

LEBANON REAL ESTATE SECTOR

A TEMPORARY RELIEF RATHER THAN A GENUINE RECOVERY?

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- **Surge in activity fueled by buyer financial concerns**

The Lebanese real estate market has witnessed strong activity in the past few months, with the October 17 revolution and the ensuing exacerbation of the economic and financial crisis spurring significant demand for real estate. Apartments and land are widely perceived as a safe-haven investment, and are sought after by buyers fearing a haircut on their bank deposits. The value of real estate sales progressed by 52.5% in 5M2020 to reach US\$ 3.7 billion, following double-digit contractions over the past couple of years. This mostly reflects residential market developments, which account for the vast majority of realty activity. The commercial segment in both its retail and office components yet saw a continued downturn within a context of weak economic and business activity, the ongoing political uncertainty post-October 17 revolution, the instability of the parallel market exchange rate and the lockdown that was imposed due to the outburst of the COVID-19 pandemic.

- **Weakening construction activity amid acute economic crisis**

Historically, supply and demand trends in the Lebanese real estate market were quite intertwined. But not this time. Supply has sharply decelerated and the recent socioeconomic crisis has only exacerbated the trend. On the one hand, the country still has a stock of residential properties for sale that accumulated over the past few years. The latter is declining but remains non-negligible and needs to be absorbed before it makes sense for property developers to think in terms of kick-starting new projects. On the other hand, with new bank loans practically non-existent and the cost of construction materials indexed to the parallel market greenback and remaining sharply on the rise and very volatile, developers are refraining from initiating new projects today. The total area of new construction permits, reflecting future construction activity, declined by 32.6% in 2019 and by a further 61.0% so far this year. Similarly, cement deliveries contracted by 31.9% last year and by a further 55.7% so far this year.

- **Prices generally on the rise due to safe-haven perception of properties**

With the economic and financial crisis exacerbating, and a lot of realty being sold relative to previous months, sellers somewhat regained the upper hand in negotiations and some of them even started to increase their asking prices (against bank check payment). Gradually, asking prices of residential real estate in the capital city rose for the growth to reach 20%-30% in June 2020 relative to a year ago, as per the estimates of Ramco Real Estate Advisers estimates. This is due to high demand, decreasing stock, and the marked depreciation of the value of local dollars in tandem with the local currency depreciation, noting that a local dollar is today valued at less than half a fresh money dollar (i.e. a dollar banknote or coming from inward international bank transfers).

- **Relatively sustained demand in the near term amid mounting uncertainties**

What can be ascertained is that the current situation of high demand is likely to prevail at least in the next few months, awaiting drastic measures by Lebanese authorities to deal with the ongoing economic and financial crisis. It might be a while before an economic settlement is reached and/or a financial and monetary restructuring is agreed upon. Until then, this might cause lingering uncertainties for investors, and warrant a continued race to refuge investments, including realty. In other words, demand is unlikely to wane in the next few months. Given high construction materials costs due to FX depreciation, new supply is highly unlikely anytime soon. Hence, market dynamics currently in place are likely to be prolonged over the coming period. This might mean further upward pressures on realty prices in local dollar terms, that is until sellers would refrain from being fully paid in local dollars.

- **A sound investment diversification option at all times**

Recent developments in Lebanon have supported the perception of safe haven investment that realty has been known for. That does not however mean that the property market is out of the woods, after a considerable downturn in the past few years. True, it is benefiting from some form of relief today, that is only bound to be sustained as long as uncertainty does not subside. But once the dust settles, and the country emerges from one of its deepest crises in recent history, sellers would surface again in order to cash in on their placements. The evolution of prices then would depend on demand dynamics, although downward price pressures are then likely. What is sure though is that realty remains a center of interest for residents and expatriates, and a mean for investment diversification at all times.

MARKET DEMAND

Surge in activity fueled by buyer financial concerns

The Lebanese real estate market has witnessed strong activity in the past few months, with the October 17 revolution and the ensuing exacerbation of the economic and financial crisis spurring significant demand for real estate. Apartments and land are widely perceived as a safe-haven investment, and are sought after by buyers who wish to take their funds out of financial institutions, fearing a haircut on the value of their bank deposits.

Soon after the outburst of the October revolution, buyers have started to look for a safe haven placement, and naturally realty has come to their minds. For those buyers, investing in real estate withholds the value of their money, while a potential haircut threat adding to mounting uncertainties in the wake of the financial crisis is making them shy away from bank deposits.

Depositors cannot transfer their funds out of the country, at least not freely within the context of the de facto capital controls. In the recent past, they could withdraw in liras bearing in mind withdrawals are capped (withdrawals capped in USD at first then now only possible in liras), go to the exchange house, secure dollars at a discounted rate against those pounds and transfer fresh money through banks. Those de facto capital controls forced by the current situation took a toll on their mood, and made them decide to seek refuge elsewhere.

Buyers have found reasons to purchase properties, for their children, a secondary home, a house only as an investment to rent, etc. Most buyers did not really want an apartment, but sealed a deal due to the new situation in the country. Such buyers were mostly locals as of the end-months of 2019, then expatriates started joining the buying spree a bit later on.

But who is selling? In such conditions characterized by unprecedented uncertainties, false collapse rumors about some financial institutions and widespread malaise about the future of the financial system (especially in a haircut/bail-in context), sellers were mostly property developers or owners in debt and thus in need of funds to reimburse bank dues. Such sellers were those accepting bank checks instead of cash or partial payment abroad.

As a result, apartments being sold are generally new or a few years old only and usually were part of the stock of unsold apartments of the last few years across all size ranges. It is worth noting that land has also seen a surge in interest and sales activity, though the limited supply of land in a small country has made it somewhat more difficult for buyers to find a suitable land plot to buy. Land sellers again were mostly indebted owners looking to settle their dues, in addition to Solidere, the largest real estate company in the country that has land plots available for sale across the Beirut Central District mainly.

Speaking of the real estate giant company, it recently declared that proceeds collected from sales this year will reach US\$ 342 million by end-June 2020. Revenues come from 15 land sales transactions signed last year and in 2020 and covering 234,000 sqm of buildable area, all located in the New Waterfront area. A Solidere official added that 95% of clients were Lebanese looking to free bank deposits. In the first five months of this year, Solidere closed eight sales transactions totaling US\$ 183 million, against six for US\$ 110 million in the first five months of last year.

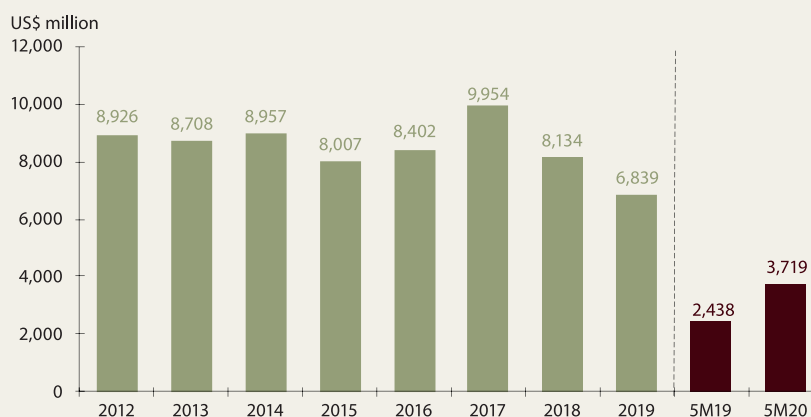
The Solidere official mentioned that the company settled outstanding dues worth US\$ 190 million on the back of such sales, and has US\$ 170 million in excess funds parked in banks, thus ensuring the continued operations and growth of the company. Within this context, Solidere "A" and "B" share prices more than doubled since the popular uprisings began to reach a near four-year high, reflecting some investor preference for Solidere shares especially as the company is experiencing a turnaround in sales activity which will reflect on earnings to be announced in the near term.

To put some numbers on broad market developments, the latest official figures released by the General Directorate of Land Registry and Cadastre in Lebanon show that the total value of real estate sales

progressed by 33.9% in December 2019 on a yearly basis, after months of continuous double-digit contractions. This reduced the full year 2019 sales contraction to -15.9%, with total realty sales of US\$ 6.8 billion of which US\$ 1.1 billion in the sole month of December. It is worth recalling that those figures mostly reflect the residential market developments, which accounts for the vast majority of realty activity in the country.

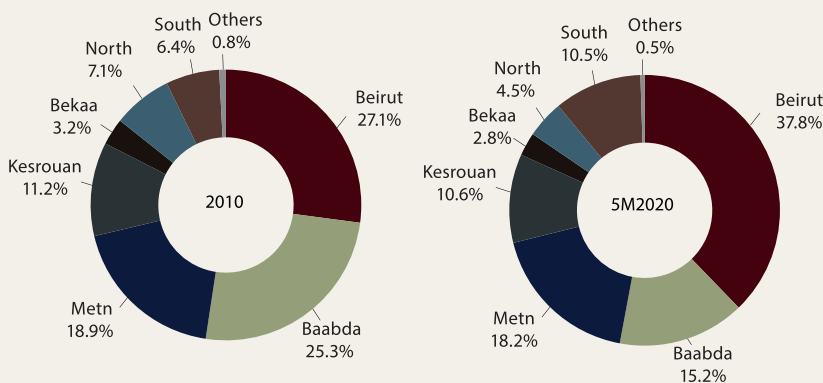
The upward trend accelerated in the first couple of months of 2020, with January witnessing a 49.9% yearly increase and February seeing an 84.3% growth, albeit from a low base in the corresponding months of 2019. Obviously, the COVID-19 pandemic and forced country lockdown slowed down the momentum with March and April recording contractions on a yearly basis. However, with pent-up demand for realty in a deteriorating economic context, real estate sales activity recorded a 198.4% yearly rise in the month of May 2020 (US\$ 1.1 billion in sales), taking the first five months of 2020 increase to +52.5% for the total value to reach US\$ 3.7 billion, a three-year high for the local realty market.

PROPERTY SALES TRANSACTIONS VALUE



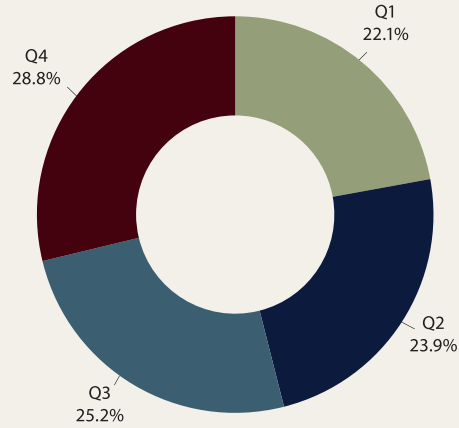
Sources: General Directorate of Land Registry and Cadastre, Bank Audi's Group Research Department

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 (2010-2019)

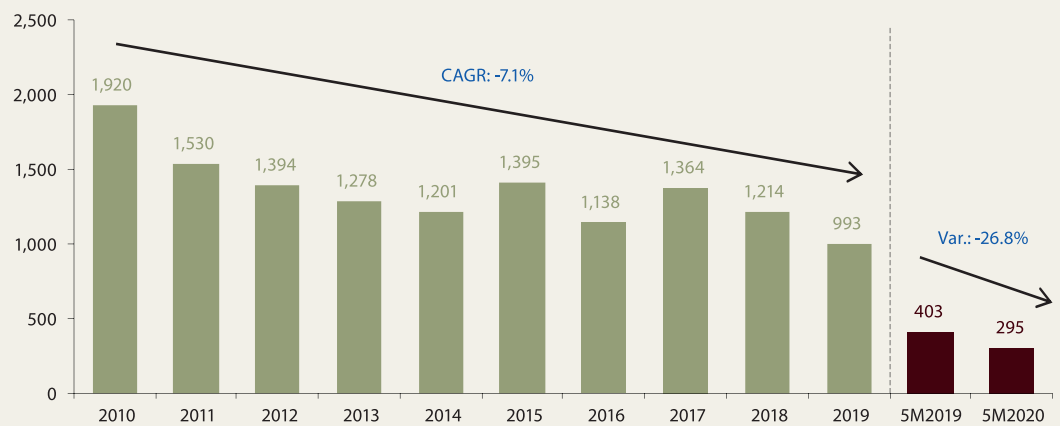


Sources: General Directorate of Land Registry and Cadastre, Bank Audi's Group Research Department

More or less similar trends were observed at the level of the number of real estate sales transactions, except that the May increase could not counterbalance the drop of the lockdown months of March and April, leading to a cumulative 0.8% decline in the first five months of 2020 after a contraction of 17.1% in full year 2019. This means that the surge in May 2020 real estate sales value is due to a rise in the average sales value, reflecting higher prices as would be discussed in the Market Prices section.

It is worth mentioning that foreigners largely stayed out of the market in view of the deteriorating local conditions, as evidenced by the continued contraction in the number of real estate sales to foreigners by 18.2% in full year 2019 and by a further 26.8% in the first five months of this year.

NUMBER OF PROPERTY SALES TO FOREIGNERS



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

A lot of sales were funded by existing deposits, which means that they have been self-funded. Bank financing was already receding prior to the October 17 revolution outbreak, and the current situation only accentuated that trend, especially as some depositors chose to settle their loans in advance in light of the mounting uncertainties. As a result, the total stock of outstanding housing loans for the entire banking sector decreased by 2.3% in the last quarter of 2019 as per the latest available BDL figures, to reach the equivalent of US\$ 12.2 billion, marking a 5.6% annual decline and almost a three-year low level.

PROPERTY SECTOR FINANCING

US\$ million	2012	2013	2014	2015	2016	2017	2018	2019
Property sales transactions	8,926	8,708	8,957	8,007	8,402	9,954	8,134	6,839
o.w. Built property estimate*	4,219	4,191	4,353	3,987	4,243	5,166	4,059	3,071
Housing loans portfolio	7,269	8,535	9,879	10,917	11,927	13,026	12,887	12,169
New housing loans	1,287	1,266	1,344	1,038	1,010	1,099	-139	-718
Avg bank lending ratio	30.5%	30.2%	30.9%	26.0%	23.8%	21.3%	0.0%	0.0%
Avg self financing ratio	69.5%	69.8%	69.1%	74.0%	76.2%	78.7%	100.0%	100.0%

* estimate derived from the share of the number of built transactions out of the total number of sales transactions; 2019 estimate based on 9M built property figures

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

While the residential market segment witnessed a renewed interest after a few years of prolonged sluggishness to say the least, the commercial segment saw a continued downturn for specific considerations. Lebanon's commercial market was tilted to the downside over the past couple of years, however it shifted into a more critical situation this year. This comes within the context of weak economic and business activity, the ongoing political uncertainty following the October 17 revolution, the instability of the parallel market exchange rate and the lockdown that was imposed on the country due to the outburst of the COVID-19 pandemic. The currently prevailing political, economic and social conditions left their imprints on the entire commercial segment.

Demand for offices waned especially as the crisis intensified in recent months. Many companies have closed or are on the verge of closing or at least scaling back activity (and thus reducing their footprint), and the COVID-19 pandemic did not do the segment any good, as office space was used less. Similarly, demand for retail space decelerated further, with many shops closing and vacancy rates rising. Even the F&B segment suffered (except for some big brands to a certain extent), with the coronavirus-related lockdown hitting hard food and beverages outlets (i.e. restaurants/pubs/night clubs etc.), which prompted some F&B outlets to shut down temporarily or permanently.

MARKET SUPPLY

Weakening construction activity amid acute economic crisis

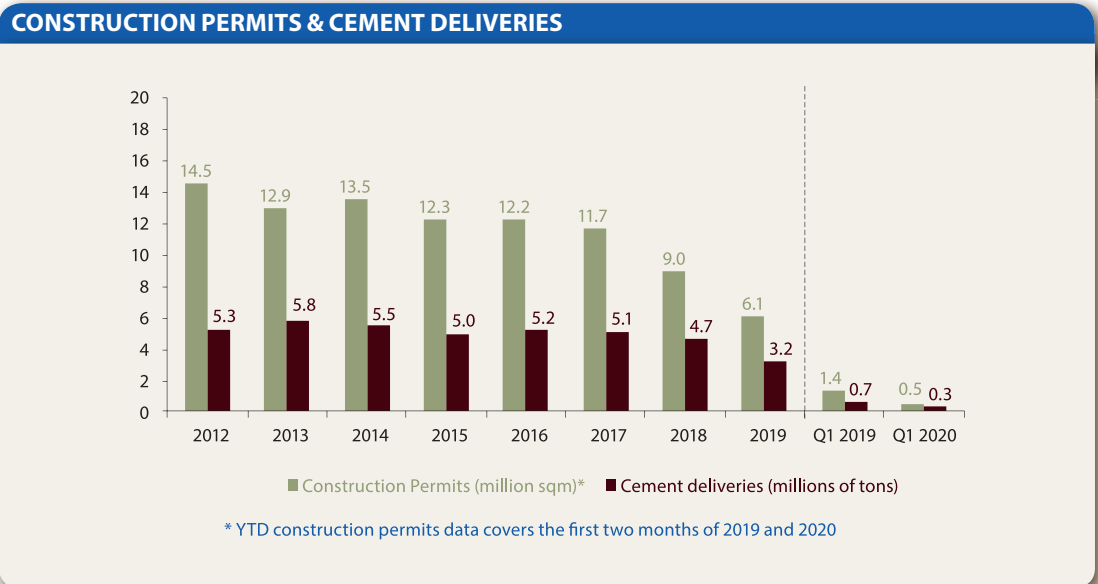
Historically, supply and demand trends in the Lebanese real estate market were quite intertwined. But not this time. As a matter of fact, supply has sharply decelerated and the recent socioeconomic crisis has only exacerbated the trend, whereas demand soared for the reasons mentioned earlier in this report.

On the one hand, the country still has a stock of residential properties for sale that accumulated over the past few years. While the current real estate sales upturn is reducing the stock, the latter remains non-negligible and needs to be absorbed before it makes sense for property developers to think in terms of kick-starting new projects.

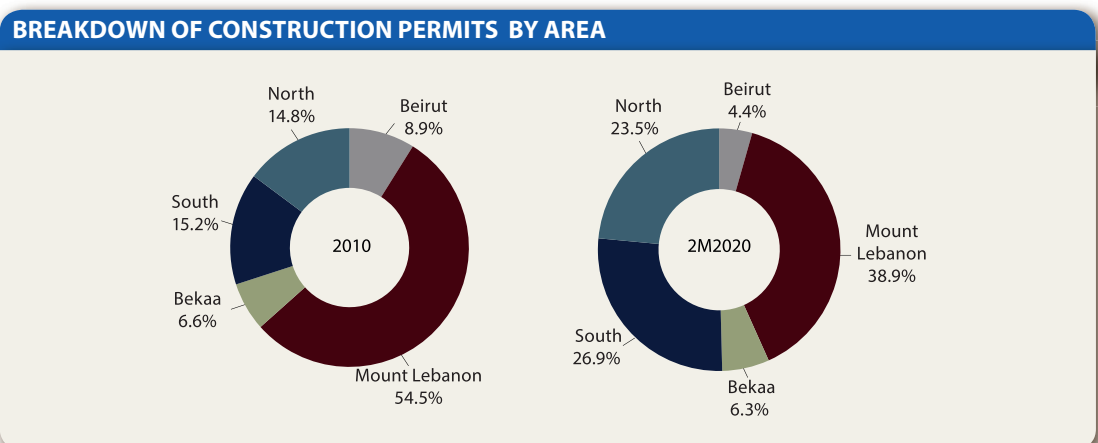
On the other hand, with new bank loans practically non-existent, especially for real estate projects, and the cost of construction materials indexed to the parallel market greenback and remaining sharply on the rise and very volatile, developers are refraining from initiating new projects until the dust settles.

The latest statistics released by the Order of Engineers of Beirut and Tripoli confirms such trends. Indeed, the total area of new construction permits, reflecting future construction activity, declined by 32.6% in 2019 and by a further 61.0% on a yearly basis so far this year. Around 39% of new construction permits area wise were earmarked for Mount Lebanon in 2M2020 (latest available figures), followed by South Lebanon with 27%, North Lebanon with 24%, the Bekaa with 6% and Beirut with 4%.

As such, the breakdown by region varies from historical figures (2010) when Beirut and Mount Lebanon accounted for larger shares (almost a combined two-thirds of new permits), whereas now farther areas are accounting for higher shares (North and South). Construction permits figures for 2020 largely cover the pre-coronavirus months, as the COVID-19 pandemic delayed the issuance of such figures. Similarly, cement deliveries, a quasi-indicator of current construction activity, contracted by 31.9% last year and by a further 55.7% in the first quarter of 2020.



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



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

This affected all market segments, be it the residential market, which accounts for the overwhelming majority of construction activity, or the commercial market. Within the prevailing context, the retail market segment is not really seeing any new project development. As to the office market, the number of projects underway is decelerating when compared to the previous year, thus accentuating the yearly downward trend witnessed in the past few years.

The latest Ramco Real Estate Advisers survey shows that the number of office projects under construction in the capital city reached 17 in March 2020 for a total area of 90,017 sqm, against 24 last year for 113,127 sqm and marking the sixth consecutive year of deceleration. As a matter of fact, no new project kicked off in last 12 months to the survey date, on the back of dwindling demand. Also to note is the fact that less and less investors are willing to consider buying on the map fearing that developers might not be able to finish their construction works, at least on time. The current rise in FX-related construction costs is affecting developer sentiment as well and is adding to the wait-and-see mood.

MARKET PRICES

Prices generally on the rise due to safe-haven perception of properties

It is normal that in such circumstances where demand is soaring, even though for reasons not really driven by the need for lodging, people start wondering about the price levels at which deals are being sealed. While no official figures on real estate prices are yet available in the country, anecdotal evidence on the ground shows that the latest developments have warranted some upward pressures on realty prices (against bank check payment), at least in the overwhelmingly dominant residential market segment.

We should first mention that from the start of the year 2019 until October, asking prices in the capital city had dropped by around 20% in some cases according to Ramco Real Estate Advisers estimates, as developers were suffering from the deterioration of socioeconomic conditions in an environment of weak economic and realty activity. Developers who lowered their prices were mostly the ones indebted and thus eager to close a sales deal. Some developers, mostly those who do not owe funds to banks, did not really change their prices, awaiting a buyer or better days, whichever comes first.

Then soon after banks reopened in early November, restrictions on deposit withdrawals in cash and transfers abroad had to be implemented in view of the depositors' panic post-revolution outbreak. People started calling real estate brokers or looking up themselves a good realty deal. In their opinion, especially amid rumors of a potential haircut on their deposits, then later on of a restructuring of the banking system, buying a property could be a safer option than keeping funds at the banks (at least all of their deposits). Hence, apartments or land that were unsold over the past few years started being in demand. Generally speaking, buyers were targeting good neighborhoods they see value in, rather than popular ones.

Progressively, the market started verifying a new equation: sellers consisting of indebted developers or owners getting frequent calls from buyers consisting mostly of depositors seeking to park their funds in real estate assets and not necessarily needing a house/land for their own use, at least immediately. With the economic and financial crisis exacerbating, and a lot of realty being sold relative to previous months, sellers somewhat regained the upper hand in negotiations and some of them even started to increase their asking prices. This marks a stark contrast with a period of buyers squeezing sellers in negotiations and obtaining sometimes interesting discounts due to long-lasting market sluggishness, estimated to have reached 30%-40% in some cases between 2018 and 2019.

Gradually, asking prices of residential real estate in the capital city rose for the growth to reach 20%-30% in June 2020 relative to a year ago, as per Ramco Real Estate Advisers estimates, meaning that they have increased slightly on a net basis relative to early 2019. This is due to high demand, relatively low stock (one should bear in mind that not all apartments are still available for sale on the market, with some owners preferring not to sell at the present time), and the marked depreciation of the value of local dollars in tandem with local currency depreciation, noting that a local dollar is today valued at less than half a fresh money dollar (i.e. a dollar banknote or coming from inward international bank transfers). Due to the latter reason, some developers/owners have increased their sales prices to accept bank checks,

or started asking for a partial cash payment, which has faced resistance on behalf of potential buyers. Some of the latter actually agreed to that, depending on their capacity and willingness to provide cash amounts.

In contrast, the commercial segment suffered from dwindling demand and consequently further downward pressures on rents. In the retail market, vacancy rates are increasing across shopping outlets, and malls, which used to fare somewhat better than isolated shops, are also in a difficult situation. Some brands are intending to leave malls and find cheaper rents elsewhere. Rents are estimated to have declined by 50% on average in the capital city relative to a year ago, as per Ramco Real Estate Advisers, with a multitude of pricing options further complicating activity (payment in LP, check, cash in USD or combination of cash and check). Some owners are not accepting payment that does not comprise a cash portion, which is further pushing the market down and vacancy rates up.

The office market has also been under a lot of pressure, even though there is some demand from existing companies seeking to relocate to cheaper locations in the aim of decreasing operating costs. Rents are down by 20% on average in the capital city relative to a year ago, as per the same source with also four pricing options, noting that rents in the Beirut Central District are down more than the market-wide average given its flagship status (hence higher asking rents generally speaking). The stock of offices available on the market remains non negligible, noting that new projects are mostly core and shell while current demand is focused on finished projects as the cost of finishing has increased significantly in recent months.

MARKET OUTLOOK

Relatively sustained demand in the near term amid mounting uncertainties

While property market activity surged in the past few months, many observers understand perfectly well market dynamics, and the reasons behind the mounting interest as of late in buying residential properties or land across the country. This comes as a boon for developers, especially those who were indebted and in a rush to pay back dues to banking institutions. But given the current circumstances, and the high volatility on the FX market with a continued depreciation of the local currency, supply has not and cannot follow suit. Developers do not wish to kick-off new projects, adopting a wait-and-see attitude, and even refrain from doing so even if they intended to launch construction works because of current market conditions.

Hence, the key questions that come to mind are the following: how does this augur for property market activity in the months ahead? Are upward price pressures going to build up further? Given that demand is nowadays circumstantial, aren't prices heading south? Strongly or just a bit? Those questions are very legitimate, and we will try in what follows to answer them with the most reasonable degree of accuracy, bearing in mind that volatile market conditions and the fluid politico-security situation remain a major source of uncertainty for the forthcoming period.

What can be ascertained is that the current situation of high demand is likely to prevail at least in the next few months. That is, awaiting drastic measures to be taken by Lebanese authorities to deal with the ongoing economic and financial crisis. Given the ongoing negotiations with the IMF and among local authorities themselves, it might be a while before an economic settlement is reached and/or a financial and monetary restructuring is agreed upon. Until then, this might cause lingering uncertainties for investors, and warrant a continued race to refuge investments, including realty.

In other words, demand is unlikely to wane in the next few months. And given high construction materials costs due to FX depreciation, new supply is highly unlikely anytime soon. Developers would rather not start projects before volatility eases and FX instability cools down. But there is still an important stock of properties for sale on the market, regardless of whether owners would like to sell today or postpone the sale.

In other words, market dynamics currently in place are likely to be prolonged over the coming period. This might mean further upward pressures on realty prices in local dollar terms, that is until sellers would

refrain from being fully paid in local dollars. At that point in time, demand might decrease back to below “normal” levels. By normal, we are thinking of people in actual need of lodging. Others might find realty too expensive and/or not be anymore in a rush to buy property. Property owners might continue refraining from selling their apartments/land, especially if the financial crisis is not fully dealt with. The demand/supply mismatch should thus continue but be reduced. The extent to which demand decelerates and supply evolves would determine the consequent pressures on prices, which are in such a scenario likely to be downward. To sum things up, prices might go down but not collapse, especially given the lack of significant increase in supply.

For the existing stock of residential realty, the urgency of current owners of finished apartments to sell and secure funds would determine the extent to which the prices of their properties would evolve in the less immediate term. In particular, current owners, especially new ones of the past few crisis months, might not be willing to sell for a few years unless the economic cycle kicks off again in style. For any new construction project that might see the light in the future, even if the FX depreciation subsides, construction costs would have increased in any case, whatever rate at which the trade of raw materials settles. This, in conjunction with a limited supply of land in a small country, suggests a lack of significant downward pressures on prices, or at least a full collapse.

As for the commercial segment in its retail and office components, there are no different headwinds and a complete lack of tailwinds apt to turn around market dynamics in the near term. Hence, downward pressures on rents would continue. The only exception in the next few months is likely to be at the level of sales (rather than rentals) of new commercial space for depositors wishing to invest in properties, if anything.

All in all, the recent developments in Lebanon have supported the perception of safe haven investment that realty has been known for. That does not however mean that the property market is out of the woods, after having witnessed a considerable downturn in the past few years. True, it is benefiting from some form of relief today, that is only bound to be sustained as long as uncertainty does not subside. But once broad economic and financial conditions change, sellers would surface again in order to cash in on their placements. The evolution of prices then would depend on demand dynamics. What is sure though is that real estate remains a center of interest for Lebanese residents and expatriates, and a mean for investment diversification at all times.

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