Lebanon Real Estate Report

June 2010

NO PRICE BUBBLE BUT FLATTER GROWTH OUTLOOK

- Lebanon's real estate sector has grown to become one of the success stories of the Lebanese economy. The market has demonstrated strong performance and noticeable resilience in the face of the global crisis which triggered acute activity slowdown in peer regional and global markets.
- Although prices have been appreciating at double-digit rates on average over the past few years, the sector, emanating from a very low base, is not believed to undergo a price bubble nowadays.
- Recent years' price hikes in various market segments only contributed to bringing real estate prices more in line with regional and international averages. Domestic market prices are by no means overinflated relative to such benchmarks.
- Demand for Lebanese real estate is genuine and non-speculative. This demand is driven by the organic growth of Lebanese resident households, the large Diasporas of Lebanese non-residents around the globe, and a growing Arab demand for secondary lodging in Lebanon.
- Within the context of a stringent regulatory framework, the real estate sector is characterized by considerably low leverage on behalf of developers and consumers. Within this context, the market is benefiting from new waves of housing loans which amount today to US$ 3.1 billion (still only 2.5% of banks' balance sheets).
- The growing gap between Lebanese residents' purchasing power and the quality of the housing stock available today in the market has yet been raising the question of affordability of lodging for a large portion of Lebanese residents. With prices at record highs in Beirut, demand is shifting to small-to-medium size estate, and is increasingly headed to capital city outskirts.
- Lebanon's realty prices are likely to remain sticky on the downside, as the increasing scarcity of land plots, especially in the capital city, combined with healthy demand, is providing support to land prices which are increasingly weighing on end-user prices.
- The short-to-medium term outlook is that of a flatter price growth relative to previous years, with less room for drastic appreciation after realty prices became more in phase with their fundamental value.

SWOT Analysis

Strengths • Investment-friendly environment with no capital gains tax • Sound fundamentals with genuine needs for realty on the demand side and low leverage on the supply side • Buoyant economic performances in recent years supporting real estate activity	**Weaknesses** • Historical volatility of domestic politico-security conditions burdensome for the sector • Discrepancy between quality of housing stock available on the market and purchasing power of Lebanese residents • Construction and raw materials costs subject to erratic global market fluctuations
Opportunities • Growing expatriates demand and steady demographic trends to continue sustaining real estate activity • Increasing availability of banking sector housing loans at all-time low debtor rates • Realty prices likely to remain sticky on the downside	**Threats** • Relapse in security drifts and/or political bickering might put some strains on sector activity • Prolonged global sluggishness or exacerbation of uncertainties could affect foreign demand

The Lebanon Real Estate Report can be accessed via Internet at the following web address: http://www.banqueaudi.com

CONTENTS

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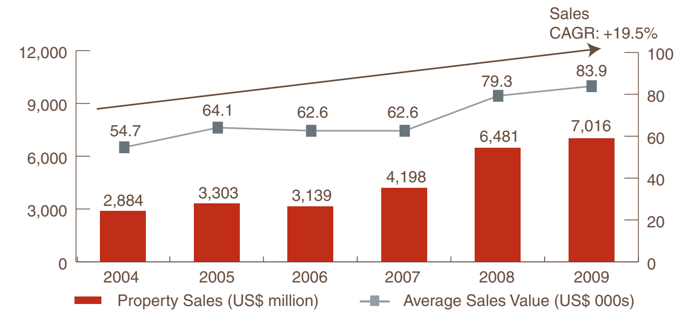
1. Sector Overview

Lebanon's real estate sector has grown to become one of the success stories of the Lebanese economy. It weathered times of adversity on the domestic front in a relatively good fashion, posting more or less steady performances, recently fared quite well in the face of the global financial crisis and its spillovers, and is now gaining more steam within the context of a gradual global and regional economic recovery at large.

While the Lebanese real estate sector has not been entirely spared by the spillover effects of the global crisis, it not only pulled out a decent performance in the year 2009, known across the globe as the "crisis year" and in peer real estate markets as a period of acute activity slowdown, but actually somewhat intensified since the start of the current year, thus further bolstering the healthy trend of the previous five years.

On the demand side, real estate sales, which grew by 19.5% on average per annum between 2004 and 2009, more than doubled in this year's first five months, while the number of such transactions, which posted a CAGR of 8.2% in the 2004-2009 period, rose by a healthy 39.5% in the first five months of 2010. This actually translated into a remarkable 47.2% surge in the average real estate sales value since the start of the current year.

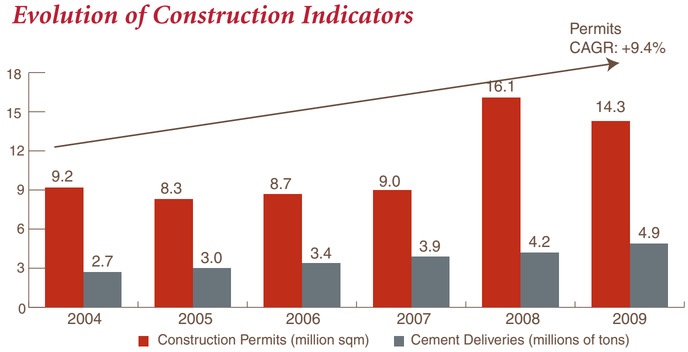
Evolution of Real Estate Indicators



Sources: Real Estate Registry, Bank Audi's Research Department

Supply side indicators also support this trend, reflecting continuing building activity. Construction permits, which rose by 9.4% on average per annum over the past five years, soared by a yearly 53.7% over the first five months of 2010, and reflect developers' increasing acquisition of news plots for forthcoming projects. Cement deliveries, which had witnessed a healthy 12.4% annual average growth over the past five years, surged by 15.1% over the first four months of 2010 (latest available statistics), thus highlighting real estate market dynamism.

Evolution of Construction Indicators



Sources: Order of Engineers of Beirut and Tripoli, Banque du Liban, Bank Audi's Research Department

What lies behind such performances that are capturing the attention of an increasingly large number of keen local, regional and international observers and investors? Have recent developments in the domestic real estate sector been shaped by new market trends? Are Lebanon's real estate market prices still lagging behind regional and international peers in spite of recent turmoil abroad, or have they grown to become comparatively overinflated? Is the current real estate cycle about to witness a reversal?

In what follows, we will address all such trendy sector topics, ranging from key resilience factors, dominant market forces, and shifts in demand patterns in the wake of latest trends, to the analysis of the performances of the different segments of the real estate market, namely the residential, retail, and office segments, and their price levels relative to peer regional and international averages, and lastly the short-to-medium term perspectives of this truly intriguing sector.

2. Sector Trends

a. What helped Lebanese real estate sail through stormy waters so smoothly?

Lebanon's realty market has been doing rather well in times of real estate turmoil across the region and the globe at large for a variety of reasons. First, demand for real estate in Lebanon remains one of end-users, and not speculators as was the case for many peers in the Gulf region and across global markets. This means that the wide majority of realty buyers are not looking to make a quick buck, enticed by relatively favorable buying prices and payment terms while betting on realty appreciation and consequently the opportunity of a rather juicy sale. Speculators do exist in Lebanon, but remain in small numbers relative to peer markets in the region and elsewhere in the world and thus do not have a tangible impact on domestic market activity volumes. They are roughly estimated not to exceed 20% of buyers, as per Ramco Real Estate Advisers.

What happened to realty markets abroad is that when the global crisis erupted, there was no market left for speculators to resell purchased properties to, which caused a downward price spiral as these had to untie their positions to match arising liquidity needs. Moreover, within the context of a shortening of liquidity across the globe, speculators were no longer in search of an investment and rather adopted a wait-and-see mood until the cloud of uncertainties starts to dissipate. In

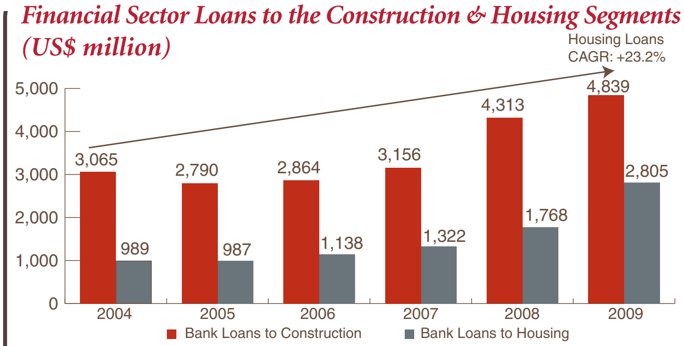
Lebanon however, a steadily increasing local resident base and a growing number of returning expatriates could not really afford to postpone house purchases and thus allowed the market to witness more or less sustained demand throughout recent months.

Second, realty developers in Lebanon do not rely much on financial leverage (i.e. borrowings from banks), but rather on their own funds to undertake their projects. Developers alternatively get a boost from presale money that actually adds to self-financing, but leverage in real estate development remains relatively low thus underlining the solid financial standing of the industry on the supply side, while ensuring the continuity of projects underway in difficult times.

Third, a stringent regulatory framework actively contributed to preventing the real estate sector in Lebanon from entering into a bubble. The Central Bank of Lebanon issued a couple of years ago a circular limiting real estate loans from banks to 60% only of the project's value, while requiring collateral against such loans to amount to at least 60% of the project's value, thus putting a cap on leverage and somewhat pushing speculators away from the sector. This has not discouraged demand, as the new measure is not applicable for instance to housing loans intended for the acquisition of a first home, loans extended by the Housing Bank, and those extended to the Public Housing Institute and those targeted at army volunteers. Further, the quasi-absence of Lebanese banks' exposure to toxic assets and their overall increasingly solid financial stance allowed them to continue funding the private sector in spite of tight credit conditions across the globe, and thus extend housing loans to Lebanese residents and expatriates or even project financing for developers.

More recently, Lebanese monetary authorities exempted a number of lending categories from reserve requirements in LP as of mid-2009, by allowing banks to deduct up to 60% of new lending in local currency directly from their LP required reserves. This left room for reduction in debtor interest rates on local currency housing loans to lows near the 5% range, which further extends the downward trend in interest rates on loans of the past few years and somewhat spurred demand for

Financial Sector Loans to the Construction & Housing Segments (US$ million)



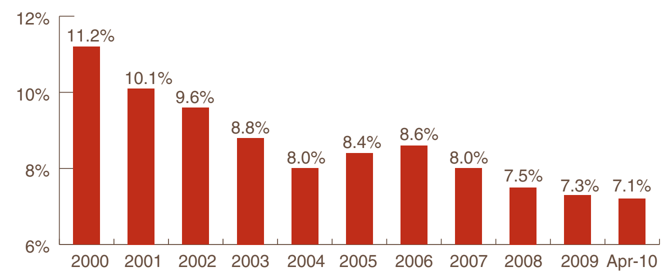
Sources: Banque du Liban, Bank Audi's Research Department

realty. Financial sector housing loans, as per latest available Central Bank statistics, surged by 58.7% in 2009, a year of strong deleveraging across the world, thus extending the five-year CAGR to 23.2%. Further, lending activity in general accelerated since the start of the current year, with lending growth in volumes over the first four months of 2010 more than five times that of the corresponding period of the previous five years. Part of such volume growth was captured by the housing segment, which continues to benefit from record low debtor rates and healthy demand (+11.1% over the first quarter of 2010).

June 2010

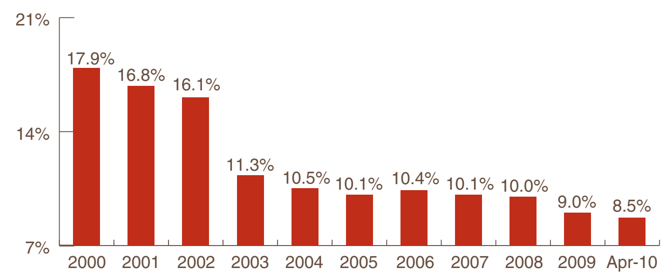
Fourth, Lebanon's open and liberal real estate sector benefited from the buoyant performance of the domestic economy, which recorded 9% real growth rates in each of 2008 and 2009 within continuously robust inflows of capital into the country and overall favorable politico-security conditions, in a period when peer realty markets in the region and worldwide were suffering from a severe slowdown in economic and realty activity. Official figures put total investments in Lebanese real estate at a high of nearly US$ 7 billion in 2009, i.e. slightly more than 20% of the country's total output.

Avg. Interest Rates on Bank Loans in US$



Sources: Banque du Liban, Bank Audi's Research Department

Avg. Interest Rates on Bank Loans in LP



Sources: Banque du Liban, Bank Audi's Research Department

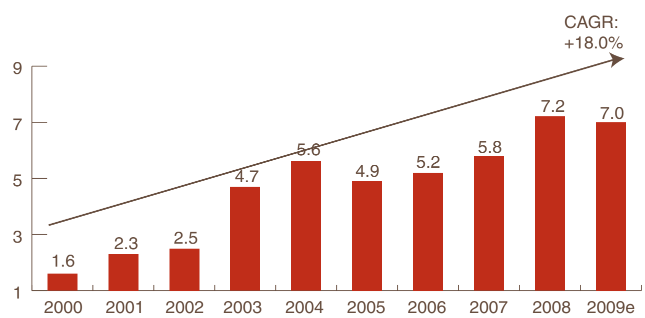
b. A Lebanese-driven market impulse …

Within this context and given the misfortunes of foreign Arab and Western investors suffering from an acute liquidity squeeze as of late 2008 and throughout most of 2009, Lebanese residents and to a certain expatriates demand was further put in the driver's seat, accounting for an estimated 85%-90% of total demand, and largely helped the market continue to witness rather healthy activity levels.

Lebanese resident demand, estimated to account for practically half of realty demand, is mainly a consequence of the steady growth in resident population year after year (at a long-term average of 1.6% per annum over the past couple of decades), and evolving lifestyles with the emergence of double-income households in recent years and sociological patterns with more and more bachelors seeking to live by themselves and non-Beirutis renting or purchasing a foothold in the capital city for education or professional purposes. All such factors indeed translated into accrued demand for housing realty, within the context of a steadily improving per capita income at an annual average rate of 11.6% over the past couple of decades (to reach US$ 8,707 in 2009).

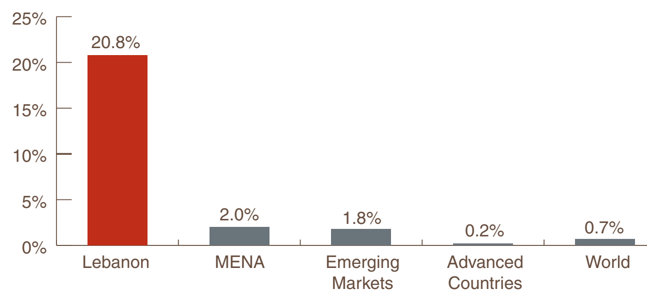
What also supported local resident demand are their strong ties with the wealthy and well-scattered large Diaspora. Lebanon continues to benefit from substantial inflows of capital year after year even in the most difficult times, with remittances from Lebanese expatriates to relatives in their native land maintaining in 2009 their highs of the previous year, and rising by 18.0% on average per annum over the past decade. Lebanon actually benefits from one of the highest per capita remittances on a global scale, which represents financial support for locals and facilitates their acquisition of residences.

Remittances to Lebanon (US$ billion)



Sources: World Bank, Bank Audi's Research Department

Remittances/GDP (Year 2009 estimates)



Sources: World Bank, IMF, Bank Audi's Research Department

On the other hand, Lebanese expatriates, accounting for roughly 40%-45% of real estate demand in the country, are more and more seeking a foothold (secondary residences) in their home land for their increasingly frequent visits and stays following the normalization of the domestic politico-security conditions a couple of years ago and the quasi-stability of the local environment ever since. Part of the younger segment of the expatriate inflow is attracted by a robustly performing economy and improving labor market conditions in a period of delicate conditions across the globe and lingering weaknesses in advanced economies' job markets.

Within the context of a relative improvement in regional economic conditions and a rise in average oil prices of 61% on a yearly basis when comparing the first five months of 2010 with the first five months of 2009, sales transactions to foreigners, which in number only account for a minor share of total sale transactions but mostly include Gulf Arabs, have been posting healthy performances lately. The number of sales to foreigners rose by 10.7% year-on-year in the first five months of 2010, as per Real Estate Registry statistics. Such figures actually come in extension to those of the full-year 2009, and reflect continued interest in Lebanese realty on behalf of foreigners, but should not really lure anyone. Foreigners are not trend-setters in the real estate sales compartment, as their purchases of continue to account for a minor share of the total number of real estate sales transactions, and concentrate in relatively remote regions and areas outside Beirut and thus relatively less expensive than the capital city.

c. … shifting to small-to-medium size estate, and increasingly headed to capital city outskirts …

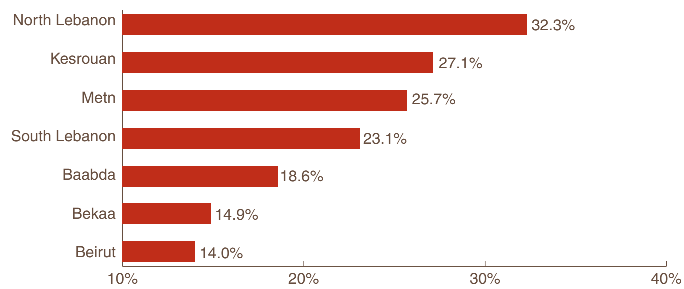
With Arab nationals and the local and expatriate elite more cautious when it comes to purchasing large size high-end realty at record high price levels, the local real estate sector has witnessed a slowdown in demand for such properties, for instance sea front and downtown flats in Beirut.

With local residents' budgets on the overall relatively lower than Gulf peers, Lebanese demand is witnessing a gradual shift to smaller size good quality residential units of 150 to 200 square meters catering to smaller size families and single person households. Recent Order of Engineers of Beirut and Tripoli estimates put newly granted construction permits for residential units in excess of 300 square meters at no more than 15% of total issued residential unit permits in 2009, a trend quite consistent with previous years also marked by notable rises in property prices.

But perhaps a more noticeable recent change in demand patterns is the rising demand for real estate properties on the outskirts of Beirut and surrounding areas. On one hand, developers are expanding their scope of investments outside the capital city due to the increasingly critical scarcity of land plots available in Beirut and thus soaring prices in the area. On the other hand, realty purchasers are seeking less crowded residential streets with more greenery within affordable areas, all the more so infrastructure development is ongoing and new roads linking the capital city to major suburbs are facilitating daily commuting and transportation to workplaces.

Sector figures actually come to confirm this growing trend, with areas immediately outside the capital city and other regions in the country gaining a larger share out of total real estate sales value. For the first time in years, Baabda (when accounted for alone and thus not included within the broader Beirut area) has been outstripping the capital city of its top spot in terms of real estate sales since the start of 2010, after having consistently gained ground in recent years. Beirut actually boasted the lowest 2004-2009 five-year CAGR relative to other regions in the country in terms of realty sales (+14.0%), in spite of remaining quite active itself, trailing North Lebanon (+32.3% CAGR between 2004 and 2009), Kesrouan (+27.1%), the Metn (+25.7%), South Lebanon (+23.1%), Baabda (+18.6%), and the Bekaa (+14.9%).

Evolution of Real Estate Sales by Region: 2004-2009 CAGR



Sources: Real Estate Registry, Bank Audi's Research Department

d. … in a market witnessing a cooling down in property price growth

Following notably robust property price hikes in the 2005-2008 period estimated at an annual average of 20%-30% (mostly for Beirut) by Ramco Real Estate Advisers, and due to a variety of factors such as the steady increase in land prices on the backdrop of a gradually decreasing stock of land availability in the capital city, overall healthy demand from all market driving forces for own usage purposes especially following the normalization of politico-security conditions, and the surge in global construction material costs in the 2007-2008 period, the pace started to cool down at the start of 2009, and the market regained a state of relative stability.

But with demand for Lebanese realty structurally driven by end-users and benefiting from relatively healthy fundamentals both on the demand and supply side, and the gradually increasing scarcity of land plots in the capital city continuing to put upward pressures on prices, realty prices in Lebanon, which had not attained inflated levels as compared to regional and international averages in the first place, really had little excuse to nudge down, at least tangibly.

What the Lebanese market has practically seen in the year 2009 is a relative stability in real estate prices, or at most mild price variations throughout the year. With global and regional property markets engulfed in a severe downturn, buyers have become increasingly cautious and self-conscious of market developments, which incited them to bargain more and ask for discounts. Even though demand for large-size high-end estate and from non-Lebanese slowed down in the earlier part of 2009, price have not really followed suit. Some developers (about a fifth of them) agreed to grant a 10% to 15% discount to demand buyers, but have not really been tempted to decrease asking prices much, mostly in anticipation of a potential upswing in prices in an overall healthy market bucking global trends.

After the market took some time to digest the latest developments on the global and regional front and after domestic realty prices witnessed stability or in some cases a return to -or closer to- more appealing price levels, real estate in Lebanon regained some steam. Realty prices in Beirut resumed a slightly upward trend towards the end of the year and rose by 5% to 10% from nearly end-2009 to date, as per Ramco Real Estate Advisers estimates, thus more or less regaining year-end 2008 levels. This definitely wiped off the overall relative stability witnessed throughout last year, largely as a consequence of both continuously healthy demand and a 10%-20% rise in land prices over the past six months, according to the same source. Even though the high-end large-size flat stock, mostly the result of strong demand in the previous couple of years, remains rather difficult to liquidate, small-to-medium size estate, tailored for current demand trends, is witnessing slight price increases.

Having said that, one has to wonder whether the steady price rises in Lebanon's property market in recent years, followed by relative stability throughout last year and moderate rises since the last few weeks of 2009, within the context of a downturn in regional and global property markets, has made the domestic market suffer from comparative price inflation relative to such peers.

In other terms, has the Lebanese market found itself engulfed in a real estate bubble? Or on the contrary, has the local market been catching up with regional peers and today boasts price levels much more in tune with those elsewhere in the region and across emerging markets at large?

In order to answer such a puzzling question, we proceed in what follows to the analysis of the various segments of the real estate sector in Lebanon, namely the residential market segment, and the commercial segment comprised of the retail market segment and the office market segment, while providing comparisons with price levels in other cities of the world and regional and international benchmarks.

3. Sector Segments

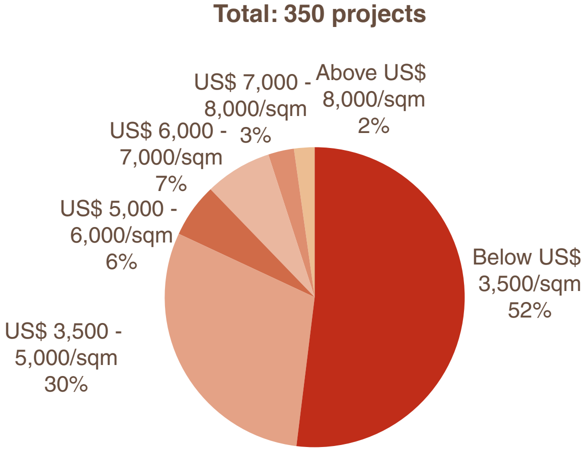
a. The residential market segment

The residential segment of the real estate market in Lebanon remains by far the largest, accounting in 2009 for more than 80% of new construction permits issued during the same year. It continues to witness sustained activity, yet evolving at a pace that is much more realistic than that of the couple of years building up to the outbreak of the global crisis.

The total number of new residential projects under construction in Beirut as we speak (i.e. ranging from the start of excavation works to the moving in of first resident) roughly reaches 350, as per Ramco Real Estate Advisers figures. In line with current market trends, demand for relatively more affordable small-to-medium size residences valued at US$ 500,000 and less, and thus whose prices per square meter range below US$ 3,500 (first floor apartments), is dominant, accounting for more than half of total projects underway in the capital city.

Those projects posting prices per square meter of US$ 7,000 and above, mostly located at the seafront coastline of Beirut (and mainly in the high-end range) only account for 5% of total projects under construction, according to the same source.

Residential projects under construction in Beirut - June 2010
First floor apartments (% out of total projects)



Sources: Ramco Real Estate Advisers, Bank Audi's Research Department

The Beirut Central District area

The Beirut Central District (BCD) area, currently witnessing 24 projects under construction, has felt the pinch of the global financial crisis since the end of 2008. The area indeed mostly boasts high-end residences with prices no less than US$ 6,000 per square meter and peaking at about US$ 10,000 (first floor) on the sea front coastline. Apartments in the BCD, mostly targeting Lebanese elite and wealthy Arab nationals (Syrians, Jordanians, and Gulf nationals), have been more difficult to sell than in other areas of the capital city, either due to liquidity squeeze post-crisis outbreak or to a sort of reluctance to buy at elevated costs during a time of global uncertainties.

The BCD area's residential realty market has nonetheless seen speculators show interest and somewhat support demand in the past few months. These have been enticed by attractive down payment conditions and discounts on behalf of developers eager to launch projects successfully in their early stages.

Speculators mostly look for flats in the early stage of construction (and thus whose payment terms are much more suitable given that buyers are to pay the entire amount of an apartment when construction works come to an end). Areas in demand indeed range between 250 to 350 square meters as they are easier to sell later on the secondary market than for instance units of 500 square meters targeting a much narrower segment of the market.

Mostly under the impulse of speculators attracted by recent years' quick and tangible price gains but also within the context of moderate price hikes elsewhere in the capital city, prices in the BCD area have been slightly on the rise since the end of the year 2009, posting a 5%-7% growth according to the same source.

The Western and Eastern sides of the BCD

The Western and Eastern sides of the BCD, respectively Ras Beirut and Achrafieh, remain dynamic on the residential market front, with many neighborhoods witnessing sustained demand. Indeed, ever since some projects in Achrafieh (Sursock and Georges Haimari Street near Sassine) and Verdun - Ain Tineh started posting asking prices of US$ 5,000 – 5,500 per square meter, the price gap relative to the BCD area started narrowing down, standing today at about 10%-15% (when comparing first floor apartment prices), as per Ramco Real Estate Advisers figures.

In Ras Beirut, the Verdun - Ain Tineh, Clémenceau and Hamra areas are much in demand. Koraytem's residential prices have risen by about 10% since the last few weeks of 2009. Verdun remains an area for luxury flats with asking prices starting at US$ 5,000 per square meter (first floor apartments) but still sees many projects

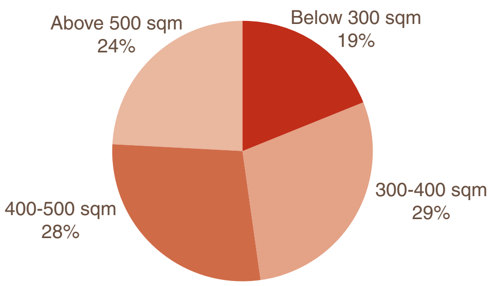
Box 1: BCD Residential Market Survey - October 2009

A survey conducted by Bank Audi's Real Estate and Engineering Department late in 2009 on the BCD residential market and fully covering 32 projects which are either completed, in the course of construction or in the pipeline, and initiated since the very late 90s, sheds light on the large size high-end nature of the said area.

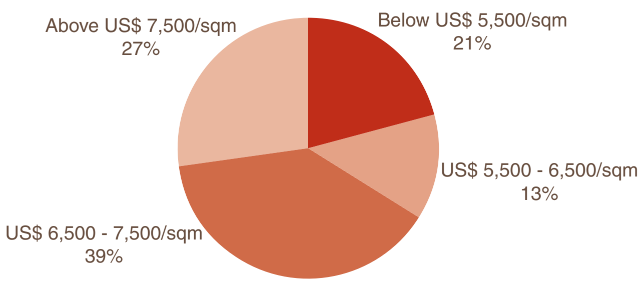
While the survey includes residential projects whose flat areas range between 130 square meters and 830 square meters, it actually shows that only 19% of the referenced apartments as at October 2009 have areas of less than 300 square meters. The average unit size stands at 440 square meters, with the average price nearing the US$ 7,000 threshold. At the time of the survey completion, about 60% of the 1,181 BCD residential units put on the market were sold.

About 81.7% of surveyed apartments are located in the Minet el Hosn area, 7.7% in reclaimed land area, 4.2% in Bashoura, 3.4% in the Port area, 2.0% in the Zokak el Blat area, and 0.9% in Saifi.

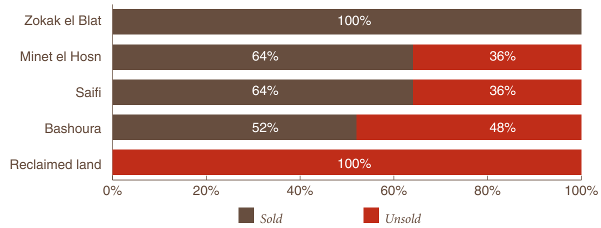
BCD supplied residential units by size - October 2009



BCD remaining residential units by price - October 2009



BCD residential units sales performance as at October 2009



Sources: Bank Audi's Real Estate and Engineering Department

come to the market, and witnessed a 10% price rise over the same period. Clémenceau is a well-developing residential neighborhood with many 250-350 square meter apartments targeting the upper-middle class. Asking prices have gone up 10%-15% over the covered period and start at US$ 4,000 per square meter.

Hamra is a booming area on the residential front, with activity and demand driven by the retail and commercial flurry of recent years. Hamra remains a historic venue in the eyes of many and benefits from close proximity to major retail and commercial centers. Demand in that area mainly stems from upper-middle class locals working in areas and streets nearby. Asking prices have risen more than the Beirut average (+10%-15% over the same period) and have exceeded the US$ 3,800 threshold.

The middle class segment of the population in search of housing is increasingly targeting Zarif, Mar Elias, Mousseitbeh, and Ras el Nabeh whose prices start at US$ 2,500 - US$ 3,000 per square meter depending on the street/area and have risen by 10%-15% since the end of 2009, according to the same source.

On the Eastern side of the BCD, the golden triangle, i.e. the area extending between Sofil, Sassine, and Sodeco, remains pretty much in demand with prices also rising by 10%-15% lately. Sursock (a trendy area) and Georges Haimari (actually one of Achrafieh's heights) streets have seen a 10% price rise in recent months, while those in Furn el Hayek increased by 15%. Abdel Wahab, Trabaud and Saint Nicolas are still home to new and ongoing projects, while the Mar Mitr and Zahret el Ihsan area is developing at a healthy pace with six to seven new projects under construction. Mar Mikhael is emerging as a new residential area. The Hotel Dieu neighborhood is in demand, especially flats of 150-200 square meters targeting the middle class segment and that remain more affordable than those closer to the city center.

On the outskirts of Beirut, the areas of Fanar, Mar Takla, Baabda, Mansourieh, Bayada, and Yarze, among others, are booming and seeing many residential projects arising, all the more so prices have reached new highs in the capital city.

Residential prices in Beirut have grown indeed, but only to become more in line with regional and emerging market benchmarks

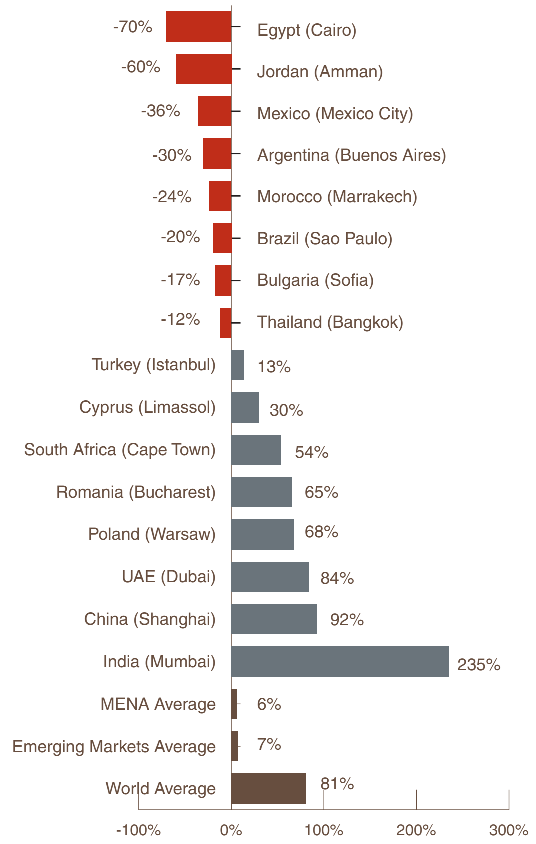
While it is true that prices in Beirut's residential market have risen fast in the past few years, and have resumed a slightly upward trend in recent months, they have nonetheless grown to become more in line with regional and international benchmarks, and by no means are comparatively overinflated today.

The latest statistics of worldwide real estate consultants

Global Property Guide indicate that Beirut only ranks 60th out of 90 locations surveyed in terms of average buying prices per square meter for 120 square meter apartments in the heart of the most important city of each country. While prices in Beirut are indeed higher than in some Middle East and North Africa cities such Egypt's Cairo, Jordan's Amman, and Morocco's Marrakech as per Global Property Guide, Beirut continues to trail major hotspots in the region such as Dubai. Even after tangible prices drops in the UAE city, residential prices in Dubai stand today 84% higher than those in Lebanon's capital city. Along the same lines, residential prices in Turkey's Istanbul are today 13% higher than those in Beirut.

As such, Beirut has been witnessing upward price corrections bringing the city only closer to price levels in the countries falling in the Middle East and North Africa geography and surveyed by Global Property Guide. Those remain on average 6% higher than Lebanon's Beirut, while emerging markets prices remain on average 7% higher than those of the domestic market. Still, Beirut remains nowhere near the global highs of Monaco (about 17 times higher than Beirut), New York and Moscow (about 5.6 times higher), or Mumbai (about 3.4 times higher), with global prices on average 81% higher than those prevailing in the capital city.

Avg Residential Property Prices May 2010
Relative to Beirut Prices



Sources: Global Property Guide, Bank Audi's Research Department

A rental residential market still lagging behind …

Even though the rises in residential prices in recent years shook things up in Lebanon's real estate market, the rental segment of the residential market failed to follow suit, remaining more or less stagnant and bucking global trends which saw sharp slowdown in new home sales somewhat spur the rental segment. Further, price hikes in recent years actually contributed to creating some distortions in the rental residential segment, with supply on the rise in the large size high-end segment and demand rising on the more affordable smaller size flats.

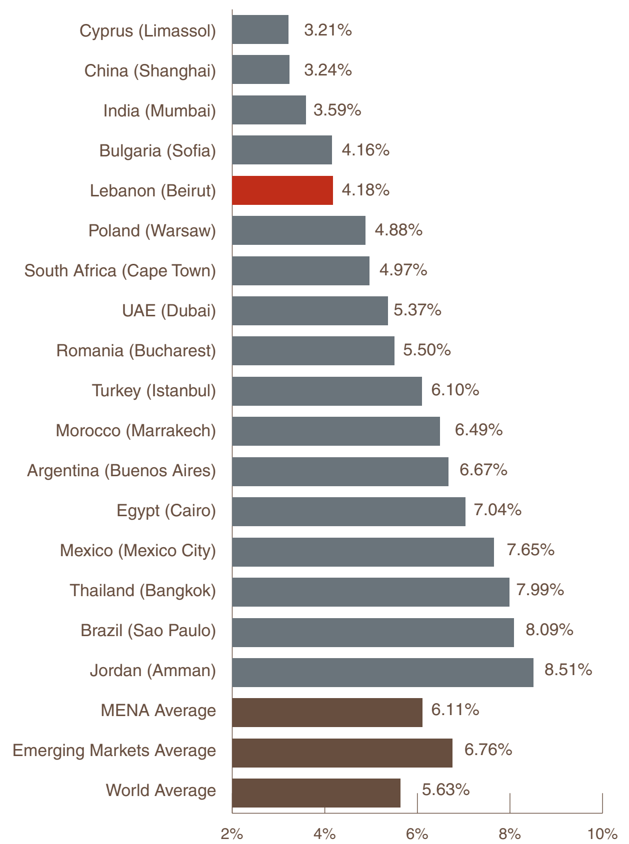
To begin with, demand for realty in Lebanon has traditionally been more focused towards purchasing houses rather than renting them. Realty is widely viewed as a long-term investment, and was facilitated by housing loan products on behalf of the financial sector, while rental is subject to rigidities and uncertainties. On one hand, the old rental law (pre-1992) allows transmission of the rent to heirs and thus renders it difficult for landlords to terminate a contract which in any case does not yield much annually especially following the depreciation of the national currency during the civil war. On the other hand, the new one practically allows landlords to terminate a contract upon expiry, mostly every three years. Landlords can actually demand an increase in rents, which if not accepted can lead to the termination of the contract, thus somewhat refraining residents from wanting to move into a house they might leave a scant couple of years later.

Demand in the rental residential segment stems from local residents and foreigners working in Lebanon. The former comprise of newlyweds awaiting the completion of their permanent residence, or suffering from temporary cash shortage, or even not inclined to borrow from banks, but also celibates and students. A few hundred customers are foreigners temporarily working in Lebanon, mostly in embassies and multinationals and often stand ready to pay higher rents per annum than locals.

Higher-end flat demand in this segment is focused mostly in the BCD, Saifi Village, trendy Ras Beirut avenues, and certain golden triangle neighborhoods in Achrafieh. Areas close to embassies and diplomatic missions' headquarters are also in demand, such as Yarzé, Baabda, Rabieh, Mar Takla, and Hotel Dieu.

But with prices increasing notably in recent years, it became difficult to increase rents proportionately, especially in the high-end segment, and investments in this segment's projects have been nowhere near those aimed at the much wider non-rental residential market. This mainly lies behind the gradual decline in rental yields in Beirut to 4.18% currently as per Global Property Guide figures (120 square meter apartments in the heart of the most important city of each country). This figure compares rather shyly to other rental markets in the region such as UAE's Dubai (5.37%), Morocco's Marrakech (6.49%), Egypt's Cairo (7.04%), and Jordan's Amman (8.51%). Beirut's figures fall short of countries in the Middle East and North Africa geography (6.11% on average), emerging market countries (6.76% on average), and the global average (5.63%).

Average Residential Gross Rental Yields May 2010



Sources: Global Property Guide, Bank Audi's Research Department

b. The commercial market segment

b.1. The retail market

While the residential market has been witnessing a more normal growth pace and relatively regained stability, the retail market remains dynamic. Demand continued to be largely driven by local and foreign food and beverages outlets seeking best spots in town and within or close to commercial hubs and streets. In the past 12 months, the lack of available shops for rent in Beirut (except in the BCD) on the supply side within the context of continuously healthy demand has fostered some upward pressure on rents.

Major new developments over the past 12 months consist of the recent opening of the Souks in the BCD (Phase 1 of the project) and restaurants in the Hamra area. The former has somewhat triggered upward pressures on rents in some downtown Beirut streets (Foch, Allenby, Weygand) with prime locations seeing rents of US$ 1,500-1,800 per square meter per annum for outlets of 75 to 100 square meters, though BCD shop spaces in other areas remain empty (for instance in Lazarieh, Toubia Aoun Street, Karame Street, Souk Bazerkane Street).

Over the past 12 months, Hamra has seen the highest rise in rents, estimated in the range of 10%-20% by Ramco Real Estate Advisers, within the context of the ongoing boom of the past three years in this particular area. Hamra is indeed characterized by rather heavy foot traffic each day, and hosts several major universities, which drove local and international chains and stores to seek a spot in this increasingly busy area of town.

Traditional hotspots such as ABC Achrafieh, Verdun, Dora's CityMall, Sin el Fil's LeMall, Mar Elias, Furn el Chebbak, and Kaslik continue to benefit from rather steady demand, and could be assimilated to well-oiled machines operating on relatively solid grounds, notably boasting a good share of food and beverages outlets.

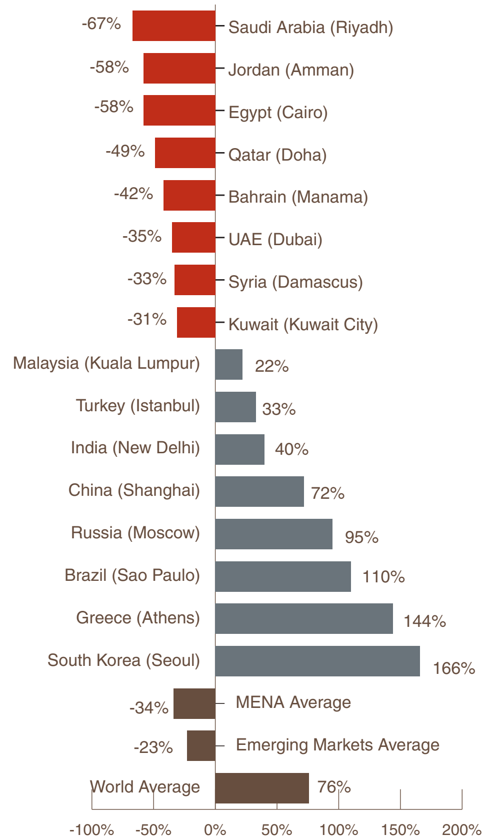
Price hikes in recent years buoyed by healthy demand but remain largely below global benchmarks, with no excessive inflation relative to regional peers

Just like demand for residences in the Lebanese market has been largely driven by locals and expatriates with genuine needs for housing in recent years, demand in the retail segment stemmed from restaurants and shops truly seeking a place to cater for clients at large. It is such healthy demand that drove rents to rise in recent years and sometimes slightly exceed those currently prevailing in some of the peer markets in the region which suffered from a sharp downturn in demand following the outbreak of the global crisis in late 2008.

A study released by global property consultants Cushman and Wakefield and covering the twelve months to June 2009 indicates that rents in Beirut's most expensive retail hotspot rank 33rd out of 60 cities surveyed. The countries falling in the Middle East and North Africa geography post on average a lower rent per annum figure than the Beirut figure (-34%) and those of emerging markets at large are 23% lower than the Beirut figures, but this is only due to a severe real estate downturn at large in those countries in the covered period, and to the fact that Beirut really has become a renowned venue for the most prestigious boutiques and brands in the world.

These boutiques are indeed rather heavily concentrated in its most expensive location (the BCD), and it is thus quite logical to see such a location in the capital city, which is more and more becoming a touristic retail hub in the region, boast higher annual rents than other peers in the region. Further, Beirut's top retail location remains nowhere near the average of global markets, including both emerging and advanced market countries that mostly remain way more expensive than the BCD. The world average stood 76% higher than the BCD even after most cities included suffered from severe downwards pressures during the covered period.

Avg. Retail Rents 12 months to June 2009
Relative to Beirut Rents



Sources: Cushman and Wakefield, Bank Audi's Research Department

b.2. The office market

The office market held up relatively well in recent months. This segment has been seeing very few projects in the pipeline (very few in Ras Beirut and one or two in Achrafieh), and supply thus remains quite limited. This, coupled with steady demand, has put upward pressures on prices, which rose by at least 5% in Beirut in 2009, according to Ramco Real Estate Advisers.

Local demand revolves around office spaces with asking prices of US$ 150-200 per square meter per annum (prices exclude VAT and other charges), according to the same source. The high-end segment, mostly driven by international companies, sees rents in the range of US$ 350-400 per square meter per annum.

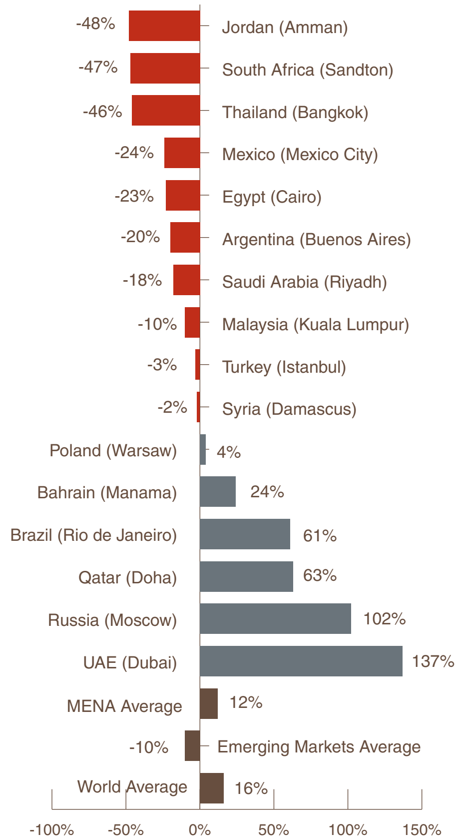
The BCD area has seen improvement in demand during 2009 and so far this year, which translated into a 5%-10% rise in rents in the past 12 months. Following several years of relative stagnation, the market is benefiting from some increased dynamism, with the BCD office segment posting its highest occupancy rate in ten years, exceeding the 75% threshold as per the same source, and rising by 37% relative to the year 2003. While demand remained more or less steady, the market saw little supply in recent times in the BCD, which progressively led the stock of available office spaces to be reduced. This said, the Foch, Allenby, Weygand and Uruguay streets are more demanded than others in the BCD, given the high-standing of the area, easy access, and proximity to the Souks.

The Beirut outskirts remain as well much in demand, with office spaces in Hazmieh, Sin el Fil, Zalka, and Dbayeh more affordable, increasingly accessible and easier to modulate in order to optimize specific space needs of companies.

Office rents slightly closer to regional and global benchmarks

Recent developments in the office market only drove prices slightly closer to regional and global market averages. According to Cushman and Wakefield's latest survey covering the year 2009 and office occupancy costs in the most expensive location in each city, Beirut's BCD ranked 32nd out of 56 cities worldwide. Beirut's BCD continues to trail rising business centers in the Gulf countries, with Dubai and Doha's central business districts occupancy costs outpacing those of the BCD by 137% and 63% respectively.

Avg. Office Occupancy Costs 2009
Relative to Beirut Occupancy Costs



Sources: Cushman and Wakefield, Bank Audi's Research Department

More generally, countries falling in the Middle East and North Africa geography have seen 2009 occupancy costs higher than those of the BCD by 12%, while the global average stood 16% above those of Lebanon's BCD.

4. Sector Outlook

While Lebanon's real estate market has not been entirely spared by the global financial crisis and has felt some spillovers mostly as the market took some time to digest new price levels and to a certain extent through lower demand from foreigners, it continued to boast rather healthy activity levels in a difficult year 2009 and even appears to have gained some steam so far in 2010, a year of gradual yet slow recovery across regional and global markets.

The Lebanese sector's sound fundamentals, namely healthy end-user demand from Lebanese residents and expatriates within overall favorable domestic politico-security conditions and buoyant domestic economic performances, have continued to be supportive of real estate activity over the past 18 months, even though the market took the opportunity to cool down and witnessed relative stability on the overall in the year 2009, and mild rises so far in 2010.

Now that we have established there is no bubble today in a Lebanese real estate market regaining normal growth patterns after unusual price hikes in recent years due to upward corrections relative to a period stagnation in late 1990s and early 2000s, and within a context of evolved regional price dynamics, the golden question remains: Where do we go from here? Do the Lebanese realty market activity and prices have enough impetus to continue growing in the short-to-medium term time frame? And if so, how pronounced of a growth are we talking about?

From an overall macro perspective, Lebanon's real estate sector remains well positioned to benefit from the favorable political and economic environment in the country. On the politico-security front, stability continues to reign since the Doha agreement of May 2008, sending positive signals to regional and foreign investors and leaving a favorable impact on the investment climate at large. Recent milestones, namely regional municipal elections scattered over several weeks, have turned out to be pretty smooth on the overall, in line with the general political climate in the country.

On the economic front, after robust growth rates in the past couple of years, all indicators released so far this year point out to an extension of recent performances in 2010. Both internal and external growth drivers are on the upside this year, seemingly unscathed by persistent sluggishness worldwide and slow regional recovery. Indicators that are supportive of real estate activity the most have been boasting quite vigorous performances likely to go on throughout this year. Foreign direct investment, which rose by about 20% last year, continued to rise this year, driven by improving domestic conditions and recovering liquidity in the region within the context of a 61% growth in average oil prices on a yearly basis so far this year. The robust double-digit surge in capital inflows in the first four months of 2010 led to a seven-year high in the balance of payment surplus over the same period (US$ 1.4 billion). Tourism indicators are continuing to post robust growth rates among the highest on a global scale, with +28.6% in the first five months of 2010, and the country is anticipating another hot summer touristic season with positive implications on demand for furnished apartments and possibly other areas in the residential market segment.

The banking sector has been consistently developing housing loan products in recent months, the demand for which got an additional boost following latest regulator measures and incentives to drive interest rates on such loans further down. Lebanese banks have largely helped local residents afford more expensive estate as of late through tailor-made lending products, a trend continuing as we speak and poised to last for quite a while, with banks persistently liquid and looking to optimize asset uses, and latest Central Bank incentives extendable until mid-2011.

From a pure real estate sector perspective, current market trends are expected to continue prevailing, at least for the remainder of this year. The market would likely witness a flatter price growth relative to previous years, or at the worst relative stability in the near term.

With land prices in the capital city unlikely to go down given the increasing limited availability of buildable plots, and flat prices in Beirut today higher than what many locals can afford -even with financial help, developers will continue to explore new areas to offset the glut in Beirut, be it in the immediate suburbs of Beirut still boasting relatively lower prices, or in farther areas where housing remains more affordable for the Lebanese-driven market. A trend already in the making would be rising demand for flats between 150 and 175 square meters valued at between US$ 400,000-500,000, as per Ramco Real Estate Advisers.

Genuine housing needs for locals and expatriates, supported by favorable demographic trends, would thus remain the major driver of Lebanese realty in the period ahead. This, coupled with pressures on end-user prices stemming from higher land prices in the capital city -in which some would continue to seek residences given proximity to major commercial and retail centers- and stronger demand in immediate and less immediate suburbs, could foster a sustained albeit moderate rise in prices, namely in the small to medium size market segment, all other things held constant.

But what would really determine price dynamics in the real estate sector in the short-to-medium term is the dynamism of resident demand. Indeed, should the market deem it necessary to take some time to get accustomed to new price levels, and postpone for a short while planned purchases of realty, real estate prices could more or less stabilize in months ahead. Discrepancy between the purchasing power of Lebanese residents and residential real estate prices could, notwithstanding growing financing on behalf of Lebanese banks, exacerbate the issue of housing affordability in the country, and put some strains on demand dynamism.

What could also to a certain extent be supportive of relative housing price stability in the near term is a potential stagnation in high-end demand mostly for large-size flats in Beirut's posh areas from locals and Arab nationals. With a few developers caught in the hype of the 2007-2008 boom, some large-size units are expected to come to the market soon, and such new supply might not find a match -or at least be met by sufficiently strong demand- within slow regional economic recovery conditions, somewhat causing downward pressures on prices in this segment -or at the best continuing stability- that could to a certain extent offset healthy opportunities in small and medium size counterparts.

This is not to say that the real estate sector performance in the period ahead is not subject to further downside risks. A return of instability on the political front or a relapse in security conditions, although unlikely at this stage, cannot be entirely ruled out. Prolonged sluggishness in the global economy, or even renewed uncertainties in financial markets, might leave some imprints on foreign demand for Lebanese real estate. While the market remains driven by Lebanese residents and a well-scattered Diaspora across the four corners of the globe, troubles abroad could lead to the materialization of some downward pressures on sector activity in Lebanon.

Nonetheless, the Lebanese real estate market remains structurally sound, and thus appears well poised to continue being a major pillar of economic activity in the country. Gradually burgeoning residential towers and steadily developing touristic hotspots, larger scale retail and commercial centers, provided the domestic politico-security environment permits, could contribute to raising further Lebanon's visibility in the region and render the country a world-renowned hub for tourists and a sought-after venue for multinationals and businesses at large.