LEBANON REAL ESTATE SECTOR

LINGERING SLOW DEMAND IN A MARKET SEARCHING FOR TANGIBLE CONFIDENCE SIGNALS

TABLE OF CONTENTS

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- **Persistent property demand lull tied to local and regional uncertainties**
  Lebanon's property market has been witnessing sluggish demand throughout 2013 and so far in 2014. The local political tensions and occasional security drifts, coupled with lingering uncertainties in neighboring countries, have anchored the wait-and-see attitude of realty investors. The real estate sales value declined by 2.4% last year from an already low base before rising by 9.7% in the first seven months of this year amid more positive signals sent by government formation and security plans implementation early in 2014. Yet, occasional security incidents later on and domestic political bickering, coupled with the deterioration of the regional security conditions, prompted a deceleration in year-to-date growth by end-July.

- **Locals continuing to drive the residential market with Beirut seeing growing share this year**
  The residential segment continues to account for the bulk of market activity, and has been largely driven by residents seeking to acquire a property to actually live in it. These have a genuine need for lodging rather than acquiring a property as a pure investment aimed at booking capital gains in the future. While buyers have sought to go a bit farther and look for residences in Beirut's surrounding suburbs in recent years, the share of Beirut in total real estate sales value increased so far this year to 29% relative to 25% of total sales value in 7M 2013.

- **Commercial realty market weighed down by domestic politico-security conditions**
  The rather volatile politico-security conditions in the country over the past few months lead to a deceleration in demand for retail spots on behalf of companies operating locally. While some landlords opted to remain quite rigid in negotiations, some others are readjusting their asking rents to the downside. The currently prevailing market conditions have also started to take their toll on demand for office space across major business hubs in the country, and office rents have been facing some reductions in 2014.

- **Supply side adjusting to new demand trends with smaller apartment sizes**
  The newly established reality in the real estate market, that of sluggish demand and relatively flattish prices (albeit with some discounts granted to buyers) amid a tough operating environment, has forced the supply side of the market to adapt to changing dynamics. Developers have had to get accustomed to buyers' lower appetite for purchases and review their upcoming projects to better match new demand trends. Housing units of less than 150 sqm saw their share in total newly issued residential permits rise from 44% in 2010 to around 61% in 2013, thus strongly reflecting the shift towards smaller size apartments.

- **BDL policies and bank financing supporting realty demand**
  Amid the property demand slowdown of the past three years, the BDL provided both in 2013 and 2014 stimulus packages aimed at supporting the domestic economy in general and the realty sector in particular through subsidized loans encouraging some Lebanese to finalize buy contracts. The incentive packages came amid a tough domestic and regional environment, and aimed at favoring demand for housing at a time of market activity slowdown while maintaining healthy lending growth. This complemented efforts on behalf of banks deployed over the past few years and aimed at catering to the buyers' growing funding needs amid a widening structural gap between their purchasing power and apartment prices.

- **Upward price movements only possible in the event market activity picks up noticeably**
  Upcoming local political milestones, such as the Presidential and legislative elections, and security forces' success in their efforts to contain drifts in some areas are likely to be key determinants of the activity and performance of the real estate industry in the near future. In the event the political and security climate does not improve, the current situation is likely to be prolonged and the market would be apt to witness slight downward price pressures. In the event the politico-security situation improves and milestones go smoothly, the market in its various components is likely to see some upward movements in prices from current levels provided market activity picks up noticeably.

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PROPERTY DEMAND

Sluggish property demand tied to local and regional uncertainties and lack of foreign buying

The Lebanese property market has been witnessing sluggish demand throughout the year 2013 and so far in 2014. The local political tensions and occasional security drifts, coupled with lingering uncertainties in neighboring countries, have actually anchored the wait-and-see attitude of realty investors. Local buyers have been refraining from making purchases unless they have imminent lodging or relocation needs, and foreign buyers have just felt the currently prevailing conditions in the country called for postponing investment decisions or even sought to invest in other recovering realty markets in the region or across the globe.

Figures released by the Real Estate Registry show that the total value of real estate sales declined by 2.4% last year from an already low base before rising by 9.7% in the first seven months of this year. But this year's rise should be read with caution. In fact, the first few months of the year witnessed an amelioration in property sales value amidst the relatively more positive signals sent to the investor community by the formation of the government and the implementation of security plans early in 2014, and helped real estate sales rise from an already low base in last year's corresponding period. Yet, the occasional security incidents in the spring and summer months and the political bickering, coupled with the deterioration of the security conditions in some regional countries and fears of repercussions on the local front, prompted a deceleration in the registered growth year-to-date by end-July.

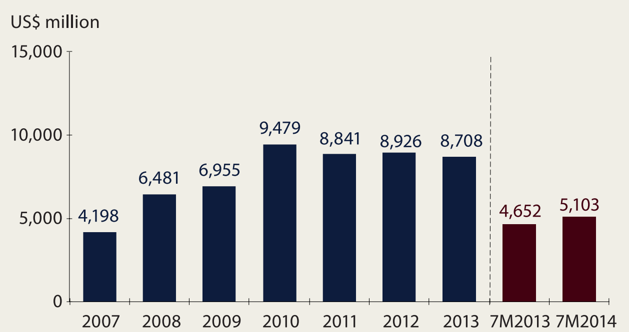
It is worth noting that the total value of transactions remains one of the most adequate gauges of market activity on the demand side given its very high correlation with the BDL's average coincident indicator, a synthetic index aimed at assessing economic activity in the country. Our regression analysis linking the latter and the transactions value over the past decade and a half, shows a very high correlation of about 96% between the two variables.

Similarly, the number of sales transactions declined by 7.2% in 2013 from an already low base in 2012 (-10.1% relative to 2011). So far in 2014, real estate sales transactions inched up by a slight 2.2% in number in the first seven months. Here again, the advance registered during the first few months of the year appears to have faded with negative yearly variations recorded in the summer months.

Locals continuing to drive the residential realty market

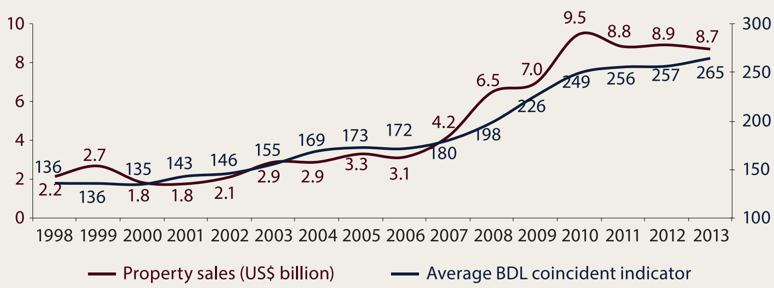
The residential segment continues to account for the bulk of market activity in Lebanon, and has been largely driven by residents seeking to acquire a property to actually live in it. In other terms, they have a genuine need for lodging rather than acquiring a property as a pure investment aimed at booking capital gains in the future. This is not to say that speculators do not exist in the Lebanese real estate market. It

PROPERTY SALES TRANSACTIONS VALUE



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

PROPERTY SALES V/S AVERAGE COINCIDENT INDICATOR



Sources: Real Estate Registry, BDL, Bank Audi's Group Research Department is just that they do not account for more than a fifth of total demand. Some of them, notably those who were enticed by the short-term gains of a few years ago, have even been discouraged by the relative stagnation in prices in recent years.

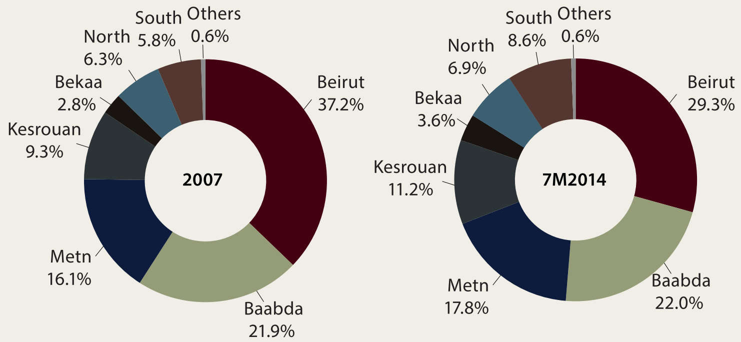
Residential realty demand remains mostly driven by young couples getting married and looking for an apartment where they can establish a family. Some growing families looking to move to a larger place are also on the lookout for good buys in the market, and same can be said about some well-off parents acquiring a property for their children. Lebanese expatriates, who benefit from a relatively higher purchasing power than locals, might still be interested in acquiring a residence in Lebanon to have a foothold upon visiting the country, but are taking more time to decide and actually go ahead with a purchase. They are not in a rush to buy and can afford to wait for more clarity on the security front before pouring money in Lebanese realty.

Foreigners, particularly those stemming from the wealthy GCC countries and which used to purchase residences in Lebanon in the aim of staying there during their more or less frequent visits (holidays, summer period), have practically shied away from the market over the past couple of years. They accounted for only 5% of real estate demand in 2013, according to Plus Properties figures. The politico-security conditions in the country dissuaded them from visiting, and from investing in the sector.

It is worth noting that the number of real estate sales transactions to foreigners dropped by 8.3% last year following a similar drop in the previous year, and plummeted by 20.3% in the first seven months of 2014, also posting negative yearly variations during the summer months.

The prospective buyers in the lodging market might be shyer than during the pre-Arab Spring years, but are perhaps more informed. The dynamics of the realty market and the standstill of the past couple of years gave buyers the opportunity to study the market ahead of time and negotiate better prices and conditions. It is definitely a buyer's market with a larger-than-before stock of unsold apartments in the country. As a matter of fact, a recent study conducted by Ramco Real Estate Advisers on the residential realty market in Beirut (65 projects completed last year with starting sales price on the first floor above US$ 2,800 per sqm) revealed that 277 new apartments completed in 2013 have not been sold by year-end, representing 27% more than the number of unsold apartments in buildings completed in 2012.

PROPERTY SALES TRANSACTIONS VALUE BY REGION



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

SEASONALITY ANALYSIS: PROPERTY SALES BY QUARTER

	Q1	Q2	Q3	Q4	Total
2008	16.3%	23.7%	29.4%	30.6%	100.0%
2009	14.5%	20.4%	26.5%	38.6%	100.0%
2010	22.3%	27.4%	23.7%	26.6%	100.0%
2011	20.5%	23.1%	24.7%	31.8%	100.0%
2012	21.9%	24.6%	24.3%	29.2%	100.0%
2013	17.4%	26.4%	25.6%	30.7%	100.0%
Total	**19.1%**	**24.5%**	**25.5%**	**30.9%**	**100.0%**

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

With prices in the capital city reaching highs and, despite some discounts granted to serious enquirers, remaining close to those highs, buyers have sought to go a bit farther and look for flats or residences in the immediately -and less immediately- surrounding suburbs. Though remaining the largest, the share of Beirut in total real estate sales value declined relative to a few years ago to 29% in the first seven months of 2014 (37% in 2007) to the benefit of all other regions in the country, especially the Metn and Kesrouan areas which have seen a notable number of real estate developments in recent years. Nonetheless, the share of Beirut increased so far this year relative to the first seven months of 2013 when it reached 25% of total sales value.

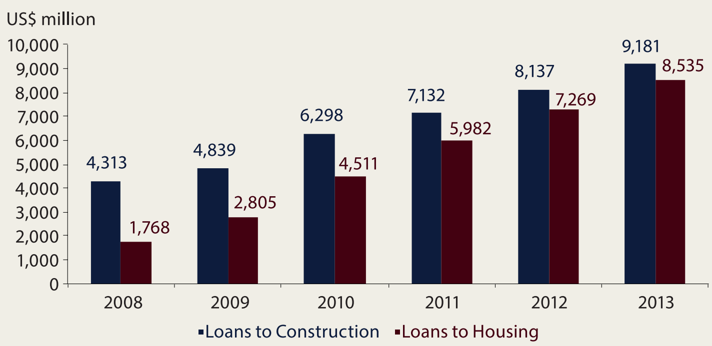
BDL policies and bank financing supporting realty demand

Amid the property demand slowdown of the past three years, the Central Bank of Lebanon (BDL) provided both in 2013 and 2014 stimulus packages aimed at supporting the domestic economy in general and the real estate sector in particular through subsidized loans. While the latter are capped at around half a million US Dollars and thus provide support to smaller sized apartments, they have encouraged some Lebanese to finalize buy contracts and gave some fresh impetus to the market. The incentive packages came amid a tough environment both in Lebanon and in neighboring countries, and aimed at favoring demand for housing at a time of market activity slowdown while maintaining healthy lending growth.

This complemented efforts on behalf of commercial banks deployed over the past few years and aimed at catering to the buyers' growing needs for funding amid a widening structural gap between their purchasing power and the prices of apartments in the country.

Within this context, housing loans extended by banks grew by a further US$ 1.3 billion during 2013 according to the latest available BDL statistics. The total housing loans portfolio thus reached US$ 8.5 billion at end-December, growing by 37.0% per annum between 2008 and 2013. While the volume of housing loans increased in recent years and homeowners increasingly relied on banks to fund their purchases, the self-financing ratio practically stabilized after a considerable drop from 92% in 2007 to nearly 70% last year. It is undeniable that the banking system support measures to the sector, through fostering realty demand, have provided real estate developers with further liquidity and are apt to contribute to creating employment opportunities and supporting economic activity in corollary sectors.

BANK LOANS TO CONSTRUCTION AND HOUSING



Sources: BDL, Bank Audi's Group Research Department

PROPERTY SECTOR FINANCING

US$ million	2007	2008	2009	2010	2011	2012	2013
Property sales transactions	4,198	6,481	6,955	9,479	8,841	8,926	8,708
o.w. Built property estimate	2,207	3,318	3,367	4,542	4,089	4,219	4,191
Housing loans portfolio	1,322	1,768	2,805	4,511	5,982	7,269	8,535
New housing loans	184	446	1,037	1,706	1,471	1,287	1,266
Avg lending ratio	8.3%	13.4%	30.8%	37.6%	36.0%	30.5%	30.2%
Avg self financing ratio	91.7%	86.6%	69.2%	62.4%	64.0%	69.5%	69.8%

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

Retail demand suffering from sluggish real economy and persistent uncertainties

The rather volatile politico-security conditions in the country over the past few months lead to a deceleration in demand for retail spots on behalf of companies operating locally. While some landlords opted to remain quite rigid in negotiations, some others are readjusting their asking rents to the downside. Rents have declined by 20% to 30% in the past 12 months or so across the capital city's major retail areas (noting that mall space is also seeing some discounts) with the exception of Badaro and prime Hamra spots, according to Ramco Real Estate Advisers.

Nonetheless, a lot of retail spots remain empty and those reductions seemingly did not manage to draw the sought after interest on behalf of market players. This is reflected in an increasing number of shops to rent in the capital city, as per the same source.

A notable exception to this trend proved to be the Badaro area, where demand has so far been outstripping supply and putting upward pressure on rents. With the major nightlife spot in the city, i.e. Mar Mikhael, boasting expensive rents and nearing saturation, Badaro seems to be offering opportunities for companies operating in the food and beverages sector, with some available supply, and easy access from both within and outside the capital city's major arteries. Badaro is a residential and commercial office area providing prospective tenants with a non negligible potential client base.

Office demand starting to feel the pinch of difficult market conditions

The currently prevailing market conditions have started to take their toll on demand for office space across major business hubs in the country, as investments of businesses have been on a downward trend. Office rents have been facing some reductions in 2014, with the downtown Beirut business district, the premier business destination in the country, seeing rent decreases of about 10% in today's slow market according to Ramco Real Estate Advisers. The area is witnessing an increasing number of office space availability. Some landlords are proving quite flexible, or at least more than before, and have been granting rent discounts. There is diversity in the stock of available offices in the downtown Beirut business district, with offices which are well maintained and boast better finishing faring better than others.

Elsewhere in the capital city, the market is likewise witnessing downward pressure on rents, especially with regards to large offices, notably in Achrafieh, Verdun and Hamra, among others. While the office market as a whole is feeling the pinch of the current conditions, small sized offices are somewhat faring better, due to their relatively lower rental values and higher affordability. The office stock in the Adlieh and surrounding area is seeing new developments with rents somehow more affordable than those in the traditional business centers of the capital city.

Also, an exception to the overall decelerating trend in the office market is the Sin El Fil and Antelias/Dbayeh zone, which has grown in population density and is strategically situated at close proximity to both the capital city and surrounding northern and mountainous Metn areas. It is worth noting that existing demand for local office space mainly arises from local companies, with demand from foreign companies weakened due to the country's uncertain conditions and the region's political and security instability.

PROPERTY SUPPLY

Smaller in size is a growing trend in the residential market, new supply through malls and office buildings in the commercial market

The newly established reality in the Lebanese real estate market, that of sluggish demand and growing price discounts amid a difficult operating environment, has forced the supply side of the market to adapt to changing dynamics. Real estate developers have had to get accustomed to buyers' lower appetite for investments and review their upcoming projects in a way to better match the new demand trends.

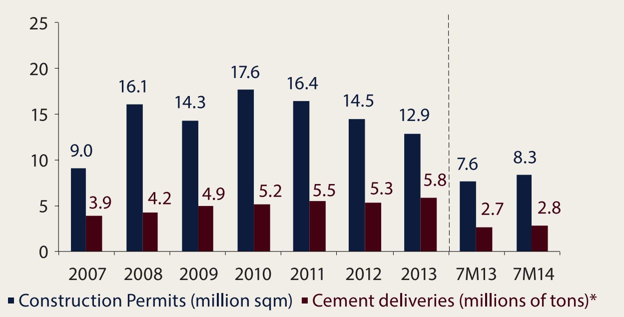
Total construction permits (measured in square meters), a supply side indicator of forthcoming activity in the sector, decreased by 10.9% during 2013 after a more or less similar decline to an already lower base in the previous year. This could be attributed to the slowdown in demand but also to the shift towards smaller sized properties, especially on the residential front.

So far this year, construction permits registered a 9.0% increase year-on-year in the first seven months according to the latest available statistics from the Order of Engineers of Beirut and Tripoli, noting that the summer months' figures during which the security situation deteriorated have lead to a deceleration in the pace of year-to-date permits increase. Developers were yet to a certain extent encouraged in the first few months of the year by the relative amelioration in the political climate with the formation of the government after months of bickering. Some developers were buying up space for future use by acquiring land plots and preparing their projects.

Anyhow, what is noticeable is the increase in the share of Beirut out of total new construction permits so far this year after a decline in recent years. Beirut only accounted for 4.8% of total construction permits issued last year, down from 17.8% in 2007 before picking up to 9.0% in this year's first seven months.

The relatively lower share of Beirut in recent years is yet mostly due to the lack of investments on behalf of foreigners and the lower buying on behalf of expatriates whose purchasing power is usually higher than local residents, also echoing trends on the demand side reflected in a lower number of sales to foreigners. Mount Lebanon maintained its lead with a 45% market share over the same period, with the Metn and Kesrouan areas benefiting from high prices in the capital city and witnessing a shift in construction projects to their advantage.

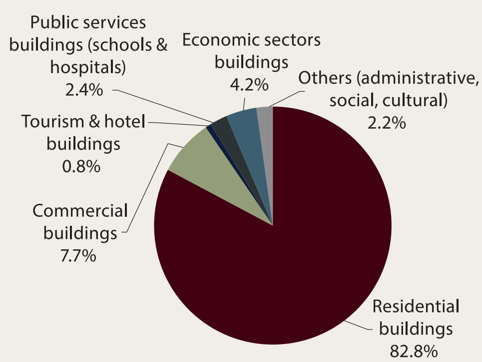
CONSTRUCTION PERMITS & CEMENT DELIVERIES



* Cement deliveries data cover the first six months of the years 2013 and 2014

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

CONSTRUCTION PERMITS (AREA) BY USAGE PURPOSE (2013)



Sources: Order of Engineers of Beirut, Bank Audi's Group Research Department

Another coincident indicator of market activity on the supply side, cement deliveries, recorded a 10.0% increase last year from a low base attained in the previous one (-3.6% in 2012 relative to 2011) and a more subdued 5.2% rise in this year's first half. This reflects some deliveries for projects still under construction, and also favorable weather during winter time marked by a much lower rainfall in the 2013/2014 season according to Cimenterie Nationale. It is important to recall that cement deliveries are also very highly correlated with overall economic activity in the country, with our regression analysis run over the past decade and a half between cement deliveries and BDL's average coincident indicator showing a 90% correlation between the two variables.

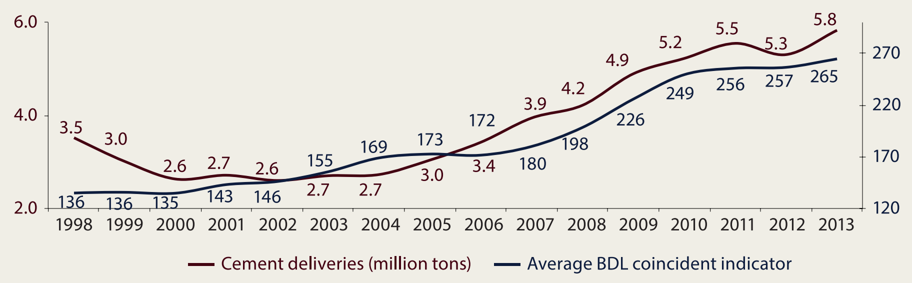
With real estate activity hindered by slowing demand in the country, construction costs stood almost still both last year and over the first half of 2014. The Audi compiled construction cost index for Lebanon, including various materials and labor prices, registered an insignificant 0.9% increase in 2013, owed to a tiny 1.1% increase in materials cost amid an almost nil change in labor costs. During the first half of 2014, construction costs practically stagnated, mirroring a tiny 1.5% increase in labor costs offsetting an insignificant 0.3% decline in materials cost. This actually reflects the overall market mood in a much calmer realty sector than during the pre-Arab Spring years. Also, the considerable inflow of Syrian refugees willing to work against lower wages provides competition to Lebanese workers and puts adverse pressures on labor costs.

NUMBER OF CONSTRUCTION PERMITS FOR HOUSING UNITS

	2010	Structure	2011	Structure	2012	Structure	2013	Structure
Less than 100 sqm	1,695	6.4%	1,853	7.4%	1,504	6.8%	2,503	12.1%
101 - 150 sqm	10,053	37.9%	11,573	46.0%	9,938	45.0%	10,111	48.8%
151 - 200 sqm	7,201	27.2%	5,735	22.8%	5,401	24.4%	4,117	19.9%
201 - 300 sqm	4,046	15.3%	2,771	11.0%	2,386	10.8%	1,431	6.9%
301 - 400 sqm	503	1.9%	505	2.0%	345	1.6%	218	1.1%
More than 400 sqm	543	2.0%	279	1.1%	151	0.7%	79	0.4%
Individual houses	1,426	5.4%	1,583	6.3%	1,464	6.6%	1,585	7.7%
Villas	1,036	3.9%	863	3.4%	914	4.1%	672	3.2%
Palaces	1	0.0%	6	0.0%	5	0.0%	1	0.0%
Total	**26,504**	**100%**	**25,168**	**100%**	**22,108**	**100%**	**20,717**	**100%**

Sources: Order of Engineers of Beirut, Bank Audi's Group Research Department

CEMENT DELIVERIES V/S BDL AVERAGE COINCIDENT INDICATOR



Sources: BDL, Bank Audi's Group Research Department

The breakdown of annual figures provided by the Order of Engineers of Beirut only and covering the bulk of market activity in the country, shows that during the year 2013, around 83% of total permits issued were earmarked for residential projects, confirming its leading position and weight in the sector. What is even more worth noting is that the distribution of those residential permits by size of property reveals the growing trend in the market, one of demand, and by extension supply, geared towards smaller sized properties. As a matter of fact, housing units of less than 100 square meters saw their share in the total rise from 6.4% in 2010 (pre-Arab Spring years) to 12.1% last year. Similarly, housing units of size ranging between 101 and 150 square meters saw their share rising from 37.9% to 48.8% over the same period (the largest among the residential property categories). Altogether, they both accounted for around 61% of the total last year (44.3% in 2010), thus strongly reflecting the shift towards smaller apartments in the country. In contrast, the share of housing units of size higher than 150 square meters (excluding individual houses) declined from 46.4% in 2010 to 28.3% last year.

With the office market somewhat faring better than the residential market during the slowdown phase, the market has recently seen a handful of modern office stock projects in relatively new and more affordable areas than the capital city, mainly in the eastern and northern periphery and suburbs. A large chunk of the available office stock under construction lies in the Adlieh, Corniche el Nahr, and Badaro areas. As for surrounding areas, the market remains active in Sin el Fil, Hazmieh, Zalka and Antelias which are emerging as new destinations for companies. The peripheral Beirut areas are competing with the traditional office hubs such as Achrafieh by offering adequate and easy access, ample parking facilities and good quality finishing. These areas are also a practical destination for companies that want to avoid the congested Beirut streets, and remain easy to access for stakeholders in the capital city or even farther areas.

Recently, the northern part of the capital city has been catching the eye of market players, especially around the Dbayeh area with the large scale Waterfront City development underway. The seaside front of the Zalka to Dbayeh area has been seeing new office developments emerge over the past couple of years, with around 50,000 square meters of office space under construction according to Le Commerce du Levant. The growing residential density in and around those zones has been creating demand for office space in this area located at a crossroad between Beirut, the Upper Metn and the North.

On the retail front, after ABC Dbayeh added retail space and finished its renovation works, and after the launch of the large Beirut City Centre mall in Hazmieh and the LeMall Dbayeh right on the highway, new developments are targeting some underserved areas south of the capital city. Among the projects, we mention the Spot C Mall in Choueifat, with 47,000 square meters of leasable areas, the Airport Mall in Aramoun, with 60,000 square meters of leasable area as per Ramco Real Estate Advisers, and the Spot Mall in Nabatiyeh with a gross leasable area of 14,735 square meters and expected to open before the end of the year, while the Sour Mall further south of the country is expected to open by 2018. Another City Centre project is in the pipeline in Dbayeh and a Spot T Mall in Tayyouneh is also under construction.

PROPERTY PRICES

Relatively flattish prices with some discounts granted to serious enquirers

The buyer's market that currently is the Lebanese realty sector has seen prospective investors turn into harsh negotiators. Developers usually start by sticking to last year's asking prices but with sales slowing down and the market seeing an increasing stock of unsold apartments, discounts of up to 10% can be obtained more easily than before in the capital city, as per Ramco Real Estate Advisers. Discounts actually depend on the area and the size of apartments, although they tend to be larger on larger size properties. Some developers find themselves pushed to readjust slightly their prices to close a sales deal, especially as supply has been exceeding demand in recent times. And while developers are more inclined to grant discounts than before, that does not mean they are willing to go further. Some projects, especially those in demand and offering smaller sized apartments, are seeing more resilience in terms of prices. Some developers also are reluctant to nudge down their prices as they purchased their land plots at an elevated price.

Generally speaking, residential prices remain much stickier on the downside than demand on behalf of market players. This is due to a number of factors that helped the local realty market avoid a property bubble and a subsequent price collapse such as what was witnessed amidst property sector slumps a few years ago across regional and global markets. First and foremost, the bulk of residential demand in the country comes from locals with genuine needs for lodging and seeking a residence to live in it. Those might think twice before buying and take more time than before but cannot postpone indefinitely their purchases and decisions. In this sense, they do not exit the market at the first unrest signals as speculators do. Besides, the Lebanese population growth remained at 1% per annum during the sluggish years, providing support to demographic-driven demand dynamics in the sector. This is primarily why real demand in the country is supporting real estate prices and preventing them from declining sharply.

Second, apart from construction costs which have not nudged much and developers' margin, a major component of apartment prices consists of land prices. With Lebanon in general and the capital city in particular having fewer available plots for sale throughout the years, it is difficult for land prices to go down amid such increasing land scarcity. Hence, a major driver of apartment prices is everything but leading to downward pressures on the value of residences. Besides, land estate is widely believed to be a relatively safer investment haven. Some developers are still searching for potentially lucrative opportunities despite buyers' cautious mood and the still uncertain domestic environment, but are not willing to purchase land plots at any cost and are increasingly cautious especially as land prices have reached high levels.

Third, the supply side of the market, i.e. real estate developers, is not highly leveraged at all. While loans to the construction sector have increased in recent years, their share out of total bank assets remained relatively low at 5.6% at end-2013. In fact, most realty developers rely either on self-financing or even more on pre-sales rather than bank debt. This means that whenever things get less rosy, they are not, in general, in a rush to liquidate their stock of flats to reimburse bank dues. This is why they tend to stick to their asking prices or close to the latter, even if they do offer some discounts to serious enquirers in order not to miss a sure sale.

BOX A: LEBANON'S SCORE REGRESSES IN 2014 REAL ESTATE TRANSPARENCY INDEX

Lebanon's real estate market transparency regressed in Jones Lang LaSalle (JLL)'s 2014 Global Real Estate Transparency Index, as the country posted a decline in its composite score. Lebanon came in the 81st position (66th in the previous 2012 survey) out of 102 countries across the globe. The country attained a score of 3.90 out of 5.00, slightly behind the MENA region's transparency level of about 3.8, as per Jones Lang LaSalle.

It is worth mentioning that Lebanon struggled to maintain momentum over the past two years, as per the same source. The country faced economic, security and political hurdles and the security situation remained unstable, exacerbated by the continued civil war in neighboring Syria. These challenges hindered any progress towards improved regulations and real estate transparency, effectively reversing the gains registered in previous surveys, as per Jones Lang LaSalle.

The majority of the 15 Arab Middle East and North Africa (MENA) markets covered in the Transparency Index showed an improvement in transparency since 2012. However, these changes have been relatively modest in the MENA region (compared to pre-global financial crisis), with the MENA remaining one of the least transparent regions in the world, as per Jones Lang LaSalle.

The index aims to help real estate investors, corporate occupiers, retailers and hotel operators understand important differences when transacting, owning and operating in foreign markets. It is updated every two years and broken down into five categories that address factors affecting real estate transparency: performance measurement, market fundamentals, governance of listed vehicles, regulatory and legal, and transaction process. The Transparency Index scores range on a scale from 1.00 to 5.00. A country or market with a perfect 1.00 score has total real estate transparency; a country or market with a 5.00 score has total real estate opacity.

Real Estate Transparency 2014 - Composite Index, Middle East & North Africa

Transparency Level	2014 Composite Rank	Market	2014 Composite Score
Semi	49	UAE - Dubai	3.11
	53	UAE - Abu Dhabi	3.20
	58	Qatar	3.37
	60	Bahrain	3.40
Low	67	Saudi Arabia	3.57
	69	Jordan	3.62
	72	Egypt	3.67
	75	Kuwait	3.74
	76	Morocco	3.76
	80	Oman	3.88
	81	Lebanon	3.90
Opaque	90	Algeria	4.20
	92	Tunisia	4.23
	97	Iraq	4.45
	102	Libya	4.63

Sources: Jones Lang LaSalle, Bank Audi's Group Research Department

PROPERTY RENTS

Residential rental market supply somewhat benefiting from property sales lull

The residential rental market has been somewhat taking advantage of the lull in property sales of the past couple of years. Realty developers would usually put new apartments up for sale rather than for rent for higher return considerations. But with the trouble they have had closing sales deals in recent times, especially in the mid-size to larger apartment categories, some of them opted instead to make unsold units available for rent. Then again, comparatively low rental yields relative to global standards did not encourage the development of rental-specific ventures in the past few years.

Nonetheless, demand for rental apartments does exist in the local market and stems from diverse tenant profiles. On the one hand, resident newlywed couples waiting for the completion of their newly purchased apartment (especially given construction and finishing works delays on the market), or short on cash and waiting for their financial means to grow, could temporarily look for a flat to rent.

On the other hand, young professionals working in areas far from their place of residence or hometown and seeking to avoid long commuting on a daily basis go after rentals within Beirut or in areas within close proximity to the capital city.

Moreover, demand for rental apartments lately came from Syrians fleeing their country and looking for refuge in a nearby country. At first, they rather opted to stay in hotels, but with the security situation in their home country worsening and the war prolonging, started looking for flats to rent, sometimes to cater for many families at once.

Multinational organizations and missions and other NGOs have also become a client base and source of revenue for the rental market, albeit in the furnished apartments segment given the usually shorter-term duration of their work contracts.

BOX B: NEW RENTAL LAW VOTED BUT YET TO BE APPLIED

A new rental law passed by the Lebanese Parliament earlier this year legalizes the gradual increase of annual rents concerning contracts signed before 1992 in order to level with current market values within a six-year timeframe while providing tenants with incentives to leave their respective apartments. Tenants will be offered the choice of staying in the same apartment or making an early exit against financial compensation. In the former case, the law allows property owners to gradually increase their annual rent to reach 5% of the apartment's value, which is considered to be the fair lease price. During year one, the tenant will pay, on top of the usual rent, 15% of the difference between the old rent and those 5% (new rent), and during each of the subsequent three years, an additional 15% would be paid. During years five and six, an additional 20% will have to be paid by tenants and in year seven, the lease price would reach the fair price until the end of the ninth year. After the ninth year, lower income households would be able to extend their stay until the 12th year while other tenants could still reach a new freely negotiated agreement with landlords.

A fund will be set up to help tenants with lower income. Those whose income does not exceed three times the minimum wage will be assisted by the authorities with the fund helping them to finance at least part of their rent. Tenants whose income is between two and three times the minimum wage will have the fund cover the difference between the new rent and 30% of their income. Tenants whose income is less than two times the minimum wage will have the fund pay on their behalf the difference between the old and new rent. Non-Lebanese and tenants residing in buildings that were classified as luxury buildings are not entitled to benefit from this fund's assistance.

Tenants might also be asked to leave the premises during the first year of adjustment notably for demolition or family usage under certain conditions. In the former case, the landlord would pay a compensation equivalent to six times the new annual rent, and in the latter case, compensation would amount to four times the new annual rent. Compensation gradually declines year after year until reaching nil after nine years. Non-Lebanese are not entitled to compensation if they own another residence in Lebanon. The law envisions that tenants are during that period entitled to have priority to get subsidized loans by the Banque de l'Habitat or the Public Corporation for Housing in case they want to leave and buy another apartment.

While the exact implementation details of the law are not yet all finalized, it is expected to provide support to demand on residential housing as some tenants will progressively seek a new apartment while liberated properties can be refurbished and put on the market again or be replaced with new ones and thus alleviate the land scarcity burden on realty prices.

Retail rents pressured by slow economic growth environment

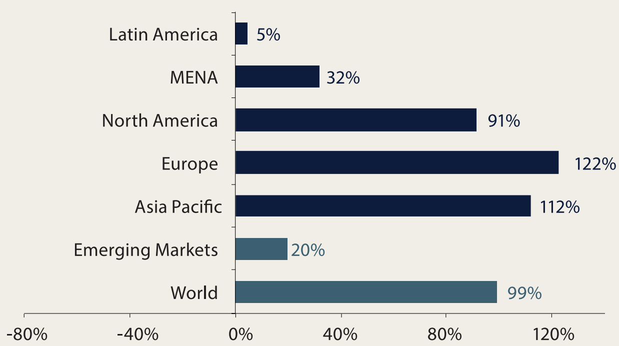
At the level of the retail market, rents have been squeezed by the sluggishness of the domestic real economy and ensuing effect on retail sales and demand. The market has seen a 20% to 30% decline in rents over the past 12 months or so across the capital city's major retail areas with the exception of Badaro and prime Hamra spots, as per Ramco Real Estate Advisers. The same trend is echoed by the latest Cushman & Wakefield survey of rents in the 12 months to June 2013, albeit at a slower pace given the deterioration in market conditions over the past 12 months (until this summer). Indeed, within the context of domestic politico-security uncertainties, foreign direct investments have slowed considerably and retail sales were also mostly reliant on local consumers amid weaker touristic flows to the country. Occupiers dependent on local demand were somehow more resilient over this period. Vacancy is increasing and adding considerable retail space to the market, as per the same source. The central district of the capital city houses the majority of luxury retailers, mostly situated along Allenby and Foch streets. There are however plans for luxury locations in the suburbs of the city, concentrated around Beirut suburbs and surrounding areas, according to the same source. This has widened the rental gap between the prime retail locations in the Lebanese capital city and regional and international benchmarks. Prime MENA and emerging market rents were 32% and 20% more expensive than prime Beirut rents over the covered period, which remain nowhere near the global average, which is almost twice higher than the corresponding prime Beirut rent average.

Office rents supported by steady demand last year but seeing declines this year

At the level of the office market, rents have been more or less steadily supported by demand for new office space amid the relatively lower supply stock last year, even though new projects are underway in several areas of the country, whereas this year the office market has started seeing rent declines. Occupancy costs managed to pull out a small 4% increase last year as per Cushman & Wakefield's latest survey of prime office locations across cities globally covering the year 2013. The Beirut central business district occupancy costs, including rents and additional costs, have proven more or less in line with the average of the countries falling within the broader Middle East and North Africa geography, which have benefited from higher demand and consequently rents, especially in Qatar and Dubai on the back of business confidence pick-up, and the global average of the 67 cities included in the survey over the covered period.

RETAIL RENTS 12 MONTHS TO JUNE 2013

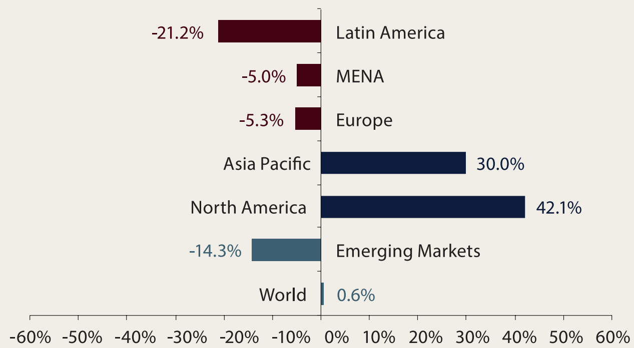
RELATIVE TO PRIME BEIRUT RENTS



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

CENTRAL DISTRICTS OFFICE OCCUPANCY COSTS 2013

RELATIVE TO BEIRUT CBD OCCUPANCY COSTS



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

BOX C: SOLIDERE 2013 PROFITS UP FROM LOW BASE AMID LAND SALES REPRIORITIZATION

Solidere, Lebanon's leading real estate developer and a regional market player, posted an improvement in profitability metrics during 2013 on the back of a pick up in the revenue base from low levels attained in the previous year.

The company registered a 53% year-on-year increase in net revenues from operations in 2013 to attain US$ 109.5 million. This improvement in the net revenue base last year was attributed to an increase in revenues from land sales, which surged by 91% in 2013 to attain US$ 94.9 million after three land sale contracts were secured during the year. But this improvement in the revenue base still did not allow sales figures to level up with those of previous few years (until 2011), when both land sales revenues and net revenues from operations were above the US$ 200 million mark.

Revenues from rented properties declined by 5% on a year-on-year basis, moving from US$ 54.3 million in 2012 to US$ 51.6 million in 2013. Solidere's management said that the company is reprioritizing land sales and somewhat focusing less on the development of Solidere-owned rental properties, thus aiming to generate a larger revenue base, while noting it does expect a positive effect on rental income from the new cinema and entertainment complex inaugurated last year, among others.

Solidere has also been focusing on cost cutting measures and was able to achieve a noticeable reduction in general and administrative expenses. The company's general and administrative expenses fell by 16% year-on-year to reach US$ 30.9 million in 2013. More specifically, administrative expenses dropped by 55% year-on-year to attain US$ 6.6 million in 2013, more than offsetting an increase of 10% in salaries, benefits, and related charges.

With the revenue base resuming its upward trend and the company keen on cost management, Solidere reported an increase in net profits on a consolidated basis to US$ 42.6 million in 2013 from a much lower US$ 17.2 million in the previous year. It is worth mentioning that net profits in 2013 and 2012 were well below the levels of US$ 158.8 million and US$ 195.5 million attained in 2011 and 2010, respectively. Within the context of Solidere's marginal increase in total equity over the course of 2013 to reach US$ 1.95 billion, the company's return on average equity ratio attained 2.2% in 2013, up from 0.90% in the previous year, yet also remaining lower than the previous years' levels.

Having said that, Solidere continues to benefit from sound fundamentals, with a low leverage ratio (bank debt to equity) hovering around the 35% mark and adequate liquidity with cash and banks balances of US$ 176.7 million at end-2013 on top of a large land bank that the company could progressively liquidate and turn into substantial cash flows, noting that the latter sales are dependent upon an amelioration in the domestic investment climate. Solidere share prices are up by 7% year-to-date at the closing date of this report, noting that they remain well below their fair value. It is worth recalling that current price levels are almost 70% below their peak attained in the summer of 2008.

Solidere selected financial indicators

US$ million	2008	2009	2010	2011	2012	2013
Revenues from land sales	256.6	305.1	337.2	241.7	49.6	94.9
Revenues from rented properties	21.7	27.3	41.2	49.9	54.3	51.6
Net revenues from operations	206.1	234.1	272.5	227.9	71.4	109.5
General and administrative expenses	19.4	26.2	42.7	38.2	36.7	30.9
Net profits	182.7	189.2	195.5	158.8	17.2	42.6
Total assets	2,453.8	2,399.0	2,600.4	2,768.9	2,835.9	2,873.5
Total equity	1,859.7	1,810.0	1,838.2	1,935.1	1,908.2	1,950.8
ROAA	7.3%	7.8%	7.8%	5.9%	0.6%	1.5%
ROAE	9.9%	10.3%	10.7%	8.4%	0.9%	2.2%

Sources: Solidere, Bank Audi's Group Research Department

PROPERTY MARKET OUTLOOK

After more than three years of decelerating activity volumes, the real estate market in Lebanon is more or less still in a standstill mode. This is mostly due to the uncertain regional conditions heavily weighed down by the situation in neighboring countries, and its spillovers on the political and security environment on the domestic front. As a consequence, investors are refraining from making property purchases, at least non-residents as those can afford to postpone their buys until they perceive a regained sense of stability in the country. Resident buyers remain the most active component of the domestic realty market, as they have genuine and more pressing needs for lodging. But their purchasing power, even with the help of bank loans, remains far from the still high levels attained by property prices in the country in general and the capital city in particular.

As a result, market activity proved much more subdued than in the previous few years. Buyers and market players actually need to digest the new price dynamics and are taking more time before deciding. And with developers not in a dire need of closing a sales deal given their relatively low leverage, prices remained around their highs even if some discounts are being given to serious enquirers. The increasing number of unsold units in the market has been prompting developers to grant some discounts to serious enquirers, though no price collapse has been observed due to the stickiness of realty prices to the downside in the country.

It is true that the formation of the current government and the implementation of security plans earlier this year sent some positive signals to the market players and the investor community, but the deterioration of the security situation in the neighboring countries and the continued political bickering around the Presidential election have washed those positive effects away. The foreign investors and expatriates need more stability to resume their investments in the country. The upcoming local political milestones, such as the Presidential and legislative elections, and the security forces' success in their efforts to contain drifts in some areas of the country are likely to be key determinants of the activity and performance of the real estate industry in Lebanon in the near future.

In the event the political and security climate does not improve, the current situation is likely to be prolonged and the market would be apt to witness slight downward price pressures. It is important to note that with land prices definitely not causing downward pressures on property prices in the country and construction costs difficult to modify, at least tangibly, the only leeway developers would have is to decrease their margins on residences sold. This is why the price declines in this case would only continue to be rather mild. Similarly, on the retail and office market front, a standstill in market conditions would imply more availability of commercial space on the market, and thus this would likely cause further downward pressures on rents.

In the event the political situation improves and milestones go smoothly and the security situation ameliorates, the market in its residential and commercial components is likely to see some upward movements in prices from current levels provided market activity picks up noticeably. But for market activity to pick up noticeably, the market needs to have some more sustainably positive factors resurfacing: a resumption of consumer confidence, a pick up in tourism flows, and an amelioration in the investment climate. It is only then that the developers will be able to start selling their accumulated stock of properties in a gradual way after a few years of sluggishness. One should not forget that the scarcity of land in the small country that is Lebanon is an undeniable factor that provides promising prospects for realty prices in the long-term.

The outlook for property market activity and prices thus remains now more than ever tied to the evolution of the security and investment climate in the country, and there are quite a few uncertainties in this respect. Some positive signals would be sent to the market in the event of an improvement in domestic conditions, but even in this case, the era of brisk property price hikes witnessed towards the end of the past decade does not seem to be making its way back anytime soon.

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