these zones are permitted the following incentives:

- Exemption from taxes, duties and other charges related to the importation of machinery, equipment, raw materials, semi-processed goods and other materials such as packaging and fuel used in company operations

[13] July 2007 Interview, Carla Lopez, CBRE Panama
[14] "Industrial Property in Panama," Jones Lang LaSalle, April 2007.

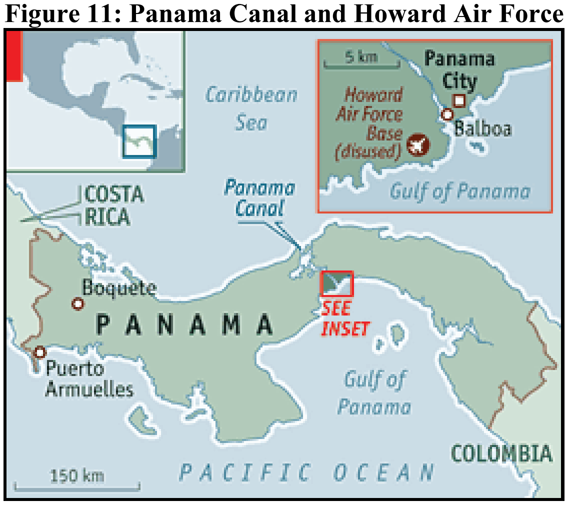
- Exemption from income tax on profits arising from exports. Companies are treated as off-shore and pay no tax if they receive all their income from outside the country
- Exemption from export sales taxes, as well as from taxes on capital and assets of the export industry
- Less stringent labor and immigration provisions for employees of EPZ firms

Originally, zona procesadoras were specifically designated areas; however, the law has changed to allow any company to set up their own export processing zone. Although they share many of the same export & tax benefits as in Colon, these areas lack the synergistic value and location offered by the original FTZ; consequently, they are not a significant contributor to the export market.

Panama Pacific Special Economic Area

Perhaps one of the largest and most promising concession land areas from the US Canal Zone, and greatest opportunity for industrial growth, is the former Howard Air force base. Established under Law 41 of 2004 as the Panama Pacific Special Economic Area (AEEPP) to be developed under supervision of the World Bank's International Finance Corporation (IFC), the 3,700 acre site is poised to be a massive new trading hub on the Pacific entrance to the Canal, a half mile from Panama City. The site is poised to be a massive new trading hub, known as a "multimodal port" which will take in both the air-strip, the canal and build vast depots to store all manner of goods that pass through the canal.

Figure 11: Panama Canal and Howard Air Force



Like other concession areas, the parcel of land was put out for bid and in early 2007 was awarded to London & Regional Properties, a privately owned British developer, who will invest $700 Million over the next 40 years. While the parcel is mainly zoned for commercial & industrial uses, the area is also earmarked for thousands of new homes, hotels, a golf course and science park; all told the area is projected to generate at least 20,000 jobs. To avoid competition with the CFZ, there are restrictions on the import and re-export of certain products into the AEEPP, and show rooms of goods (common in the CFZ) are prohibited. Incentives have been provided to attract the following types of businesses:

- Companies engaged in light manufacturing, such as assembly plants related to electronic business
- Storage & logistics businesses dealing with trade and traffic
- Companies specialized in information, communications and technology, such as call and internet data centers

Dell has already developed and located a call center in the area which currently employs over 1,500 people. The company started operations three years ago in an effort to expand into Latin America, and were attracted to the Howard Base by government incentives that made it an attractive cost location. Additionally, Singapore Technology Aerospace, the largest private airplane maintenance company in the world, recently signed to operate an aircraft service center at Howard, to provide service to the Latin American Market. With proximity to the largest container port on the Pacific Side, an airport within the premises for air cargo movement, and the potential to develop a Mega Port at the Rotland Navel Base adjacent to the property, this project has both the financial incentives and location for huge industrial development in the future.

4.2 Macro changes and Projected Growth in the industrial sector

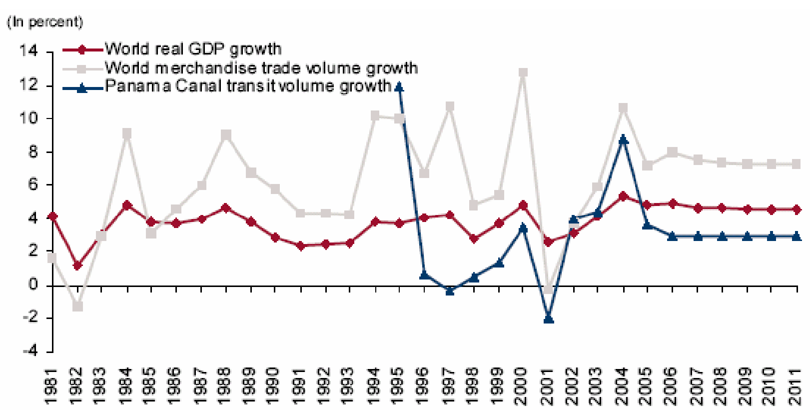
In comparison with its Latin American counterparts, Panama's small size and relatively higher wages put it at a disadvantage for traditional export-oriented manufacturing. However, Panama has a strategic niche in the industrial sector: to develop facilities that take advantage of its location as a shipping and distribution hub. According to Zach

Cheney at Jones Lang LaSalle, the demand for this type of product is already there, as more multi-national logistics companies look to locate near the canal and its ports.[15] As global trade increases, new opportunities continually emerge for this type of product, particularly given that shipping is the most cost effective movement of goods. Additionally, the canal expansion and signing of a free trade agreements with Singapore and, more importantly, its largest trading partner the United States, will increase and perhaps expand the depth industrial real estate in Panama.

Trends in global trade and logistics

The opening of industrialized markets, advances in transportation, an increase of outsourcing, and the advent of free trade agreements have fueled globalization, and consequently trade, over the past few decades. The World Trade Organization statistics show that world trade continues to grow at approximately twice the rates of the world economy; average export growth over the past 10 years has been around 6% per year. [16] The Panama Canal, serving as a strategic link in global trade, has transit volume growth that closely mirrors the expansion of the world output and trade growth, as shown in the chart below.

Figure 12: Global Economic Trends and Panama Canal Transit Volume



Source: IMF, Panama Canal Authority and Credit Suisse
1/ World merchandise trade growth is computed by taking the weighted average of the growth of export and import volumes, weighted by the dollar value of imports and exports. Data from 1981-2007 is sourced from the IMF's WEO database. Forecasts for 2008-2011 are IMF forecasts of world output and trade in goods and services published in its most recent *World Economic Outlook* (April 2006).

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[15] July 2007 Interview, Zach Cheney, Jones Lang LaSalle
[16] "Panama Canal Expansion Position Paper," World Shipping Council. May 2006

While the United States continues to be a principle driver of world trade, the rapid growth of China's exports to global markets has been a particularly crucial statistic. Currently, container trade between the two markets alone accounts for 35% of US trade. [17]
This trend has enormous implications for Panama Canal transit; currently the Asia to US East Coast route is overwhelmingly the canal's principal trade route, providing the cheapest all-water route from the export manufacturing centers in Asia to the population centers of the East coast. This route alone accounts for close to 50% of all canal transit.

Figure 13: Panama Canal Principle Trade Routes

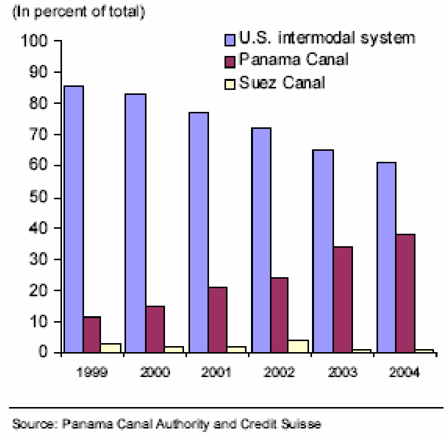
	Route	% of Transit
1	U.S. East Coast - Asia	45%
2	Europe - West Coast South America	8%
3	U.S. East Coast - West Coast South America	7%
4	U.S. East Coast - US West Coast	3%
5	U.S. East Coast - West Coast of Central America	3%

Container Trade

While globalization has been the catalyst for world trade, the advent of containerized shipping has revolutionized the shipping industry by providing fast, cost-effective movement for international cargo. Container shipping, the system of using standard ISO containers (Isotainers, or shipping containers) that can be loaded and sealed intact, has caused a huge reduction in freight charges and, consequently, has boosted trade flows. Considered to be one of the most important innovations of 20th century logistics, container trade has increased more than an average of 11% each year since the year 2000, with growth projected to grow rapidly in the future. Container capacity, which is measured in twenty-foot equivalent units (TEUs), has increased the importance of all-water routes in global trade, consequently increasing the strategic importance of the Canal. The chart below evidences this trend, showing the canal's increasing market share against the routes' competitors: the US intermodal system (involves the transport of goods by sea to ports on the west coast and then by rail to the east coast) and the Suez Canal (has a greater capacity than Panama, but requires much longer sailing times from Asia).

[17] "Panama Canal Expansion Position Paper," World Shipping Council. May 2006

Figure 14: Canal share of container market from Asia to U.S. East Coast



Panama Canal Project

The rise of global trade and the cost-effective way to facilitate it through container shipping has greatly increased demand figures for the Panama Canal; consequently, it is currently running close to full capacity. This demand, in addition to the rise of larger container ships or "post-panamax" vessels, has triggered the much anticipated $6 Billion expansion of the Panama Canal. The larger container ships are appropriately named: Panamax refers to the maximum sized ship that can enter the canal, namely one that has capacity for 1,091 TEUs. According to the world shipping council, 50% or more of the global fleet will be comprised of these larger ships by 2011. The project was overwhelmingly approved by referendum in 2006, and is projected to double the capacity of the canal once the eight year plan is completed.

Given the global shipping trends, it is clear that the canal will continue to be a strategic link in world trade that will fuel Panamanian GPD directly and indirectly in the upcoming decades. However, it is important to examine the sectors affected by the Canal Economic System i.e. ports, trade zones, and logistics systems, to better understand the significance of the expansion on the industrial real estate sector in Panama. The more significant implications for this market lie in the areas supported by the canal as sites to consolidate cargo, add value along the supply chain, and re-export to and from points all over the Americas – trends that have been increasing in Panama's industrial market.

The Chart below shows industries related to the Canal Economic system that stand to greatly benefit from the expansion project. In addition to direct and indirect sectors, the canal also has "induced" the birth of sectors including the Colon Free Zone, logistics operations, and the port system – developments that are driven by the presence of the Canal, but whose growth is determined by factors other than the canal (i.e. trade agreements, tourism).

Figure 15: Panama Canal Economic System

Canal Economic System			Parallel
Direct	*Indirect*	*Induced*	
Canal Operations	Shipping lines	Ports (80%)	Ports (20%)
Transfers to Nat'l. Treasury	Shipping agencies	Colon Free Zone (CFZ) 20%	CFZ (80%)
Salaries to ACP Employees	Bunkering services	Canal tourism operators	Air hub
Domestic purchases made by ACP	Services to vessels in transit	Logistics systems	Merchant Marine
	Repair and maintenance of vessels	Railroad	Telecommunications
	Launch services and dredging pilotage	Export Processing Zones	Legal services
	Fuel sales to vessels	Inter-modal service	Financial Services
		Cruise tourism	Insurance
		Repair and maintenance of containers	Education & Training
		Ground transportation	

Source: ACP, Intracorp

Panama Port System

The growth in container trade through the canal has also had significant implications for the Panama's port activities. The Panamanian ports system has improved markedly since privatization in the mid-1990s, and Panama has become one of the most important bases in the region for container transshipment. While the Panama Port System is made up of 18 ports, the majority of container movements come through four large, privatized ports:

- Balboa: the largest port on the Pacific Coast, operated by Panama Ports Company (PPC), a subsidiary of Hong Kong-based Hutchinson Ports Holdings
- Cristobal: Located in Colon, also operated by Panama Ports Company (PPC)
- Evergreen: located in Colón Container Terminal, of Taiwan
- Manzanillo International Terminal (MIT): located in Colon and operated by Stevedoring Services of America (SSA).

Together, MIT, Evergreen, and the Cristobal ports combined to make Colon the 2nd largest port area in Latin America. HPH's port in Balboa, on the Pacific Coast of the Canal, is also the fastest growing port in the region, as shown in the chart below.

Figure 16: Latin America's 10 largest ports, measured in TEU capacity

Rank	Port	Country	2001	2002	2003	2004	2005	% Change (04 - 05)
1	Santos	Brazil	892,802	1,230,599	1,560,957	1,882,838	2,267,921	20.40%
2	Colon	Panama	1,210,852	1,450,000	1,512,365	1,943,712	2,054,285	5.70%
3	Buenos Aires	Argentina	962,965	745,658	897,123	1,138,503	1,075,173	-5.60%
4	Callao	Peru	480,706	521,382	553,138	727,840	887,035	21.90%
5	Manzanillo	Mexico	457,946	638,597	709,209	830,779	872,562	5.00%
6	San Antonio	Chile	413,900	438,585	524,376	639,762	773,048	20.80%
7	Puerto Cabello	Venezuela	620,523	506,106	380,039	597,930	746,810	24.90%
8	Puerto Limon-Moin	Costa Rica	577,621	564,357	611,984	667,344	688,563	3.20%
9	Rio Grande	Brazil	360,966	454,779	544,255	617,808	665,111	7.60%
10	Balboa	Panama	358,868	377,774	457,134	465,091	664,185	42.80%

The container movement of goods through Panama's port system has more than doubled since the beginning of the decade, and demand continues to increase. The Panama Ports Company (PPC), completed a $200 Million expansion of its Balboa container port, doubling its capacity to 900,000 TEUs, and has plans to invest an addition $1 Billion in the ports of Cristobal and Balboa to increase capacity in both locations. On the Atlantic coast, both Evergreen's Colon Container Terminal and Manzanillo International Terminal (MIT) have plans to invest a total of $500 million to double the capacity of their ports.

In addition to the existing ports, plans are in the works for the addition of a mega-port on the west side of the Pacific entrance to the Panama Canal, close to the Howard special economic area. The port will be designed to handle 2.4m TEUs per year, the project is estimated to cost up to $1 Billion. The new port is scheduled to come into operation in 2009 and is part of the government's plan to increase the port system's handling capacity to 6m TEUs, or double its current volume . [18]

Location and proximity to the canal and its ports are perhaps the most crucial factors for multinational firms interested in industrial space in Panama. The main port activity in Colon and Balboa is likely to continue to drive industrial demand at either end of the

[18] "Country Briefing: Panama." *Economist Intelligence Unit*, July 16, 2007

Canal. Another significant factor for industrial growth, however, is the import and export treatment of goods. As seen in the Colon-free zone, the absence of taxes and import duties is a huge incentive for companies to set up logistics or manufacturing facilities in these areas. Consequently, Panama has recently signed free trade agreements with Singapore, Chile, and the US, which could potentially have a significant affect on export-led industrial development throughout other areas of Panama.

Free Trade Agreements

In March 2007, Panama signed a FTA with Singapore in an agreement that is likely to make Panama a chief regional hub for Singaporean companies. Under the pact, 70 percent of Singapore's goods entering Panama will be tariff-free immediately; this will grow to 98% within in 5 years. The agreement compliments the two countries' growing bilateral cooperation in port, maritime, and telecommunications industries. Since the FTA was signed, two large scale investments by Singaporean companies have been committed, including an aircraft service center at Howard, and the development of a new container terminal at the Pacific entrance of the Panama Canal, adjacent to Howard.

The recent signing of an FTA with the United States, Panama's most important trade and investment partner, was a priority of the current administration. Currently, unilateral trade preferences allow more than 95% of Panama's goods exports to the US to enter duty-free.[19] However, US exports to Panama paid a 7 percent tariff on average. By eliminating tariffs immediately on 90% of goods, the agreement will provide a level playing field for US companies in Panama. Additionally, as more Latin American countries enter into Trade agreements with the US, the FTA is a crucial if Panama is to remain competitive in the US market. This is especially true given that preferential trade concessions under the Caribbean Basin Initiative will expire in 2008. The FTA was recently approved by both Presidents Bush and Torrijos, and is awaiting ratification in the US House of Representatives. While it is difficult to quantify the projected economic benefits of the FTA, it is certain that it will further increase exports and augment

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[19] Hornback, J.F. "The Proposed U.S.-Panama Free Trade Agreement," Congressional Research Service, August 23, 2004.

investment in the country – not only by US firms, but also foreign investors who are looking for increased access to the US market.

The industrial market in Panama offers great opportunity for growth and modernization to capture Panama's unique advantage as a strategic center for global shipping and trade. Industrial Real estate designed toward logistics, storage, and distribution is already in high demand, and it is unquestionable that trend that will continue to grow given the canal expansion, the growth of the ports, and the additional trade incentives offered by the FTA. Although the current market is mainly focused in the Colon Area, perhaps the greatest opportunity for growth in the industrial real estate market is on the Pacific side of the Canal, where plans for new ports and industrial development are coupled with tax incentives and available land.

Chapter 5: The Residential Tourism Market in Panama

Certainly the most dynamic of the real estate sectors in Panama right now is the residential resort market, inciting an unprecedented boom that has put Panama on the radar for many real estate investors internationally. Thousands of units – ranging from luxury high rise condos in Panama City to beach villas settled in master-planned communities – are popping up each year, most of which are developed as second homes for foreign buyers. An estimated 80% of new real estate development in Panama is attributed to this sector.[20] Foreign demographic trends, incentives luring a growing retiree population, the stable dollarized economy, and pure investor speculation are all driving demand behind the development surge. Although many question if the bubble will soon burst, others tout that the economy's expansion and international demand will sustain the supply growth. This chapter will explore Panama's resort residential demographics and drivers, examine local tourism and retirement policy implications, and derive potential risks and opportunities that exist in this unique and exciting real estate market.

5.1 What is Residential Tourism?

The term "residential tourism" refers to an emerging sub-sector of the tourism industry, where the visitor chooses to stay in a non-hotel accommodation, instead staying in a residence that is owned or rented, typically for a longer period of time. According to the World Tourism Association, these owners are considered "tourists" because their funds typically come from their place of origin. Additionally, the principle reason for travel to the destination is recreation, golf, leisure, etc – maintaining a certain quality of life that they identify with the chosen spot. The industry arose as a phenomenon in the 1970s in the southern coast of Spain, when tourists began to acquire real estate products that developers had constructed for locals. Since then, residential tourism has grown rapidly: over three million tourists visited their second homes on the Spanish Costa del Sol in

[20] July 2007 interview, Javier Mosquera, HSBC Panama

2003 alone.[21] Today, there is a growing presence of residential tourism – or 2nd home – communities across the globe, with an increasing number in Mexico, Portugal, Thailand, Croatia, and Central America. By generating a continual cycle of tourists with medium to high incomes, residential tourism is an economic stimulant, generating taxes, consumption, and jobs.

It is important to note that the recent residential building boom in Panama is driven mainly by the residential tourists: qualitative research suggests that approximately 75% of buyers of new residential product in Panama today are foreigners, mainly from North America, Venezuela, and Europe. Panama's extreme income disparity dictates that most locals, with an average income of approximately $400 per month, can not afford the amenity-laden luxury products that are being put on the market.

5.2 Tourism in Central America

Until the recent past, Panama, like many of its Central American neighbors, has not focused on its tourism and resort industry as a means of economic growth. While each country has had different experiences during the century, the region has been characterized by revolutionary movements and guerilla warfare tactics that prevented these countries to develop a tourism base, even years after the wars were over. This is beginning to change, however, as tourists look for more variety in their travel, and as more Latin American countries recognize the benefits of developing their tourism sectors. Perception, however, remains a large hurdle; despite countries efforts to promote a country's natural, historical, or cultural attractions, potential tourists must perceive that the destination is safe before they even consider traveling – or living – there.[22]

Costa Rica was the first of the Central American countries to focus on its tourism sector, developing tourism infrastructure and foreign investment initiatives that attracted

[21] Sesena, Jose. "Residential Tourism: It's Role in the Business and Socio-Economic Development of the Province," 2004.
[22] "Tendencias: Latin American Market Report," InfoAmericas, Inc. September 2005.

development in the sector in the 1980s. Moreover, the country was able to leverage its political stability in the region; many accredit Costa Rica's global reputation as a tourist destination with the awarding of the 1987 Nobel Peace Prize to then president Óscar Arias Sánchez. Today, Costa Rica hosts far more international visitors than any other country in Central American country a platform that many other countries hope to replicate in the future. In 2006, Costa Rica hosted 1.7 Million tourists who generated a total of $1.6 Billion for the small economy. The Costa Rica tourism board is now emphasizing high-end beach resorts – as evidenced by the arrival of Central America's first "Four Seasons" brand 2 years ago – as a means of broadening the country's range of tourism products to compete with the Caribbean islands and the popular Mexican Destinations of Cabo San Lucas and Cancun. The chart below shows statistics for each of the Central American countries and their tourism dollars in 2006.

2006 Tourism Figures

Country	Turists	Other International Visitors	Millons US$
Belice	247,325	655,929	166.0
Costa Rica	1,725,261	345,646	1,629.3
El Salvador	1,257,952	222,434	870.67
Guatemala	1,481,547	20,522	1,012.0
Honduras	738,667	397,689	474.4
Nicaragua	773,398	125,301	239.0
Panamá	**718,069**	**459,093**	**1,270.0**
Total	6,942,219	2,226,614	5,661.3

Costa Rica supplemented its tourism initiatives in the 1980s by implementing a pensionado program – a program that provided very attractive incentives for retirees to live and retire abroad - to attract residential tourists in the form of senior retirees. The program was so successful that many of the benefits have subsequently been scaled back to preserve raising home prices. Today, it is estimated that 80% of coastal property in Costa Rica is owned by foreigners and that between 20,000 to 30,000 Americans own a second home as residential tourists there.

Panama's tourism history

Historically, most international visitors came to Panama mainly for business purposes related to the canal; additionally, the 50,000 "canal zone" residents and their visitors provided fueled limited tourism throughout the country. However, in an effort to replicate the growth witnessed by their neighbor to the North, Panama began to implement similar tourism initiatives in the late 80s and early 90s. The country's first attempted to fuel resort growth was its pensionado program, modeled after Costa Rica's. In 1994, a comprehensive tourism promotion law was established in an effort to grant incentives and benefits to companies engaged in tourist activities, looking to adopt the necessary mechanisms for the public and private sectors to join and coordinate their efforts in the area of tourism.

Despite these efforts, only in the past few years has Panama's tourism industry gained steam, due largely in part to political turmoil in the 80s and the perception "hangover" it caused through the 90s, often referred to as the "Noriega-stigma." In 1999 Panama launched a tourism promotion effort, establishing a large a substantial budget for the sector that was more than 5 times what had been spent in prior years. These promotion efforts, including a large scale international advertising campaign and the establishment of the tourism bureau, produced a 67% increase in the number of tourists from 2000 – 2004, and a 56% increase in tourism receipts in the sector, despite an international economic and travel recession due to Sept. 11. [23]

In 2003, for the first time tourism surpassed the Canal and Free trade zone as the country's largest component of GDP. The past 10 years have seen dynamic growth in the sector; arrivals to the newly expanded Tocumen International Airport in Panama City have grown by 80 per cent in the last decade, with cruise ship and land arrivals showing similar increases. According to ECLAC, in 2006 Panama ranked fourth out of the Latin American Countries in terms tourism as a percent of GDP.

This growth is expected to continue in the future. An ambitious National Tourism Plan was released this year, which identifies zones of tourism potential and areas for development, while outlying strategies for development in the future. Additionally, a five year publicity campaign was launched to market Panama as a tourist destination,

[23] Instituto Panameno de Turismo, http://www.visitpanama.com

aimed primarily at North and Latin American markets. The sustained growth in this sector, in addition to the administration's backing of tourism development, lays the groundwork for the residential tourism market, especially in Panama's interior. Tourism increases the public appeal, draws more international visitors to the country, and increases necessary infrastructure for development.

5.3 Second Home Buyers in Central America

While the development of the tourism sector has significant implications as a contributor to the economy, perhaps even more significant is its role in stimulating foreign investment, as many tourists return to invest in land and properties. The tourism component is the first step in the foreigners' decision making process; once they have visited 2 – 3 times, they come back to look for a second home or investment opportunity.[24] Foreigners come to Panama and find it surprisingly "liveable": given the US's 100 year presence, Panama boasts a mature infrastructure, widespread English, and drinkable tap water – an anomaly in this part of the world. For many, Panama is extremely appealing as a second-home market for individuals looking for a "hybrid of U.S. efficiency and a Latin soul."

Panama, like other Central American markets, has realized the tremendous value of the baby boomer market, according to National Association of Realtors International development manager Jeff Hornberger.[25] These countries have implemented numerous policies and incentives as a way to open up their second home markets, which they see as an economic development tool. And with good reason: these transplants are not only a powerful form of foreign direct investment, but also provide employment for local workers, consume goods and services, and attract even more foreign visitors to their host countries. Migration studies in the US have shown that interstate migration in the United States (i.e. New York to Florida) has found that migratory streams play a large role in

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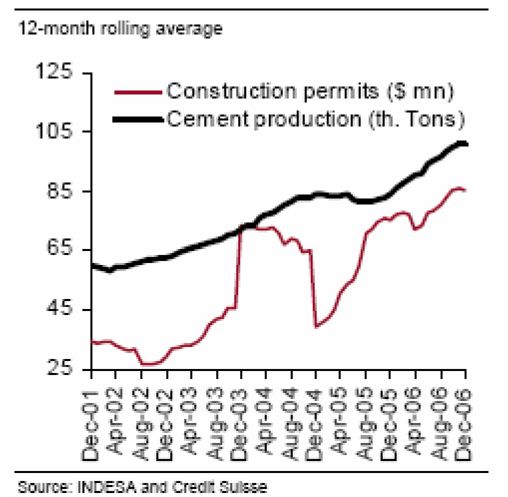
[24] Frank Morrice, Century 21 Semusa Realty Panama
[25] Barbassa, Juliana. "Central America Seeks American Retirees," Lakeland Ledger, September 2006.

redistributing wealth among states. [26] As home prices in Costa Rica and Mexico have risen dramatically due to the influx of retirees, officials in Nicaragua, Panama, Honduras, and Belize are working to lure this demographic to their countries for more affordable retirement options.

Between the years 2000 and 2004, the number of international arrivals more than doubled in Panama. This increase not only had implications for GDP growth for tourism, but perhaps more importantly reflected the change in perception of how foreigners viewed the Central American nation. Articles published in Fortunate Magazine, the New York Times, and the Economist, and further legitimized the "New Costa Rica," while International living ranked it the # 1 retirement destination in the world. Encouraged by the growing number of foreign tourists with an interest in Panama, as well as the media speculation touting the next baby boomer haven, the residential tourism sector started to grow. To further fuel the development flurry, in early 2005 the government re-instated two year tax exoneration for new real estate construction. This law, which has been used in past administrations to boost construction, allows for a 20 year tax exemption on property tax for all new residential projects that obtained construction permits before September 2006 and complete construction before September 2007. The amount of development projects spearheaded by local and foreign capital spiked during this period, as depicted in the chart below.

[26] "America's Emigrants: US Retirement Migration to Mexico and Panama," The Migration Policy Institute, 2006.

Figure 17: Construction Indicators



The last 3 years in Panama has seen unprecedented growth and construction in Panama City and, to a lesser extent, in the country's interior. The growth is most concerning in Panama City, where a plethora of high end towers are in the planning or construction phases. According to research by Prima Panama, the number of new apartments being developed in Panama City has gone from 11,000 units in July 2006 to 20,603 units only 6 months later – an 88% increase. While the real estate boom was incited by the perception of endless baby boomer population, it has recently been fueled by speculative buyers who are looking for short term plays in the market. This activity, which will be discussed further below, has raised substantial concern in Panama and has caused many to question the fundamentals of the market.

5.4 Market Demographics and Drivers

While some are concerned that there may be too much supply, others say that the boom is also driven by real growth in demand. According to Ernst and Young's real estate advisory services group, Panama is still one of the key growth markets in Latin America for U.S. baby boomers looking at retirement or second homes. [27] In addition to this demographic, Panama differentiates itself from its Central American competitors by

[27] "Real Estate: Panama Boom Despite Setback," Latin Business Chronicle, January 15, 2007.

offering a dollarized real estate investment – a very attractive amenity for the Latin American buyers. Other point to the country's GDP growth and large scale projects as fueling the economy through the next 10 years. This section will examine the main drivers behind the building frenzy and analyze prospects for future demand.

1 - North American Baby Boomers & Retirees

Developers around the world have looked to the baby boomers to justify demand for a myriad of real estate development genres, including lifestyle communities, urban condos, and full service resort destinations – and with good reason. The "Baby Boom" generation, referring to the 76 million Americans and 10 million Canadians born between 1945 and 1964, represents a cohort of the population that is significant on account of its size, age demographics, and wealth. According to the NAR "2006 Baby Boomer Profile," baby boomers have considerable buying power, with a median income of $64,700 and a median net worth of $146,000; 6.6 million households of boomers own at least one second home. This demographic is also privy to investing their money in real estate, making ownership of second homes one of the fastest-growing sectors in the real estate industry.[28] As this generation nears the retirement age (the first baby boomers turn 62 this year), many have analyzed where and how this group will spend their money – and a growing number believe that they will look further South than Florida and California to more affordable real estate in Central America.

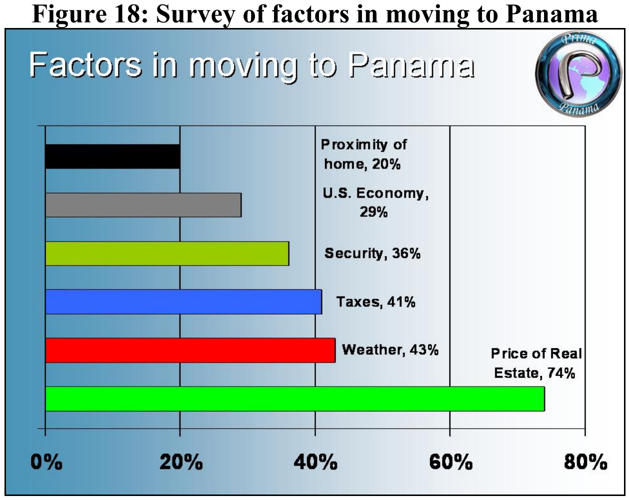
Why?

There are a number of reasons driving this demographic to look beyond US borders to make an investment in a second home. Perhaps the most significant reason is the more affordable cost of real estate, as well as an overall better cost of living. Buyers who before were buying in the familiar senior enclaves of Florida and Arizona have discovered that those markets, although cooling off, have become unaffordable.
In the fall of 2006, Prima Panama, a local real estate consultancy, conducted an internet survey to assess the motivations and preferences of foreign buyers in Panama. The 275

[28] McAfee, Jamie. "Forever Young," Urban Land. May 2007.

respondents, mainly from the North America, overwhelmingly stated that cost of living was their main motivation in moving to Panama. While other factors, including the dollarized economy, proximity to home, and tax advantages were considered, most foreigners come to Panama because they could both buy property and live cheaper than they could at home.

Figure 18: Survey of factors in moving to Panama



Source: Prima Panama

According to a recent Gallup poll, 40% of US residents are somewhat or very worried about not having enough money during retirement, a concern which has pushed some to shop around for a more affordable place to spend their golden years.[29] The lower cost of living in Panama allows retirees to have amenities that they could not afford in the US, including golf memberships and hired help, in addition to more affordable medical care.

Incentives

In addition to a cheap cost of living, Panama followed Costa Rica's lead in implementing a retiree program to offer special benefits for foreign residents and retirees. According to International Living, Panama's law No. 9 is the best retiree program across the globe, and one of the drivers that compelled the travel magazine to rank Panama top on its Global Retirement Index. The law currently has 2 types of visas for foreigners who wish to reside in Panama:

[29] "America's Emigrants: US Retirement Migration to Mexico and Panama," The Migration Policy Institute, 2006.

- The *pensionado* visa: allows foreigners to remain in the country indefinitely, provided they are retired (no longer employed, at least in Panama) and received a government or private pension of $500 per month
- The *rentista* visa: similiar visa applicable for those who do not receive regular pensions. Visa applicants must place an amount of money (currently around $225,000) in a five year CD at the National Bank of Panama in order to yield $750 in interest per month – essentially creating their own pension.

Visa holders considered to be of retirement age (age 55 for women, 60 for men are entitled to the same discounts as Panamanians. These incentives include 25 – 50% discounts on entertainment and restaurants, 25 - 30% discounts on transport including bus, boat, train and domestic air fairs, 25 - 50% off hotel stays, significant discounts on hospital bills, prescription medicines, and up to 50% discounts on closing cost for home loans.

In 2006, the US Migration Policy Institute produced a study entitled "American Emigrates: US Retirement Migration to Mexico and Panama," which studied data relating to senior migration and conducted focus groups of adults who had migrated to these countries. According to the study, members of every focus group in Panama were quick to bring up the benefits offered to *pensionado* visa holders, stating that nearly all US retirees in Panama were aware of the discounts and made use of them on a daily basis. The study also indicates that some retirees who were interested in retiring to Costa Rica have moved to Panama instead, as Costa Rica significanly scaled back the incentives associated with their *pensionado* visa within the past 5 years. [30]

Advances in Communication

The growing trend to buy abroad is also fueled by advances in communications technology as well as cheap, direct transportation. The internet is allowing more residents abroad to live and work virtually anywhere. Panama City's newly expanded airport had increased access to be in major cities in both the US and Latin America in

[30] "America's Emigrants: US Retirement Migration to Mexico and Panama," The Migration Policy Institute, 2006.

only 2 hours. This ease of communication and close proximity to home has been in factor in the residential tourism market.

Familiarity

Realtors tout that it is the "familiar" feel laid by the US groundwork that is so attractive to many second home buyers that will fuel the market in years to come. Given the US presence in Panama, English is widely spoken and many Panamanians culturally identify with US customs (i.e. Panamanians also celebrate Thanksgiving). While the dollar as legal currency reduces investment risk, it also enables US Citizens the convenience of not having to exchange money.

Diversify portfolio investment

More and more baby boomers are purchasing second homes as investments. Historically, Supply and Demand for the US 2nd home market has been difficult to track; however, the US National Association of Realtors (NAR) recently published a study that concluded that the US second home market is much bigger than what analysts believed it was: in 2005, second home sales accounted for one third of all home purchases in the US. According to NAR, the survey data also shows that more people are buying second homes as a way to diversify portfolio investments: in 2005, 63% of second homes were purchased as investment properties, while the remainder were considered strictly vacation homes. Similarly, the 2nd home trend is going abroad, as evidenced by an increasing interest in investment tours and conferences are that occurring in Costa Rica, Panama, and Mexico.

2. Latin American "refugees" – Columbians and Venezuelans

Home to the canal, the free trade zone, and over 100 banks and financial institutions, Panama has long been a hub for Latin American banking and trade. It is no surprise that they have also been part of the real estate market in Panama City. For Latin Americans, the most attractive feature of investing in Panama is its perception as a "US protectorate": that the country's historical relations with the US and the significance of the canal, along with the dollarized economy, make it seem practically as safe as investing in the US itself.[31] This perception has driven wealthy Latin Americans – especially from politically unstable neighbors Venezuela and Columbia - to purchase 2nd homes in Panama City as a stable investment and potential enclave should they need to leave their homeland. In recent years, however, Panama City has become home to more Latin American professionals; a trend that many accredit to increased US visa restrictions. Latin Americans who used to purchase property in the US, mainly in Miami, now have an increasingly harder time entering and staying in the US.

This is an increasingly relevant issue given the current political climate in Venezuela, as populist president Hugo Chavez pursues his "Bolivarian Revolution" – the leader's vision of 21st century socialism. A growing number of wealthy and middle class Venezuelans are fleeing the country, going to Miami – and increasingly – Panama City to protect their wealth and, in some cases, their future livelihood and safety. Many say that the situation in Venezuela and the resulting flight of its citizens is reminiscent of Cuba 50 years ago just before Castro's own revolution. According to Riordan Roett, director of Latin American studies at Johns Hopkins University, Chavez's government is moving into every sphere of economic and social activity in Venezuela. "If you have young children, you want out. If you have assets that have been seized, or may be seized, you want out as quickly as possible…As the alta (upper) bourgeoisie becomes more and more of a target, you want to leave before Hugo Chavez shuts the door." [32]

One indicator of the political flight from the country lies in the number of Venezuelans that are looking to be granted political asylum in the US: 1,085 last year, up from just 14 in 1998, according to the U.S. Citizenship and Immigration Services. Furthermore, far more have fled illegally: an estimated that 160,000 in the US undocumented or on overstayed visas. However, as US immigration laws get stricter, more Venezuelans fear that fleeing to Miami is too big a risk. Panama, by contrast, allows any foreigner to apply for the *pensionado* visa, which thereby would allow then to stay in Panama indefinitely.

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[31] July 2007 interview, Mauricio Saba, Prodigy International.
[32] Brown, Tom. "Venezuelans, fleeing Chavez, seek U.S. safety net," Reuters, July 16, 2007.

After the United States and Spain, Panama hosts the largest number of Venezuelan emigrants.

The effects of this migration have not neglected Panama City's Real Estate: According to local residential broker Mauricio Saba, the past 6 month have seen a huge influx of Venezuelans buying properties – sometimes sight unseen. His company Prodigy International, like others promoting high end luxury product in Panama City, have taken their projects abroad on "international road shows," traveling to Venezuela and other countries to showcase their developments. This trend has been extremely popular especially for the Venezuelan population who is looking to quickly invest their money in Panama. Recently, Prodigy International sold an entire high project in less than 2 months through a series of road shows the team conducted in Venezuela.[33]

How many?

Given the demographics of the retiring North American population, a growing interest from Latin Americans, and strong economic growth in Panama, there is certainly a compelling market for the country's second home market. The more important question to consider, however, is how many are actually coming?

This is a challenging question. Historically, supply and demand data for even the US 2nd home market has been difficult to track, and there is virtually no source for gathering data on the number of US residents who own property abroad. However, there are a number of indicators, including visa statistics and surveys of foreign owners, that can give a general idea of the types and number of foreigners that are buying in Panama.

According to the Migration Institute's retiree report, visa statistics conclude that the number of pensionado and rentista visas issued to US Citizens between 2003 and 2005 has more than tripled. Despite this trend, however, the actual number of visas issued is certainly not significant enough to satisfy the building frenzy that has occurred over the

[33] July 2007 interview, Mauricio Saba, Prodigy International

past few years. The table below shows the number of foreign visas that were issued to US Citizens and estimates the Total Foreign Visas from 2003 - 2005, considering that US Citizens make up 67% of the total number of residency visas issued.

Figure 19: Visas issued to Foreigners, 2003 - 2005

	2003	**2004**	**2005**
Total visas to US	179	363	675
% increase		103%	86%
Total Foreign Visas	**267**	**542**	**1,007**

Source: The Migration Policy Institute, 2006.

While this data is telling for the number of US retirees that have chosen to live in Panama as their primary residence, it omits a large strata of buyers who use their second home as a vacation property, as well as retirees who come to Panama as "snow birds" to live in Panama for a few winter months. This is a result of Panama's visa system, which, until recently, dictated that tourists can stay in the country on a tourist visa for a 90 day period, at which point they can renew for a 2nd 90 day period. This has allowed foreigners to stay in the country for up to 6 months of the year without going through the visa application cost and process, and allows foreign buyers anonymity. This muddles the data for this demographic given that the same tourist visas are issued for these residential tourists as for passengers arriving off of a cruise ship to stay in Panama for a matter of hours.

Projections

While many point to the "baby boomers" as the reason for the building boom in Panama, there is obviously a large discrepancy between the 76 Million baby boomers and 600 Americans who were issued visas in Panama last year. A recent study by a US marketing firm, New Global Initiatives, surveyed Americans to determine just many were planning to re-locate outside the country. The survey results showed that more than 1.6 Million households representing 3.5 million people have already decided to relocate. In addition to that figure, an additional 2 Million other households claim to be seriously interested and likely to relocate. The survey also showed that more than 40% have chosen Mexico, Central America, or Panama as the destination where they will most likely relocate. In order to estimate the number that will come to Panama, a percentage based on the on visa estimates from the Migration study report was chosen (5% of those surveyed were in Panama). Therefore, we can assume the between 30,000 and 70,000 baby boomers will buy or consider buying in Panama over the next 10 – 20 years. This goes in line with estimates by Prima Panama, who projected a migration of 30,000 over the next 20 years, an estimate based on trends over the past few years.

5.5 Overview of Existing Residential Tourism Supply

The residential real estate market in Panama can be basically split into two separate markets, both from a product as well as a market standpoint: Panama City, and everything else, or the country's "interior." Property in the interior is generally grouped by its geographic feature: beaches, islands, highlands. This section will separate each of these markets to better characterize development trends, amenities, demographics, land costs and sales prices common in each area.

Figure 20: Panama Map, Areas for Residential Tourism

Panama City

The port of entry for most foreigners into Panama, and subsequently into the real estate market, is Panama City. Although Panama City suffers from bad traffic, overused infrastructure, and escalating prices, many foreigners find it cosmopolitan and exciting – "the Miami of the South…only more English is spoken."[34] Real estate in the city is characterized by luxury high rise condominiums, many with mixed use component including hotel, marina, or casino. Panama City sees a higher concentration of Latin American buyers than anywhere else in the country – qualitative research shows that Venezuelans and Columbians especially are buying upwards of 50% of the City's real estate. According to a 2006 survey by Prima Panama, the majority of new units are being constructed in four neighborhoods: Avenida Balboa (17%), Punta Pacifica (30%), Costa del Este (13%), and San Francisco (22%). Panama City has seen both the greatest amount of construction and appreciation in the real estate market.

Pacific Coast Beaches

Approximately 1.5 hour west of Panama City along the pacific beach coast is one of the fastest growing areas for the residential tourism market. These beaches, which have long been popular for Panama City locals, are increasingly popular with foreigners given their proximity to the city, and perhaps more importantly, the airport. Some of the beach communities increasingly popular for residential tourism developments include Coronado, Rio Mar, Santa Clara, and Playa Blanca. The Pacific Beaches attract a mix of Latin Americans, North Americans, and Europeans.

Mountains and Highlands

The Highlands of Panama, most notably in the Chiriqui province bordering Costa Rica, has seen an increased interest from the international community in the past 5 years. North American retirees especially enjoy the spring-like climate and natural resources that the area boasts, including National Parks and rainforests. Many consider the Residential Resort Community "Valle Escondido" as the catalyst for the recent North

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[34] "36 Hours in Panama City," *The New York Times,* September 9, 2005.

American retirement migration to Panama. Since the golf and spa resort was developed as the first master planned community in Boquete a few years ago, the area has been rated the #1 best offshore retirement destination in all of the Americas by the American Association of Retired, and listed in the top 5 retirement destinations according to Fortune Magazine and International Living. Today, there are more than 40 master planned communities under development in the Chiriqui province. Boquete's increasing popularity has driven real estate prices; however neighboring areas including David, Volcan, and Cerro Punta are gaining popularity. Additionally, a potential airport expansion in David to accommodate international flights could have a profound affect on this market within the next five years.

Bocas del Toro

The archipelago of Bocas del Toro in Panama is situated on the northwestern coast of Panama in and around the Bay of Chiriqui, and has recently become a popular tourist years with Europeans and North Americans given its proximity to Costa Rica. This region of Panama is considered the most geographically diverse in the Caribbean, boasting coral reefs, rain forests, and unspoiled beaches. Consequently, Bocas del Toro is developing their eco-tourism industry to offer jungle tours, river tours, island tours, bird watching and turtle watching expeditions.

The Azuero Peninsula and San Blas Islands

These two areas of Panama have far less development, tourism, and infrastructure than in the above-mentioned markets, but are becoming reportedly popular with Europeans. While much of the Azuero Peninsula has largely been deforested and supplanted by farms, the beaches are mainly undeveloped and have become surfing enclaves. Similarly undeveloped are the San Blas Islands, which consist of an archipelago of nearly 400 islands off the eastern Caribbean coast of Panama. The islands are inhabited by an indigenous tribe, the Kuna Yala, and most of the existing accommodation is simple. Both regions offer unspoiled beaches and potential for cheaper land and labor than in the more developed regions.

The following chart represents an estimate of land and sales prices for the residential tourism market in each of the above mentioned areas. These figures must be considered solely as estimates given the rapid evolution of the market. Current construction costs vary on location and timing but are estimated to be in the $500 - $650 / square meter range.

Figure 21: Residential Tourism Market Data

Area	Land ($ / Sq. M)	Unit Sales Comps	Price/Sq. M
Panama City - Low	$1,000	$ 215,000	$ 1,500
Panama City - High	$3,000	$300,000 - $1,500,000	$1,800 - $3,400
Chiriqui	$50 - $100	$ 225,000	$ 1,400
Pacific Beaches	$125 - $300	$ 275,000	$ 1,700
Bocas del Toro	na	$ 350,000	$ 1,750
Azuero	na	$ 225,000	$ 1,400

Source: CBRE, Prima Panama, Century 21

Product Trends

Master-planned communities which boast amenities, services, and activities have been very popular for foreigners moving to Panama. According to the Costa del Sol report, "without a doubt, golf has been the engine for housing developments for residential tourists over the past few years."[35] Depending on where they are located, these communities typically offer a number of housing types, ranging from single family to low to mid rise condominiums; many communities often offer a hotel component. Communities in the Highlands typically are more intimate, offering 100 – 300 units; while developments closer to the city are much larger: a recent development plans to build 5,000 residential units in Costa del Este, a mixed-use concession land that is becoming increasingly residential between Panama City and the airport. Most communities design their units with the foreigner in mind; "even when they are abroad, American buyers still likes the American product – gated communities, open kitchens, and stainless steel appliances." [36]

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[35] Sesena, Jose. "Residential Tourism: It's Role in the Business and Socio-Economic Development of the Province," 2004.
[36] Roberts, Glenn. "Real Estate Without Borders," *Inman News,* May 18, 2006

5.6 Risks in the Residential Tourism Market

Boom or bubble?

While there are risks associated with developing in any emerging market, Panama is in a unique position at the height of a speculative development boom. The Panama City fury started with retirees looking for a place to cheaply relocate, it quickly became an investor's speculative market. Promoters recall investment groups that would come to Panama to buy entire building towers; after placing their cash deposit, they would sell their interests to other speculators before the project even broke ground. This type of activity has likened Panama City to other explosive markets like Singapore and Dubai, markets where speculative capital migrated and underwent subsequent volatility. Many investors believe that the market is that the market is due for a correction, and fear that if it continues to overheat the Panama City market has potential to collapse. A number of high profile projects have recently been canceled or significantly scaled back, signaling the bubble's deflation:

- *Ice Tower / Iron Tower:* At 104 stories, the Ice Tower was planned to be the tallest skyscraper in Latin America; the project had sold out at $1,000 per square meter. However, when the Panamanian developer F&F Properties declared it unfeasible, the project was re-named the Iron tower, and prices escalated to "market" at $2,500 per meter.
- *Palacio de la Bahia:* The Spanish developer Groupo Olloqui recently scaled back plans for the Avenida Balboa development, from a 97 story tower to 80 stories; however many still question if the project will go up.
- *Park 32:* a 54 story building to be constructed in the Costa del Este area that was completely pre-sold was the latest to be canceled in July 2007.

While the project cancellations send a negative message to foreign buyers around the world, others say that these projects, despite being "sold out," were still in the pre-construction phases and that cancellations do not have a serious affect on the economy. [37] In Panama, in order to start pre-sales, the developer only needs to have an option on a

[37] July 2007 Interview, Carla Lopez, CBRE

piece of land; often a deal is struck with the land owner to give them a piece of the project if the deal goes through to completion. Sophisticated artists renderings and web sites market the project; if the marketing goes well, a deposit of about 10% is collected to "purchase" a unit. If the project does not seem to be feasible or profitable before groundbreaking, the developer refunds the deposits. Therefore, many of the projects being sold – and consequently canceled – are very early in the development process. However, even with the cancellation of these projects, the market is still steaming ahead: recent estimates from Prima Panama forecast that 380 towers in Panama City are either approved or under review, representing a staggering 35,000 new units to come online in the next ten years. The instability of this market presents a considerable risk for investors looking at Panama City. Although it is unlikely that all of the units planned will come online, the current level of construction dictates an exponential increase in the market's short term supply. Additionally, even if the projected influx of baby boomers comes to Panama, it is important to understand what percentage of these buyers want to be in city condos (versus communities in the beaches or mountains). Lastly, if speculators are currently driving up prices for condominiums in Panama, there is considerable risk regarding price level fluctuation when the majority of the inventory comes on to the market in late 2007 and 2008. Uncertainty related to the level of supply, rising construction costs, and potential demand for units combine to make the Panama City market relatively risky at this time.

Volatility of second homes

There is an inherent risk associated with residential tourism markets, as second, holiday, and retirement homes are likely to be more volatile than primary home markets, for the following reasons:

- Demand is more discretionary than in primary home markets: 2nd homes are not as essential to consumers as main residences, therefore they are more likely to feel interest rate or economic shocks
- Lenders more likely to be concerned about defaults on 2nd homes

- There is little to no fallback demand for these residential tourism units, as many local households are priced out during booms. The supply side of the market is more likely to transmit volatility i.e. "feast or famine"

This risk is especially inflated in a market like Panama where there is a great income disparity and the majority of residents can not afford the new product entering the market.

Changes in laws & policy

A recent change in the visa regulations – shortening the length of the tourist visa from 90 days to 30 - brings light to risk associated with unexpected revisions to the law. This legislative change, which not only regulates the amount of time tourists can stay, also has implications on the tax treatment of the real estate foreigners buy in Panama. According to Paul McBride at Prima Panama, visa regulations have significant affects on the flow of foreign buyers, especially with the "pre-retirement" baby boomers who are buying 2nd homes with discretionary income. This group does not want to be regulated by the visa regulations or foreign laws, and they are not looking to be Panamanian citizens.[38] It is for this reason that Prima Panama has launched a campaign to the government to change their May 2007 decision to limit the length of tourist visas. According to an internet survey of 800 foreigners with Real Estate interests in Panama, 79% said that the recent changes to the tourist visa would affect their decision to buy or invest in Panama.[39] Changes like this legislation could make Panama less attractive to its Central American peers, making this market less attractive for foreign residential tourists.

5.7 Opportunities for Future Development

Clearly, there are a number of risks associated with development in this sector which warrant careful consideration: certainly the Panama City market is experiencing rapid oversupply, and unforeseen changes in policy can have serious implication on the stream of residential tourists. However, despite the numerous risks associated with development in this sector, Panama, outside the downtown high rise condo market, has a number of

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[38] July 2007 Interview, Paul McBride, Prima Panama
[39] Prima Panama website survey: http://primapanama.blogs.com/

opportunities, especially for the foreign investor, that should be explored in their residential sector.

Tourism initiatives

The Panama Tourism Development Master Plan 2007 – 2020 was recently unveiled as a measure to develop a strategy for tourism development throughout the country. Nine zones have been identified, equipped with tax incentives to attract development in different regions in the countryside. These areas will also be the focus of tourism infrastructure, as well as marketing promotion internationally. The chart below outlines each of the area and strategies for tourism development, as given by IPAT. While many of these strategies are focused on lodging/hotel, residential tourism projects can be structured to include the hotel component, and many include short term rental programs for visitors, which enable them to qualify for the same tax incentives. The nine tourism zones are as follows:

Figure 22: Tourism Zones in Panama

Zone	Province	Description	Strategy	Requirements
1 La Amistad National Park	Chiriqui Bocas del Toro	La Amistad International Park and Volcan Baru National Park	Develop ecological, leisure tourism	Ecotourism hotels, infrastructure
2 Bastimentos	Bocas Del Toro	Only marine park in country; offers world class reefs	Develop ecological, leisure tourism	Develop tourism lodging
3 Arco Seco	Herrera Los Santos	Traditional and sociocultural events	Develop tourism industry based on tradition and folklore	Develop tourism lodging
4 Farallon	Panama Cocle	75 km of Pacific Ocean coast line	Develop into premiere beach location	Develop resort-type hotels, golf courses, retail, and rentable tourism accomodations
5 Panama City Metro Area	Panama	Shopping, Commerce, Historical & Cultural Centers	Promote existing attractions as tourism sites	Business, leasure, and Ecotourism hotels and additional infrastructure
6 Portobelo	Colon	Beaches, diving, Portobelo National Park	Convert region into Caribbean Tourism attraction	Develop tourism lodging
7 San Blas Islands	San Blas	Coral Reefs, beaches, exotic indigenous culture	Develop tourism potential	Provide technical advice to Kuna Indiginous people to further development
8 Las Perlas	Las Perlas Archipelago	30 islands with beaches; sport fishing, coral reefs	Promote attractions, products, and investment in the islands	
9 Darien	Darien	Darien National Park, UNESCO Biosphere Reserve	Develop ecotourism center	Increase lodging capacity and improve quality of tourism services

Housing Canal Employees

The Panama Canal Expansion is expected to bring between 25,000 and 40,000 jobs to Panama over the next 20 years. Many of these jobs require a highly-skilled labor force of engineers, lawyers, and maritime employees who will be coming to Panama from abroad for short periods of time. This creates a need for more short-term housing options to house these employees; many will be near the Canal areas in Panama City and Colon. Currently, the rental market in Panama is shallow, and almost all new projects under construction are for sale. This demographic trend, in addition to the lack of a rental market, certainly presents opportunity for development in this arena.

Developers looking for "value – add expertise"

Like most foreign and emerging markets, the best way for foreign developers and investors to enter the market in Panama is with a local Joint Venture partner. While most of these developers have been in the market for years, locals are keen to partnering with international expertise – especially if they can offer a "value-add" to the development process such as golf course or marina development, time-share expertise, or master-plan community development. [40]

Panama is certainly experiencing a unique development boom in their residential tourism sector, with speculative capital driving the production of thousands of units in Panama City. However, the negative press related to the cancellation of a number of projects perhaps should drive the speculative capital away, and consequently insight a short term market correction. Long term fundamentals for this market sector are strong, based on the demographics and trends of the international baby boomers and the inherent benefits that Panama offers over its competitors (proximity to North and South America, dollar-based economy, cheap cost of living). Additionally, the government's agenda to increase tourism, as well as Panama's increased role as a global shipping and banking, should continue to be a significant influence that will support this market sector.

[40] June 2007 Interview, Brian E. Werner, Recro Sports Concepts, S.A.

Chapter 6: An Analysis of Risks and Practical Considerations for the Foreign Investor

Despite strong economic growth and compelling opportunities within the real estate market, Panama is not for everyone. Like most emerging markets, there are numerous risks associated with investment in a market like Panama. As noted by one local real estate practitioner, Panama is ripe for "an opportunistic foreign developer with a taste for Latin America."[41] In order to determine if potential opportunistic returns are commensurate with the risk of entering the market, it is crucial to examine each of the components of risk in the investment decision. The purpose of this chapter is to broadly survey risks associated with investment in emerging markets and relate them to Panama, while exploring practical considerations for foreign investment in the country.

6.1 Risks in Real Estate Investment

Generally speaking, the more uncertain the returns are in a market, the higher the risk associated with the investment in that market. While this is true in any real estate investment, the factors of this risk are escalated in foreign markets when political, legal, and currency factors come into play. The following issues have been identified as risks that foreign investors should consider when entering new markets.

Property Market Transparency

Perhaps one of the greatest contrasts in developed and emerging markets is the difference in "transparency," which refers to the quality and quantity of the information made available to participants, as well as the consistency of the rules and regulations with respect to property rights in a marketplace. From an investor's perspective, high transparency in markets like the US and UK eases the flow and reliability of information, but also makes it harder to find market inefficiencies that would typically earn a "risk premium." Conversely, while low transparency imposes additional risks and transaction

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[41] June 2007 Interview, John Brock, McKinney Internacional

costs, it also translates into emerging opportunity and lower cost of labor. The table below shows the 2006 transparency index for the Americas; it should be noted that this is the first year that Panama was included in the index, an indication of a growing investment appetite in the region.

Figure 23: Jones Lang LaSalle 2006 Americas Transparency Index

Transparency Level	Country	2006 Transparency Score	2004 Transparency Score	2006 Tier	2004 Tier
Highest	United States	1.15	1.24	1	1
	Canada	1.21	1.37	1	1
Semi	Mexico	2.51	3.14	3	3
	Chile	3.11	3.24	3	3
	Brazil	3.31	3.62	3	4
	Argentina	3.41	3.76	3	4
Low	Costa Rica	3.83	4.00	4	4
	Peru	4.08	na	4	na
	Colombia	4.10	4.10	4	4
	Uruguay	4.13	na	4	na
	Panama	4.18	na	4	na
Opaque	Venezuela	4.43	na	5	na

Sources: Jones Lang LaSalle, LaSalle Investment Management

Panama's "low" transparency score reflects the lack of reliable current market statistics (including investment performance indexes and market fundamentals data), as well as a weak record for property rights. Perhaps another reason Panama scores low in transparency is intentional: Panama's banking laws provide tax and privacy incentives in an effort to make the country an offshore "tax haven." Accordingly, Panama allows for the use of an anonymous share corporation to own any type of real estate. Ownership of real estate and other assets, if owned by a corporation, is anonymous. There is also no requirement to report sales or transfers of the share stock, and therefore many real estate transactions are not transparent to the market.

Political Risk

Many foreign investors consider political risk to be one of the most important determinants in the real estate investment decision.[42] Country risk analysis involves an examination of a country's economic outlook and stability of its government, as well as factors including corruption and crime. Perhaps the most salient political risks associated with real estate investment in unstable markets are expropriation of the property by military government, or physical damage to real estate from revolution, rebellion, or civil war. Political Risk insurance for Real Estate investments has recently emerged in the marketplace, allowing investors to enter riskier markets by purchasing expropriation, currency inconvertibility, or political violence coverage.[43] An increasing number of political risk policies are being written in countries like Russia and Venezuela, and are particularly attractive to institutional investors looking to enter emerging markets.[44]

Although the country still suffers from the "Noriega-stigma" 20 years later, the political climate in Panama is very stable. The Latin American Monitor notes that Panama's political risk ratings are in very high standing in the region. Similarly, Standard and Poor's and Fitch rate Panama sovereign credit rating as BB/stable and BB+/stable respectively, "reflecting a stable political environment."[45] It can be concluded that Panama's constitutional democracy under the popular Torrijos government does not warrant significant political risk in the near outlook.

Structural Real Estate Risk

According to the PPR Global Real Estate Index, structural factors – including the size and state of a country's economy – have an impact on the economic risk of a real estate market. [46] Larger economies are typically more stable and capable of withstanding external economic turmoil. The country's economic standpoint and its place in the world

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[42] Hong, Jung Hwa; Jones, Peter; and Song, Haiyan, "Political Risk and Foreign Investment Decision of International Hotel Companies," May 1999.
[43] "A World of Risk," *Marsh & McLennan Companies*, December 2006.
[44] Interview, Maura Geragh *Marsh & McLennan Companies*
[45] International Credit Update, *Fitch Ratings,* December 2006.
[46] Chen, Jun and Hobbs, Peter. "Global Real Estate Risk Index," *Property and Portfolio Research*, Summer 2003.

economy also have a significant affect on investment risk in that country. For example, a country in a "developing" stage that has not established the foundations of a market economy and does not participate in trade with other countries (i.e. North Korea) would have higher risk than an emerging market that seeks to be a part of globalization.
While the country's small population of 3.5 Million warrants concern over a shallow real estate market, Panama's role in global trade and investment make it the most globalized country in Latin America, slightly mitigating this risk factor. [47]

Financing Risk

Panama's large and well-regulated banking sector has one of the best ratings in the region (BBB).[48] In contrast with other emerging market economies, traditional bank lending in Panama is relatively efficient and is the most common source of financing for both domestic and foreign investors. That begin said, the banking system is far more conservative than in the US; since the country has no central banking authority, the bank serves as its own "lender of last resort." Over 120 banks from 35 countries are regulated by a 1998 banking law that meets the Basile Committee's international standards for transparency and reporting. Overall, Panama benefits from a more sophisticated banking sector than many of its peers, and therefore the availability of project financing is not a considerable risk.

Currency Risk

The risk of currency devaluation is a threat to the stability of dollar denominated returns. Many Latin American markets have had a history of volatile currency fluctuation, and consequently devaluation remains a real risk, most recently seen in Argentina in 2002. However, currency risk is not readily applicable to Panama, which has had a fully dollarised economy since 1904. Additionally, Panama has no legal restrictions on the transfer abroad of funds associated with capital employed in an investment. This is perhaps one of the greatest risk mitigates for capital investment into a Latin American Country.

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[47] "Latin American Globalization Index," *Latin Business Chronicle.* October 2005.
[48] Economist Intelligence Unit.

Ownership Structure Risk

The right to own – or use – land is a prevalent issue in many emerging market economies. National and local governments still own a vast majority of land in many emerging markets, requiring investors to structure long term land leases – a risk that some institutional investors have trouble accepting. In countries where the investor can purchase land, lack of title records or title insurance is common, especially in rural areas. Squatters rights and eminent domain are common practice in many countries and can present challenges throughout the development process.

Panama is no exception. Real Estate laws – and how they are enforced – differ greatly in Panama City versus the country's interior, as well as on the outlying islands and in areas near national borders. Panama has three distinct types of property: titled (i.e. fee simple), Rights of Possession (i.e. "squatters rights"), and government owned concession property, which will be discussed further in the next section. Generally speaking, titled property can be found in and around Panama City and other cities where property has been developed and traded for years; conversely, the country's interior is more difficult to obtain clean title.

Constitutionally the government cannot take possession of private property without following a condemnation process similar to the U.S.; the owner must be compensated for land and improvements at fair market value. However, there is great disparity on this issue between the law and how it is practiced. According to the 2007 Index of Economic Freedom, Panama suffers from weak property rights; foreign investors have reported that compensation of confiscated land tends to be below market value.[49] Businesses do not trust the judiciary system as an objective, independent arbiter in legal or commercial disputes. Although some of Panama's business and banking codes have been modernized and are generally enforced as a means to strengthen confidence in property rights, there is still much improvement to be made in this area. Many investors consider Panamanian property rights to be a considerable risk for real estate investment.

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[49] "2006 Real Estate Transparency Index," *Jones Lang LaSalle Research,* 2006.

Transparency of Regulatory System

In an effort to encourage FDI, laws in general make no distinction between domestic and foreign companies. In 1998, the government enacted the Investment Stability Law (Law No. 54), which guarantees foreign investors who invest at least two million dollars in Panama equal treatment under the Panamanian law to that of their domestic competition.[50] However, despite the current administration's efforts to make the government more transparent, corruption in Panama is still very prevalent. Foreign firms have reported that they are hindered by the informal links between government and local business officials. For real estate developers, this often translates into inconsistencies in building codes, permit approvals, and variances from their domestic counterparts, increasing the uncertainty and risk associated with the investment.

Although Panama suffers from weak property rights, regulatory inconsistencies, and low transparency, investment risk is mitigated by its dollarized economy, relative political stabililty, and sophisticated banking system. Qualitative research shows that industry participants active in the market feel that Panama is not as risky as it is often perceived.

6.2 Practical Considerations for Real Estate Investment

Purchasing Property

As mentioned above, Panama has three types of property, each of which have separate rules for type of ownership, financing, and in same cases, land use. It is necessary to perform complete due diligence on the property type, as well as land boundaries, tax burdens, and registered value in order to fully minimize transaction risk.

Titulo de propiedad (Titled Property): most similar to "fee simple" property in the US, where owner has sole title to the land as registered in the Panamanian Public Registry system. Title property should be verifiable through the Public Registry System and is guaranteed by the constitution of the Republic of Panama. Banks generally issue mortgages on titled properties and register liens against title as collateral. Property taxes

[50] "Doing Business in Panama: A Country Commercial Guide for US Investors." US Dept. of State, 2006.

are incurred on titled property when the registered value is over a certain amount, set periodically by the government. (unless the buyer has an exemption for the construction of a new dwelling). Typically, title property is secured by a 10-20% down payment, with the balance paid upon signing a Purchase and Sale Agreement. A public deed is then registered and title transfer on the property is complete. Both foreigners and nationals can hold title insurance on this type of property, which is strongly recommended.

Derecho Posesorio (Rights of Possession): Many coastal areas, islands, and real estate located in tourism zones are owned and managed by the government and only "possession rights" are granted for a determined period of time over this land. These "limited ownership" rights can be granted by the Natinoal Agrarian Reform, or more recently, by the Cadastral Office. Possession rights are obtained through certification documents, a process that can take up to 2 years, but they do not grant ownership and therefore don't incur property taxes. As much of the property in popular tourist areas including Bocas del Toro and the Chriqui province are considered to be under possession rights, the government has extended concession periods, ranging from 40 to 90 years. Typically, liens or mortgages can not be levied on Rights of Possession property.

Concession Property: property the government owns and grants a concession to an individual or an organization for a particular purpose, typically in the form of a land lease. Concession property is usually granted already "zoned" with a use in mind (i.e. industrial development, marina, hotel), and are granted for a set amount of time, typically 20 years with a renewable option that would double the length of the lease. Concessions are generally found in coastal areas or other government protected areas where titles are not permitted by law. This type of property is guaranteed by the government, mitigating title risk to the investor and in large part ensuring title insurance policies on the property.

It should be noted that all of the former US Canal Zone land is Concession property: in total 233,000 acres of prime real estate located around the Canal Zone. The Inter-oceanic Region Authority (ARI) manages these reverted areas, which are obtained by bids from foreign and domestic investors; the most recent example is the Howard Air Force Base to

British Developer London & Regional Properties, ltd. Although there is great potential for development of this land, the ARI has strict intentions for its use and are not accustomed to granting variances.

Another option for foreigners to purchase property in Panama is to acquire a Panamanian Corporation which already owns the land, provided that full due diligence is made on the corporation and its previous activities.

Generally speaking, all contracts for property must be in Spanish on a formal public deed and signed before a public notary in order to be legally enforceable.

Environmental Regulations

Environmental impact studies will be required for most development, but this varies according to area; for example, there are currently few zoning laws or regulations in the islands. Environmental regulations for development in the former Canal Zone are stricter than in other parts of the country, a result of the unique environmental sensitivity of the Canal-lock system. Because the canal is run on fresh water from Lake Gatun, it depends on the rainforests to maintain water levels. Type and use of development are therefore more heavily regulated in the some concession areas. A recent example of this occurred when the Colon Free Trade Zone committee rejected a number of industrial companies that were looking to locate in the area on the grounds that the heavy industrial would contaminate the area.

Tax Considerations for structuring deals

Panama has long been a center for tax-incentivized off-shore investing, and there are a number of ways to structure real estate investments to utilize tax benefits and asset protection. Most residential and commercial real estate owners establish a corporation for purchasing property; it is advised to set up one corporation for each property. This structure allows for the use of an anonymous share corporation to own real estate, providing protection of the owner's other assets. The structure also allows the seller to avoid a tax on the gain on sale; the corporation can remain as the "owner" of the real estate, and the stock certificates can be transferred to the buyer, as if no public transaction has occurred.

Real estate in Panama is subject to property tax; however, due to a lack of a formal appraisal system, the tax is levied as a percentage of the purchase price. As an incentive to boost construction, the government regularly issues moratoriums on property taxes for new construction. The last one, a 20 year tax exoneration which was issued in 2005, is about to expire, and it is unknown at this point if a new moratorium will be issued.

Financing Market

As discussed above, Panama benefits from a strong banking sector that will lend to both domestic and foreign borrowers. The Panamanian interest rates closely follow international rates, plus a country-risk premium; HSBC is quoting construction loan rates at 6 month LIBOR + 300 basis points, currently around about 8.4%.[51] Banks will typically lend up to 80% of direct construction costs (not including soft or land costs, approximately 60% TDC) to Panamanian and foreign borrowers. Typically, the developer will contribute the land as equity, and the balance of construction is funded in pre-sales.

Given the current speculative building boom in Panama City, banks have started to restrict capital flows with more stringent underwriting requirements. Most lenders will require a large amount of pre-sales (70% - 100%, depending on the average price of the unit); additionally, they are starting to require that "pre-sales" includes not just the 30% deposit on the unit, but the full sales price. This effort to contract the flow of capital into the residential market increases market risk for this sector in the short term; however, it speaks to the strength of the banking system and the market's potential to correct itself during a speculative investment period.

[51] July 2007 Interview, Javier Mosquera, HSBC

Chapter 7: Conclusion

In examining Panama from a macro and market-level perspective, it becomes apparent why real estate investors are increasingly seeking opportunities in the emerging markets. In the past few years, Panama has seen "China-like" growth, with GDP expanding over 8% last year and foreign direct investment flows doubling. Additionally, Panama's current administration has proven to be effective political platform that has passed social and economic reforms that should contribute to stable growth in the future. However, regulatory inconsistencies, weak property rights, and a lack of market information pose additional challenges and uncertainty for real estate development in this market that, like in other emerging markets, increase investor risk.

Conversely, Panama is unique among emerging economies in that it is home to its famed canal. Best summarized by a recent Credit Suisse report, "Panama: in Canal We Trust," the waterway is not just a part of the economy but a increasingly important global link that will increase the country's strategic position and provide close political links to the US and other leading world economies.[52] Accordingly, the country's dollarized currency serves to further mitigate foreign investment risk common in emerging markets.

In the next several years, Panama's industrial real estate market is projected to grow as Panama reinvents itself as a regional logistics and services hub. Industrial real estate designed toward logistics, storage, and distribution is already in high demand, and it is assured this trend will continue to grow given the canal expansion, the growth of the ports, and the additional trade incentives offered by the FTA. The long term outlook for the residential tourism sector is also strong based on international demand; however, investment in this sector is riskier in the short term. Panama City will likely undergo a market correction, and therefore it is prudent to instead consider opportunities in the country's interior. Overall, fundamentals for both markets appear to be strong, and the economy's explosive growth, openness to foreign investment, and planned expansion of the canal will fuel compelling real estate investment opportunities in the future.

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[52] "Panama: in Canal We Trust," *Credit Suisse,* March 2007

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