LEBANON REAL ESTATE SECTOR

SLUGGISHNESS PREVAILS AMID WAIT-AND-SEE BUYER MOOD

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- **Realty demand waning and mostly driven by locals**
The Lebanese realty market, predominantly residential-oriented, has witnessed further sluggishness during 2018 and so far this year, amid an adverse domestic political environment, lack of sufficient financing options and continued regional security tensions. Buyer sentiment remained impacted by lingering uncertainties and investors generally opted to refrain from making purchases as they used to in the past. The number of real estate sales transactions declined by 17.4% in 2018 and by 18.3% on a yearly basis in the first eight months of this year. The value of real estate sales transactions plummeted by 18.3% in 2018 and by a further 23.5% in 8M2019.

- **New supply decelerates and geared towards smaller surfaces**
Such dynamics prompted developers to reduce construction activity and focus on finishing existing projects while adapting to customer needs, i.e. come up with smaller surface projects. Supply-side statistics show that construction permits, an indicator of forthcoming activity in the sector, decreased by 23.1% last year and by a further 27.9% so far in 2019. Similarly, cement deliveries, a quasi-indicator of construction sector activity, fell by 8.7% in 2018 and by a significant 32.4% in the first half of 2019 as per the latest official figures. Smaller surfaces have become the most fashionable as they suit better current budgets, with buyers sacrificing space to be able to afford a home and/or be closer to the capital city.

- **Prices on the decline as buyer bargaining power rises…**
The supply/demand mismatch has been exerting downward pressures on realty prices across the country. More and more apartments are on the sales market and demand has not improved. This means that potential buyers have much more choice and can afford to be picky, knowing that their bargaining power is probably at its best in a long while. Developers are usually reluctant to drop their asking prices and prefer to offer a discount to serious buyers. Ramco Real Estate Advisers estimate that when official price reductions and the increased margins of negotiation are taken into account, residential prices have contracted by a cumulative 10%-30% in Municipal Beirut during the past five years. It also comes after several years of frenetic activity yielding a 35% average annual price increase in the previous boom period. This means that prices are still not far from their highs despite the recent downturn, thus highlighting the fact that realty prices in the country are somewhat sticky on the downside.

- **…but room for further noticeable discounts ahead is rather limited**
The local market is markedly impacted by the overall domestic and regional political and security situation. Unless the latter improves tangibly and affordable financing options make their way back, activity levels are not likely to bounce back sufficiently. Less and less deals would be sealed in a scenario where the overall situation does not change much. This does not necessarily mean that prices are heading south too. There is a floor for prices in the current phase, whereby under a specific level, developers or homeowners would rather keep their property deed in the pocket and refrain from accepting bids, although some owners might, in specific cases, grant further discounts because they need or want to. Even if there could be some room for more negotiation in the current situation, that margin is rather limited.

- **Realty purchases remain a decent option for buy-and-hold investors**
The lower level of realty prices calls for the attention of buyers who have decided they wish to purchase a property and hold on to it. Investing long-term in the property market in Lebanon never really proved to be a bad investment, with investors on the contrary registering latent profits or realizing noticeable gains. Long gone are the days where property was synonym of quick money. But realty buys are always a good long-term investment opportunity. Buying realty today when choices are generous and sellers flexible can prove to be a sound investment diversification strategy.

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RESIDENTIAL MARKET

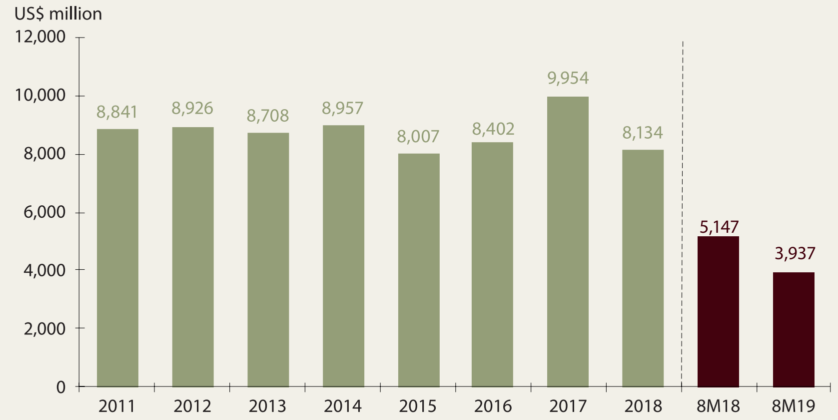
Demand waning and almost exclusively driven by locals

The Lebanese realty market, predominantly residential-oriented, has witnessed further sluggishness during 2018 and so far this year, amid an adverse domestic political environment, lack of sufficient financing options and continued regional security tensions. Buyer sentiment remained impacted by lingering uncertainties and investors generally opted to refrain from making purchases as they used to in the past. The market remains driven by local residents, who generally prefer bank financing to cash, while expatriates enquired more than they actually bought as they are not in a rush to seal a deal amid prevailing uncertainties, and foreigners (especially wealthy Gulf nationals) remained more or less on the sidelines.

With local banks proposing housing loans at higher interest rates than the previously sought-after Central Bank subsidized loans, buyers were left with three options: refrain from buying, go for higher interest rate loans or utilize their cash. The first option seemed to have been a preference, at least awaiting better days. The second option proved expensive, especially that buyers had gotten accustomed to subsidized rates for many years (the total housing loans stock declined by 2.2% between December 2017 and March 2019 as per the latest BDL figures). The third option proved difficult, either because cash is tight in such sluggish economic conditions or because potential buyers favored cautiousness awaiting better conditions or because they preferred higher yielding bank placements in the form of cash deposits to property investments.

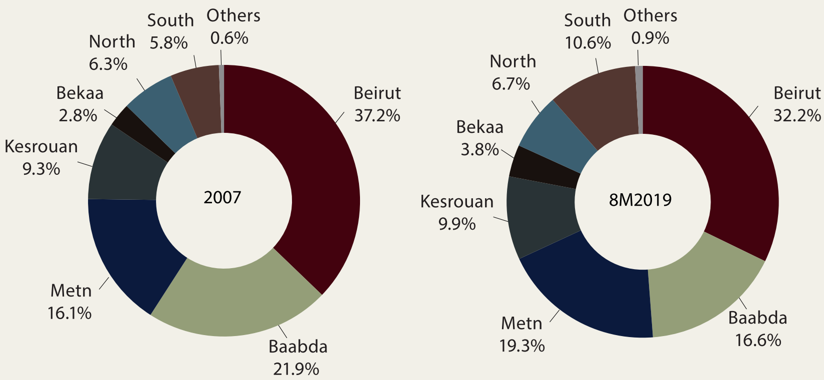
Within these conditions, demand for realty has been waning. The number of real estate sales transactions (the bulk of which is traditionally earmarked for residential properties) declined by 17.4% in 2018 and by 18.3% on a yearly basis in the first eight months of this year. In particular, sales to foreigners retreated by 11.0% last year and by 12.9% in the first eight months of 2019. The value of real estate sales transactions plummeted by 18.3% in 2018 and by a further 23.5% in 8M2019.

PROPERTY SALES TRANSACTIONS VALUE



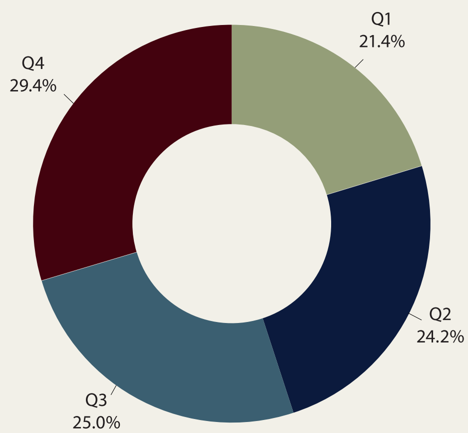
Sources: General Directorate of Land Registry and Cadastre, Bank Audi's Group Research Department

PROPERTY SALES TRANSACTIONS VALUE BY REGION



Sources: General Directorate of Land Registry and Cadastre, Bank Audi's Group Research Department

SEASONALITY ANALYSIS: PROPERTY SALES BY QUARTER (2009-2018)



Sources: General Directorate of Land Registry and Cadastre, Bank Audi's Group Research Department

PROPERTY SECTOR FINANCING

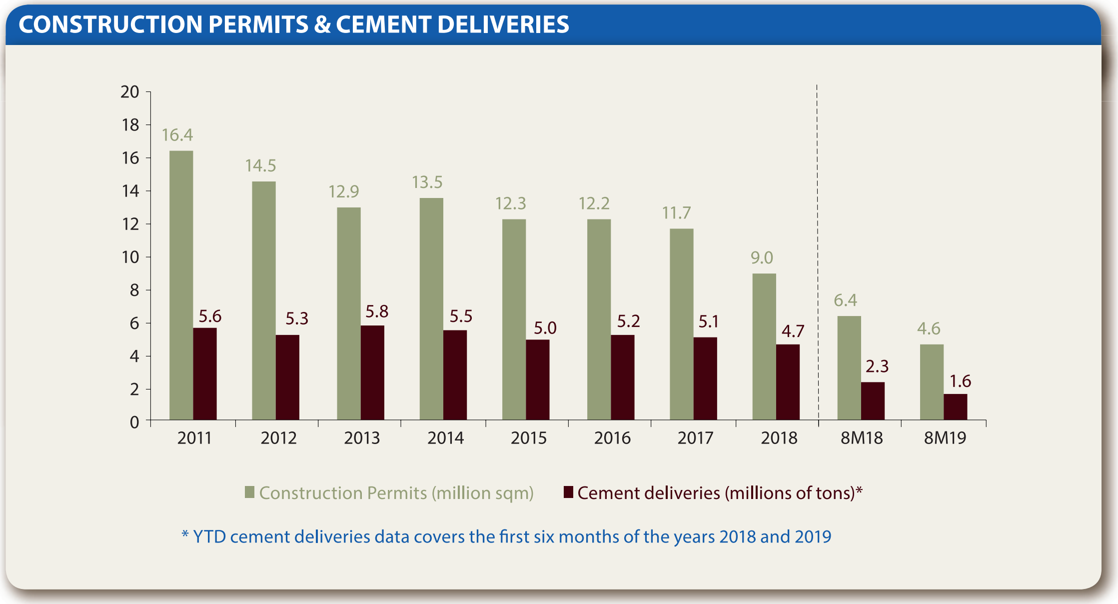
US$ million	2011	2012	2013	2014	2015	2016	2017	2018
Property sales transactions	8,841	8,926	8,708	8,957	8,007	8,402	9,954	8,134
o.w. Built property estimate*	4,089	4,219	4,191	4,353	3,987	4,243	5,166	4,059
Housing loans portfolio	5,982	7,269	8,535	9,879	10,917	11,927	13,026	12,887
New housing loans	1,471	1,287	1,266	1,344	1,038	1,010	1,099	-139
Avg lending ratio	36.0%	30.5%	30.2%	30.9%	26.0%	23.8%	21.3%	0.0%
Avg self financing ratio	64.0%	69.5%	69.8%	69.1%	74.0%	76.2%	78.7%	100.0%

* estimate derived from the share of the number of built transactions out of the total number of sales transactions

Sources: General Directorate of Land Registry and Cadastre, BDL, Bank Audi's Group Research Department

New supply is focused on the 100-149 sqm segment

Such dynamics prompted developers to reduce construction activity and focus on finishing existing projects while adapting to customer needs, i.e. come up with smaller surface projects. Supply-side statistics show that construction permits, an indicator of forthcoming activity in the sector, decreased by 23.1% last year and by a further 27.9% so far in 2019. Similarly, cement deliveries, a quasi-indicator of construction sector activity, fell by 8.7% in 2018 and by a significant 32.4% in the first half of 2019 as per the latest official figures.

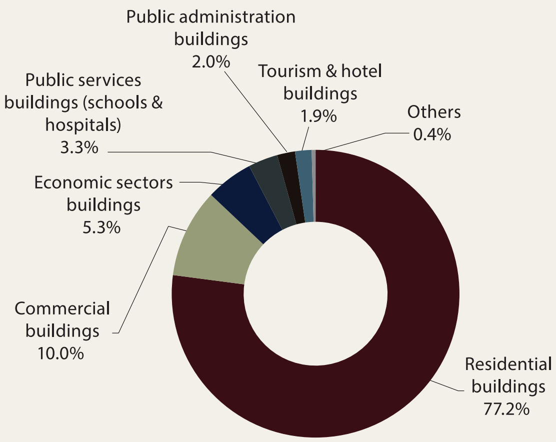


Sources: Order of Engineers of Beirut and Tripoli, BDL, Bank Audi's Group Research Department

Smaller surfaces have become the most fashionable as they suit better current budgets, with buyers sacrificing space to be able to afford a home and/or be closer to the capital city. An InfoPro study released earlier this year shows that development activity decreased by close to 59% on a yearly basis across various cazas in the first half of 2019, given that only 80 new buildings were launched as compared to 193 new buildings in the same period of 2018.

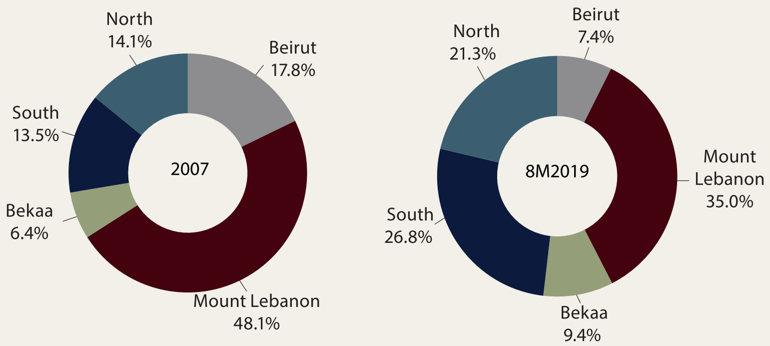
The demand-supply gap in 2018 has been estimated at close to 50% by InfoPro in Administrative Beirut and its suburbs. Close to half of supply and demand (measured by units sold) were concentrated in the 100-149 sqm segment during 2016-2018 as per the same source, with the 150-199 sqm segment ranking second with about a quarter of supply and demand across Administrative Beirut and its suburbs. A recent Ramco Real Estate Advisers survey echoed similar trends, noting that the average size of an apartment under construction in Beirut stood at 173 sqm in 2018, a yearly drop of 5%. Developers have been constantly reducing the sizes of new apartments over the past few years, leading up to a 79 sqm decline between 2013 and 2018.

CONSTRUCTION PERMITS (AREA) BY USAGE PURPOSE (2018)



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

BREAKDOWN OF CONSTRUCTION PERMITS BY AREA



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

Prices on the decline as buyer bargaining power rises

The supply/demand mismatch has been exerting downward pressures on realty prices across the country. More and more apartments are on the sales market and demand has not improved. This means that potential buyers have much more choice and can afford to be picky, knowing that their bargaining power is probably at its best in a long while. While official statistics on the evolution of realty prices country-wide remain absent, the Ramco Beirut Residential Price Index revalead a drop of 3.5% posted by developers during 2018 (asking prices, excluding negotiation margins and discounts), the fifth consecutive year that prices drop but the latter have grown steeper than previous years.

Developers are usually reluctant to drop their asking prices and prefer to offer a discount to serious buyers, but many have had to drop their official prices before the start of negotiations. Ramco Real Estate Advisers estimate that when official price reductions and the increased margins of negotiation are taken into account, prices have contracted by a cumulative 10%-30% in Municipal Beirut during the past five years. It comes after several years of frenetic activity (in the second half of the past decade, before the quasi-price standstill of the early part of the current decade) yielding a 35% average annual price increase in the referred to boom period.

In other words, after a huge cumulative increase, price declines over the past five years cumulatively barely erased one year of price increase during the boom period. This means that prices are still not far from their highs despite the recent downturn, thus highlighting the fact that realty prices in the country are somewhat sticky on the downside. This is attributed to the predominantly non-speculative nature of realty demand, the limited stock of land plots available for sale in this small country and the comparatively low leverage of developers who often rely on pre-sales and/or own funds.

Within this context, buyers are more or less refraining from making purchases like they used to, either because they cannot afford it (due to the persistent structural gap between their purchasing power and the level of realty prices in the country) or because they would rather await better conditions. It is true that the concept of leasing has begun to make its way to the market, but it has not yet made any breakthrough. It consists of the two parties agreeing to a lump sum first payment then frequent payments scattered over a few years to close the sale amount. But it remains not very common and has not had a tangible impact on the market. Sellers are having a very difficult time finding buyers and when they do, negotiations and lower price levels are deterring some to agree to a sales deal.

For these reasons, some buyers and sellers are to a certain extent leaning more than before towards the rental market. Some residents are encouraged to rent for the time being, and some buyers are choosing to consider their property as an income-generating asset and renting it rather than not being able to sell it, unless they wanted to simply retain ownership from the start and put it for rent. Rents have also followed a downward trend, as a larger number of properties are on the rental market nowadays.

RETAIL MARKET

Rents down with the F&B segment only faring better

The local retail market was severely impacted by the currently prevailing economic conditions and the squeezed purchasing power of residents. With supply exceeding demand and rents asked by landlords sometimes disconnected from the reality imposed by the sluggish economic activity, many retail shops have remained empty and vacancy rates have been on the rise. Some retail outlets being newly occupied or that are seeing their rents renewed have posted a decline of 20%-30% in rents over the past few years cumulatively across the capital city, as per Ramco Real Estate Advisers.

The latter estimated during the summer that more than 1,000 retail shops were available for rent/sale across the 20 main retail destinations in Beirut (excluding malls), representing an area of more than 180,000 sqm (more than 90% of which is put on the rental market). Beirut Central District boasts the largest vacancy of retail outlets.

In contrast, the only segment of the retail market faring rather well is the food and beverages segment. The same areas are still doing well comparatively, i.e. Mar Mikhael, Gemmayzeh, Badaro and Mina el Hosn that boast a large number of restaurants, coffee shops and bars/pubs and higher occupancy rates on the overall.

The first three are practically renowned for being nightlife hotspots, while the fourth is known to be the venue for some trendy high-end restaurants. Some large malls in the capital city also see decent F&B segment activity. It is worth noting that a couple of malls situated just on the outskirts of the capital city have attracted big brands and fare somewhat better than others.

OFFICE MARKET

Downward pressures on rents in a sluggish business environment

The Lebanese office market remained downbeat so far this year, with office rents in the capital city down by around 10% on average relative to last year, as per Ramco Real Estate Advisers estimates, and an increased amount of office stock available on the market warranting a deceleration in new supply underway.

Demand for office space has been decelerating, with a feeble economic operating environment negatively impacting the activities of businesses and thus contributing to the aforementioned decline of rents in the capital city. With new supply arriving to the market over the past few years, the supply/demand mismatch widened and took a toll on rental values in the office market, as vacant spaces in many areas have been on the increase.

It is a good time to rent an office these days, given the noticeable office supply stock and lower rents. As a matter of fact, a study carried out by Ramco Real Estate Advisers earlier this year showed that 24 new office projects are currently under construction in Municipal Beirut, representing 113,127 sqm of office area, a decline of 31% relative to the previous year. Fewer projects are underway in the country's office market, with low sales ratios and dropping prices affecting developers' appetite. The stock of unsold offices completed during the past few years is on the rise, which proves the market is starting to reach saturation point.

Within Municipal Beirut, new projects are being developed in Unesco, Mar Elias, Spears and Jnah. Hamra and Clémenceau are mostly clinics-oriented and currently oversupplied, as per the same source. Hamra Street offices suffer from a lack of easy access and parkings along with an ageing office stock on the overall. Achrafieh has become crowded as well, with new projects moving to Corniche el Nahr and Mathaf areas. The Metn area is now on market players' radar screens, mostly the coastal highway stretching from Dora to Dbayeh and the Sin el Fil area, with clients being offered relatively larger spaces at lower rents. The coastal highway had seen projects launched over the past few years to replace an ageing stock often nested in residential buildings, but the overall sluggish conditions have also left their imprints on this part of the office market as well.

MARKET OUTLOOK

Realty purchases remain a decent option for buy-and-hold investors

To sum things up, all segments of the Lebanese real estate market, namely the residential and the commercial segments (with the latter combining office and retail markets), have witnessed dwindling performances over the past couple of years. Prices and rents have trended lower and negotiation margins increased for buyers/tenants. Where does this leave the realty market? Will activity retreat further? Could prices head even lower? Is real estate out of style? Is it better to wait a bit more for better bargains? Or is now the right time to buy? Could real estate prices increase again?

First of all, the local market is markedly impacted by the overall domestic and regional political and security situation. Unless the latter improves tangibly and affordable financing options are back, activity levels are not likely to bounce back sufficiently. Less and less deals would be sealed in a scenario where the overall situation does not change much. This does not necessarily mean that prices are heading south too. There is a floor for prices in the current phase, whereby under a specific level, developers or homeowners would rather keep their property deed in the pocket and refrain from accepting bids, although some owners might, in specific cases, grant further discounts because they need or want to. Even today, the lack of deals in the market is at least partly due to the reluctance of many sellers to agree to lower price bids, and not just due to the lack of bids per se.

In other words, even if there could be some room for more negotiation in the current situation, that margin is rather limited as compared to the recent past. By no means does it mean that prices might go up quickly and soon. There has to be a sufficient and sustained buying momentum wiping out gradually the increasingly large existing stock of unsold properties for the wind to change direction.

In such a scenario, the negotiating power of buyers would shrink and evidently discounts would gradually dissipate until the supply/demand mismatch is absorbed. At a later stage, sellers would regain the upper hand or so to speak, having several offers to choose from in the base case scenario. But we are today far from this situation, and this remains conditional on the above mentioned factors and requires quite some time before potentially materializing. A more pragmatic scenario, at least in the near term, would consist of putting brakes to the current deceleration of activity, before the market begins to see any upward correction.

In any case, the lower level of realty prices calls for the attention of buyers who have decided they wish to purchase a property and hold on to it, i.e. live in it for many years or retain ownership for a long while. Investing long-term in the property market in Lebanon never really proved to be a bad investment, with investors on the contrary registering latent profits or realizing noticeable gains. Long gone are the days where property was synonym of quick money. But realty buys are always a good long-term investment opportunity.

Realty prices in the country evolve atypically: they rise and stabilize before rising again, even if it is after a long period of time. If they fall marginally relative to peaks, they do not brutally collapse owing to the structurally supportive factors (end-user demand, relatively low developer leverage and limited land plots) we mentioned. In other words, real estate investment will likely translate into price gains in the longer run, and buying today when choices are generous and sellers flexible can prove to be a sound investment diversification strategy.

DISCLAIMER

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