TABLE OF CONTENTS

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LEBANON REAL ESTATE SECTOR

SLOWDOWN IN MARKET MOMENTUM ALONG WITH RESILIENT PRICES

- Property market activity slowing down…
The Lebanese real estate sector has been slowing down over the past few months, following a period of strong activity in recent years that paved the way for an upward price trend from low bases in the middle of the past decade. This year's slowdown came within the context of domestic political bickering and regional politico-security unrest with adverse spillovers on Lebanon's growth momentum in general and real estate investment in particular.

- But with prices sticky on the downside
Despite the correction in sales activity, realty prices almost stood still, with no major fluctuations in the past 12 months. Buyers are becoming pickier when it comes to purchasing property, and developers are not in a hurry to close a sales deal (low financial leverage, adequate sales/pre-sales on projects underway), while the scarcity of available land plots in a small country ensures land increasingly weighs on end-user prices.

- Residential demand rests on sound fundamentals…
While market activity slowed down this year, demand for Lebanese realty is holding up relatively well. Property demand mostly stems from end-user Lebanese nationals, of which residents genuinely in need of lodging, and expatriates generally seeking a foothold in their country of origin, notwithstanding a high-end demand from Arab nationals. Non-residents have yet been somewhat less keen to make an immediate buy lately within the context of prevailing uncertainties.

- And increasingly shifting towards smaller size lodging
With real estate prices sticky on the downside and with a growing gap between the purchasing power of residents and prices of the housing stock in the capital city, the market has been experiencing a shift to outside Beirut and to smaller flats in the past couple of years, the most in demand being those with a total size below 250 square meters per apartment.

- Retail space still benefiting from relatively steady interest, office market stagnant
The retail landscape has been witnessing relatively steady demand across prime locations driven by resilient consumption patterns within the context of adverse domestic political developments, thus maintaining occupancy rates at stable and relatively high levels. On the other hand, the office market has been seeing less important demand than the retail counterpart, with few new office space projects coming to the market adding to a mostly old stock of office buildings.

- Property market likely to remain flat in the near term
The market is witnessing different conditions since last year, with locals and expatriates gradually digesting new price levels. Until the housing stock coming to the market and consisting of projects launched about three years ago gets gradually sold, and until lately launched projects consisting of smaller size flats find their way into the market, real estate prices are likely to remain at or near current levels. It is true that a price collapse risk is practically unlikely for Lebanon given the sticky-on-the-downside feature, but within the prevailing context, realty prices might find it hard to nudge up tangibly.

SECTOR DRIVERS & RISKS

Positive drivers	Downside risks
· Sustained real end-user demand	· Discrepancy between quality of housing available and residents' purchasing power
· Prices historically sticky on the downside	· Intensified political bickering affecting activity
· Limited share of speculative activities in real estate transactions	· Weakening property demand from Arab nationals in recent years
· Low leverage on the supply side	· Fluctuating commodity/FX rates somewhat squeezing developers margins
· Scarcity of land supporting property prices	· Possible transitory supply glut risks
· Absence of property price bubble alleviating concerns	· Regional political uncertainties could slow private sector projects

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PROPERTY SECTOR OVERVIEW

A market in stability mode after a catching up phase

The Lebanese real estate sector has been losing some steam over the past few months, following a period of strong activity in recent years that paved the way for an upward price trend from low bases in the middle of the past decade.

The emerging signs of political bickering during the last quarter of 2010 slowed down sales activity in the market. The domestic political developments at the start of the current year and the ensuing long-lasting political stalemate weighed further on overall consumer and investor confidence, while starting to affect the supply side as well. This actually coincided with political and security turmoil across some neighboring countries and the broader Middle East and North Africa region, with negative spillovers on foreign and Arab investments in the Lebanese realty market in general.

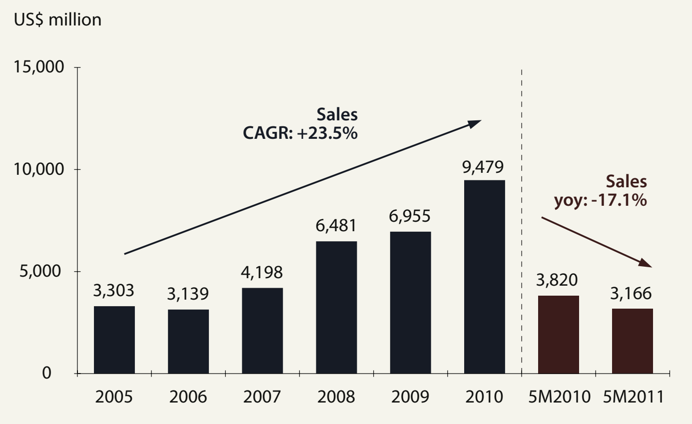
The political and security developments on both the domestic and regional fronts all came at a time when the Lebanese real estate market was witnessing record high prices somehow out of reach for a non-negligible portion of the Lebanese resident population. The persisting disparity between the purchasing power of residents and housing prices across the capital city and, more recently, its immediate suburbs, was already starting to affect appetite for new lodging in these areas, though demand does exist and stems from genuine needs for housing rather than pure speculation as can be the case elsewhere.

Within this context, real estate sales value declined by 17.1% year-on-year over the first five months of 2011 according to Real Estate Registry statistics, after a remarkable 23.5% average increase per annum over the 2005-2010 period. The number of real estate sales transactions to foreigners in particular dropped by 32.1%, reflecting reduced foreign appetite for Lebanese property this year.

The supply side of the market also began to feel the slowing down of activity. Until recently, the new housing stock coming to the market consisted of projects developers launched over the past couple of years amid soaring demand and that were to a good extent already sold to Lebanese residents and expatriates. But with demand slowing down as of late, developers are taking more time to launch new projects.

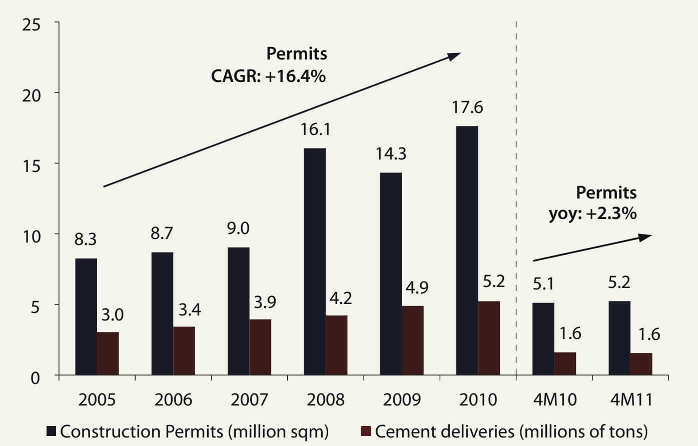
In fact, cement deliveries, which mirror current construction activity, slightly nudged down by a yearly 3.4% over the first four months of 2011 (after an 11.5% average rise per annum over the past five years). New construction permits, which give some indication about forthcoming supply in the sector, almost stagnated after a noticeable 16.4% average growth per annum in the previous five years , according to Order of Engineers of Beirut and Tripoli figures.

PROPERTY SALES TRANSACTIONS



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

CONSTRUCTION PERMITS & CEMENT DELIVERIES



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

RESIDENTIAL MARKET TRENDS

Slowdown in external demand for high-end segment

Residential market activity undoubtedly slowed down this year, but demand for Lebanese realty is holding up relatively well. Property demand mostly stems from Lebanese residents and expatriates. The former group continues to drive the market, accounting for circa 60% of total Lebanese demand. In most cases, the Lebanese resident base cannot really postpone a property acquisition and is in genuine need of lodging. It has been getting help from the widely scattered wealthy Diaspora with average remittances per capita above US$ 2,000 per annum, among the highest worldwide. Expatriates generally seek a foothold in the country of origin for frequent visit purposes, and thus also look for a residence to actually live in, but have lately been somewhat less keen to make an immediate buy within the context of prevailing uncertainties.

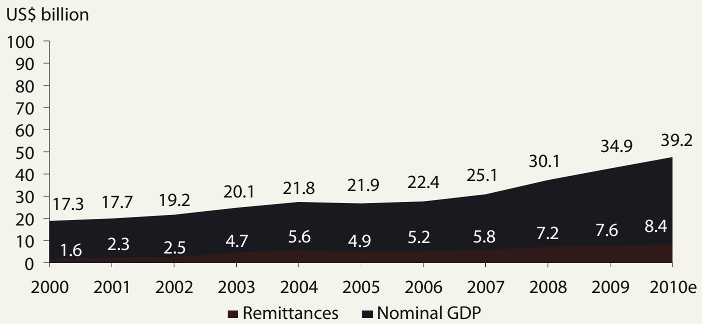
Foreigners on the other hand, most particularly Gulf nationals, had been lured by the appeal of Lebanese realty prices at levels below fundamentals a few years ago and have been a major driver of the upscale realty segment. With Lebanon high on their list of favorite tourism destinations, partly due to close geographic proximity, they purchased secondary residences in the country for their summer and holiday stays. But they are adopting a wait-and-see attitude and are to a large extent shying away from the Lebanese realty market today within the context of the domestic political deadlock and security tensions in the region at large, with some actually preferring to focus on nascent opportunities in Western markets following recently attained dips. The slowdown in demand is mostly felt at the level of larger sized apartments (usually above 300 square meters) with a value exceeding the US$ 1 million threshold.

Residential prices holding up relatively well

While some speculators do take part in residential market activity, they are estimated to account for quite a narrow portion of demand, and are thus far from being market markers. Demand for Lebanese residences unquestionably remains end-user driven. But those end-users are becoming now pickier when shopping for an apartment. They are aware that the market has slowed down, and that developers are finding it less easy to seal a deal. They are also finding a wide supply range to choose from, be it in the capital city or the surrounding neighborhoods with various apartment sizes (average Beirut occupancy rates are estimated in the low 60% range by Ramco Real Estate Advisers). End-users are thus taking the time to study technical building specifications and prices, and are not in a hurry to make a buy for a couple of reasons.

First, the domestic political stalemate and to a certain extent regional security tensions and ensuing uncertainties are somewhat putting a brake on those purchases that can be postponed for a relatively short time span. Second, end-users are to a large extent aware that prices have not much evolved in the past 12 months, and that they reached a plateau. They are increasingly bargaining, looking to take advantage of some opportunities that were not on the table in previous years. The residential market is mostly a buyer's market now.

LEBANON'S GDP & REMITTANCES



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

REMITTANCES PER CAPITA IN MENA COUNTRIES (2010 ESTIMATES)

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

At the same time, residential developers are not that much in a hurry to close a deal either. First, they know how market dynamics evolve in Lebanon, and that demand stems from genuine end-user needs for lodging and thus cannot be postponed indefinitely. The stock of housing available on the market and concentrated within Beirut city or in eastern and south-eastern suburbs is the most in demand, and continues to be widely sought after by residents or Lebanese expatriates looking to be at a relatively short distance from business and leisure centers. Second, developers have never been really reliant on financial leverage to undertake their projects. They rather rely on their own equity or alternatively on pre-sales to build residences, which underlines the generally solid financial standing of developers on the supply side. As such, they are in no rush to make a sale aimed at reimbursing lenders.

Besides, the supply side of the market has been acquiring land at higher costs over the past few years, with available land plots increasingly scarce in the capital city and, as a consequence, declining gradually on the outskirts of Beirut on one hand, and developers looking to match steady demand by acquiring plots in trendy areas on the other hand. As such, although developers have lately been less eager to purchase land plots at sometimes very elevated prices, land prices remain sticky on the downside, weighing on end-user prices.

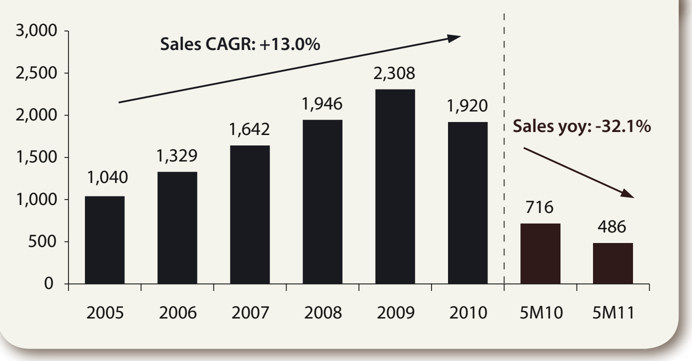
The end-result of this oriental bargaining game has been a relative stability in official residential prices over the past 12 months. Surely, some developers have succumbed to the temptation of granting unofficial discounts to otherwise hesitant realty buyers in recent months. Ramco Real Estate Advisers estimates those occasional discounts to range between 5% and 12%. The mid and lower end of the residential market segment saw fewer discounts -if any- than the upscale component, where buyers could benefit from discounts on expensive flats at the higher end of the range.

On the overall, not only are residential prices in the Lebanese market mostly inelastic to downward pressures, but they seem to borrow a staircase: they go up, stabilize for a while and then ultimately go up again, but don't really fall.

Residential units: smaller is the growing trend

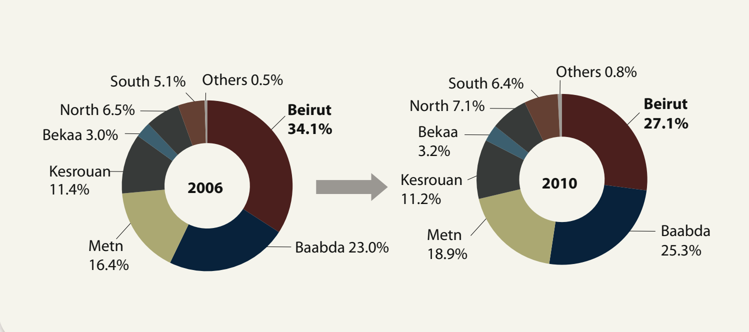
With real estate prices sticky on the downside and given the growing gap between the purchasing power of residents and prices of the housing stock in the capital city, the market has been experiencing a shift to smaller flats in the past couple of years. Developers had to get accustomed to new demand patterns and launch new projects with a smaller apartment size, the most in demand being those with a total size ranging between 100 and 250 square meters per apartment. The average flat size of projects underway in the capital city saw a 5%-8% reduction last year, according to the latest Ramco Real Estate Advisers estimates, while the majority of new construction projects boasted flats under the 275 square meters mark.

NUMBER OF PROPERTY SALES TO FOREIGNERS



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

PROPERTY SALES TRANSACTIONS VALUE BY REGION



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

Those smaller apartments are also sought after by young celibates seeking to live by themselves, young professionals looking for a small flat closer to their workplace, foreign workers temporarily residing in Lebanon, or even new divorcees moving away from their former partners.

Beirut still in demand, but suburbs appeal on the rise

While such projects are already in the pipeline in the capital city, the currently prevailing high price per square meter still renders the overall value of a new smaller size apartment somewhat above the housing budgets of the lower and middle income segments of Lebanese households.

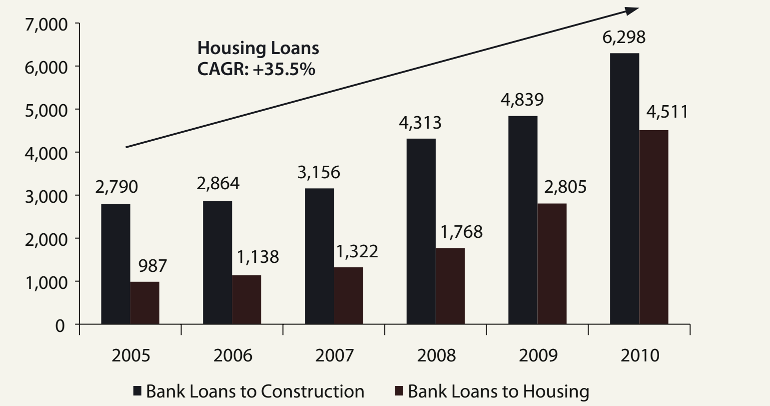
As a result, more and more buyers are turning to the outskirts of the capital city, where prices also progressed in recent years but remain more affordable and suitable for household budgets. Areas such as Baabda, Hazmieh, Yarze, Mar Takla, Fanar, Horch Tabet, Dbayeh, Damour, Mechref, Aramoun, and Bchemoun, among others, have been witnessing a relative dynamism with buyers satisfied with relatively short commuting distance to Beirut entry points. As a matter of fact, Beirut lost a 7% market share in Lebanon's real estate sales value between 2006 and 2010, while Baabda and Metn gained almost 5% over the same period.

This is not to say that Beirut has lost its appeal. Quite on the contrary, the traditional residential areas of the capital city, such as Achrafieh's golden triangle (area between Sodeco, Sassine and Sofil) and Sursock, Verdun, the seafront (Ain Mreisseh to Ramlet el Baida) and the Beirut Central District, remain pretty much appealing. Residences in these areas are mostly demanded by upper middle income earners, the local elite, expatriates and a few Arab nationals, although the latter have been refraining their purchasing decisions for the time being. Besides, some relatively underdeveloped residential areas in Beirut such as Mar Mikhael, Qobayate, and Corniche el Nahr have seen dynamic activity actually leading to moderate price hikes even in the past year.

Evidently, Lebanese banks have extended a helping hand to the sector, whether developers or more particularly retail consumers looking to acquire a residence, bridging to a certain extent the housing prices/purchasing power gap. Banks actually facilitated the process of acquiring a residence, providing loans to purchasers at historically low rates just under the 5% mark in Lebanese Pounds following BDL incentive measures since mid-2009. The latter exempt banks to the extent of 60% from reserve requirements on the conditions that the debtor rate applied to clients does not exceed a margin of 3% above 40% of the 1-year Lebanese Treasury bills yield. Financial sector loans to the housing segment grew by 36% on average per annum over the 2005-2010 period, and by 61% in the year 2010 alone, within the context of Lebanese banks' strong financial flexibility and high liquidity status and healthy domestic demand for lodging.

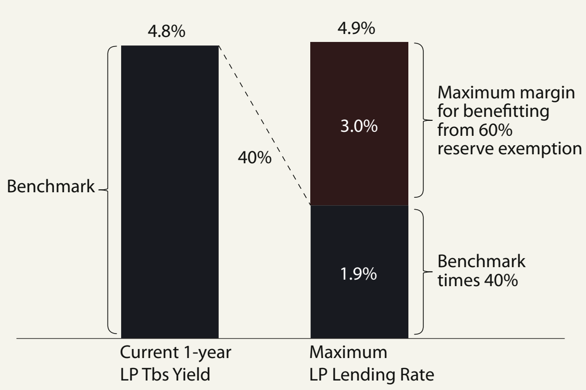
FIN. SECTOR LOANS TO THE CONSTRUCTION & HOUSING SEGMENTS

US$ MILLION



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

BDL CIRCULAR 185 (MAY 2009)



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

RETAIL MARKET TRENDS

Retail hotspots shaping the landscape

The retail landscape is nowadays shaped and influenced by the flurry of local and foreign food and beverages outlets invading the market across prime locations in the country. Demand for retail locations is ongoing, driven by the relative resilience of the food and beverages industry to the adverse political developments on the domestic front. Yet, similarly to the cautiousness of buyers in the residential market segment, retail companies are not willing to rent outlets at any cost.

The Achrafieh, Gemmayze, Hamra and Verdun retail zones continue to see decent demand, and boast high and relatively unchanged occupancy rates close to or exceeding 95% as per Ramco Real Estate Advisers. Hamra, an increasingly busy area seeing heavy daily traffic, actually stands out in the pack. The boom of restaurants, cafes and pubs on Makdissi Street has actually driven a double-digit rise in rents there over the past 12 months, within the context of proximity to several education and health services institutions attracting local and foreign food and beverages outlets.

The Beirut Central District continues to be a two-speed retail market. The Beirut Souks and surroundings such as the Foch and Allenby streets where the trendiest brand names now boast outlets are more crowded than secondary downtown streets (farther to the north of the area) where activity is rather stagnant and occupancy rates lower.

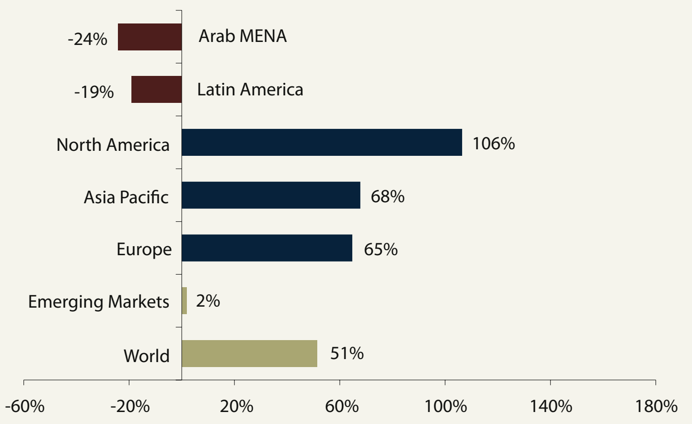
Major out-of-town retail malls north and east of the capital city, and traditional retail hubs such as Kaslik, continue to benefit from relatively steady demand, again favored by the success of restaurants and other food outlets.

With Beirut's top retail locations seeing healthy demand in the past couple of years buoyed by solid economic activity and rising tourist inflows, rent levels have been more or less sustained. Within this context, the latest Cushman & Wakefield global survey of the prime retail locations around the world covering the 12 months to June 2010 shows that Beirut's prime locations' rents stand above those of Middle East and North Africa peers. Some of the latter in fact experienced downward rent pressures on the overall in the aftermath of an economic slowdown affecting retail sales.

Those MENA countries' retail spots surveyed by Cushman & Wakefield boast average rents 24% below those of Beirut's retail locations. Still, rents across Beirut's retail locations are now more in line with those of emerging market peers, but nowhere near the rents of the world's most sought after retail hotspots.

RETAIL RENTS 12 MONTHS TO JUNE 2010

Relative to prime Beirut Rents



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

PRIME RETAIL LOCATIONS IN THE ARAB MENA REGION

City	2010 MENA Rank	2009 MENA Rank	2010 Global Rank	2009 Global Rank
Beirut	**1**	**1**	**30**	**33**
Kuwait City	2	2	39	44
Damascus	3	3	41	45
Dubai	4	4	42	46
Cairo	5	7	45	55
Manama	6	5	46	50
Muscat	7	10	47	59
Doha	8	6	54	51
Amman	9	8	56	55
Riyadh	10	9	57	58

Sources: Cushman & Wakefield, Bank Audi's Group Research Department

OFFICE MARKET TRENDS

Lack of adequate supply looming

Over the past few years, with demand headed straight to residential realty, developers opted to launch residential construction projects rather than commercial ones, especially that it takes longer for an investment in commercial property to pay off through rental revenues. This has created a situation where there are few new office space projects coming to the market, adding to a mostly old stock of office buildings, and thus under-serving needs for such commercial space.

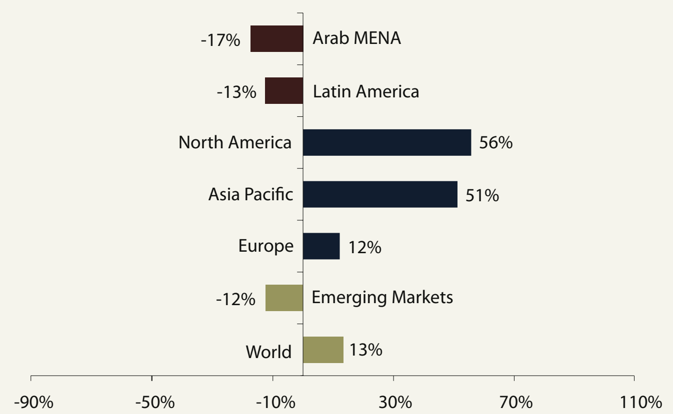
The Beirut Central District has grown to become the largest and most concentrated business hub in town, with nearly 120 office buildings. Following a few years of relative status-quo, the BCD office market supply stock has been on a gradual decline on the back of steady demand. Today, the market boasts a shortage of adequate office supply, and within this context rent levels have more or less been maintained over the past 12 months. Occupancy rates currently flirt with the healthy 80% mark, according to Ramco Real Estate Advisers estimates. Demand mainly stems from corporates looking for headquarters or well situated offices in the city's main business center. Similarly to the retail segment of the market, office space is in demand in the Foch and Allenby areas, while other secondary office zones in the Beirut Central District have been unoccupied for several years, thus weighing on the area's overall occupancy rate.

The Ras Beirut office market continues to witness rather stable occupancy rates, with offices concentrated in Hamra, Mar Elias, and Verdun. The former two boast a relatively ageing stock but stable occupancy rates (around 80%), with Hamra offices notably sought after by health professionals. Verdun remains a commercial area in demand and the most modern business center of the Western side of the Beirut Central District and registers the highest occupancy rate in the region (about 90%). In parallel, Achrafieh is still a trendy area, with companies seeking to have offices close to the BCD and at a more affordable cost, but here again, the available supply stock remains rather limited. Average occupancy rates can go up to 90%, according to Ramco Real Estate Advisers.

With Beirut prime locations' total occupancy costs (including service charges and property taxes) holding up on the overall, and some GCC markets in a situation of oversupply and experiencing downward pressures on rents as per Cushman & Wakefield's latest global survey of prime office locations (central business districts) covering the year 2010, the gap between top regional office zones and Beirut narrowed. Prime central business district occupancy costs in top Arab MENA spots (Qatar's Doha and UAE's Abu Dhabi central business districts) are 26% above those of Beirut's central business district, although the average for all 10 Arab MENA cities included in the study stands 17% below the corresponding Beirut central business district figure.

CENTRAL DISTRICTS OFFICE OCCUPANCY COSTS 2010

Relative to Beirut CBD Occupancy Costs



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

OFFICE OCCUPANCY COSTS IN CBD ACROSS ARAB MENA

City	2011 MENA Rank	2010 MENA Rank	2011 Global Rank	2010 Global Rank
Abu Dhabi	1	1	16	4
Doha	2	2	17	12
Beirut	**3**	**4**	**28**	**31**
Damascus	4	5	41	32
Manama	5	3	46	22
Riyadh	6	6	47	41
Kuwait City	7	8	51	49
Cairo	8	7	54	45
Amman	9	9	61	58
Muscat	10	n/a	66	n/a

Sources: Cushman & Wakefield, Bank Audi's Group Research Department

PROPERTY SECTOR OUTLOOK

Flattish levels likely to prevail in near term

The Lebanese real estate sector today finds itself in a situation somehow different from that of the past four to five years. It has been evolving at a more stable pace over the past 12 to 15 months, following periods of double-digit activity and price growth that can best be described as a catching up phase bringing prices more in line with fundamentals from low bases in the middle of the past decade in an overall undervalued arena.

The near-term outlook for the sector can be tied to a number of factors and considerations. First and foremost, the market is susceptible to political event risk. Domestic political turmoil can affect investor and buyer sentiment and hold back activity growth. Evidently, the formation of a new government a few weeks ago cannot but have some positive spillovers on the market's perception and overall stability in the country. Still, the new cabinet faces important challenges such as dealing with the indictment decision by the special tribunal for Lebanon and addressing conflicting issues related to regional and international relations.

In parallel, this year's regional turmoil in some neighboring countries and across the broader region is having adverse spillovers on the overall investment mood in the region. As a matter of fact, Lebanon was caught up in its own domestic political issues and has not been in a position to capture any benefit from the regional turmoil as it did in during the global financial turmoil a couple of years ago. Indeed, Lebanon was not able to build on the opportunity of redirected regional tourism and financial flows following the politico-security developments in a number of regional countries. The current equation is not only pushing some locals and expatriates to postpone their acquisition plans, but also refraining foreigners, particularly GCC investors, from making a move into the Lebanese realty market. These latter market participants are likely to await the unfolding of events in the region prior to making major investment decisions again. In this sense, a status-quo is likely to persist in the market at least in the near term.

But politics are not the only ingredient in the mix. One should not forget that the surge in real estate activity in Lebanon in recent years has brought prices to peaks never attained before. The market has actually been witnessing different conditions since last year, with locals and expatriates gradually digesting new price levels and getting accustomed to a new reality.

Until the housing stock coming to the market and consisting of projects launched about three years ago (in other terms, apartments of a larger size than those in demand today) gets gradually sold, and until lately launched projects consisting of smaller size flats find their way into the market, real estate prices are likely to remain at or near current levels. For instance, current average Beirut housing occupancy rates suggest there are some unsold properties waiting to be snatched up before demand pressures start to weigh anew on price metrics.

It is true that a price collapse risk is practically unlikely for Lebanon given the sticky-on-the-downside feature, but within the prevailing context, realty prices might find it hard to nudge up tangibly. What we could see at best though is a slight upward movement in a few underdeveloped or very trendy areas drawing marked buyer interest, provided the overall domestic climate witnesses signs of improvement. The current trend of building smaller size apartments to match buyers' needs for more affordable housing, whether in the capital city or in the immediate suburbs, is likely to continue shaping the realty market in the period ahead.

Having said that, it is still worth reminding that real estate in Lebanon is based on a strong end-user demand, which gives it a relative resilience. With a resident population growing at a long-term average rate of 1.6%, additional housing needs of residents alone are roughly estimated at close to 15,000 units per annum, notwithstanding non-resident demand which is estimated to account for circa 40% of the total demand for property in Lebanon. This suggests that demand for Lebanese realty rests on sound market considerations and strong sectoral buffers despite current overall environment uncertainties.

Fundamentally, Lebanon's property demand is apt to remain sustainable and continue supporting market activity within an increasingly scarce land bank. Over and above organic population growth and ensuing positive spillovers on resident demand for realty in the country, the strong ties between the widely scattered Lebanese Diaspora and the home country would most likely continue to play in favor of the Lebanese realty market. Non-resident support would continue to translate not only into regular and considerable financial transfers to their relatives in Lebanon but also into continued demand for Lebanese realty for their own secondary use. Notwithstanding the significant attachment of Arab nationals to one of their preferred regional destinations, especially in light of the atypical Lebanese environment allying geographic landscape attractiveness to cultural openness and which remains unmatched to this day in the broader region.

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