LEBANON REAL ESTATE SECTOR

NO NOTICEABLE BREAKTHROUGH ENVISAGED BEFORE A REGIONAL POLITICAL SETTLEMENT

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CONTACTS

Research

Marwan S. Barakat
marwan.barakat@banqueaudi.com

Jamil H. Naayem
jamil.naayem@banqueaudi.com

Gerard H. Arabian
gerard.arabian@banqueaudi.com

- **Improving domestic political climate helped prop up sales from a low 2016 base**
The Lebanese real estate sector has to some extent benefited since the start of 2017 from the amelioration of the domestic political environment. In a period marked by a well-contained security situation, the Lebanese political landscape saw the election of a new President in October 2016 and the formation of a national unity cabinet at the end of last year. Subsequently, all State institutions saw a return to life, with lawmakers meeting more frequently and passing new laws. During 2017, Lebanese political factions finally agreed on a new electoral law governing parliamentary elections. All this helped improve sentiment in the market and lead to an upturn in real estate market indicators relative to last year. The number of real estate sales rose by 14.9% in this year's first seven months from a relatively low 2016 base, favoring a 17.3% growth in the total value of real estate sales as per official figures.

- **New supply decelerating amidst relative constrained buyer appetite**
Developers are adapting more and more to restrained budgets and focusing on smaller units, with a flurry of apartments/studios below 150 sqm seeing the light. Buyers are sacrificing the much-used to large spaces to be able to afford a new home or at least to buy one not too far from their workplaces. This must have been a non-negligible factor behind the stagnation of new supply indicators. Cement deliveries, a coincident indicator of supply, retreated by a yearly 1.6% in this year's first seven months. The total area of new construction permits slightly rose by 4% in this year's first seven months after contracting by a small 0.9% in full-year 2016.

- **Continued price discounts relative to end of boom era peaks**
The currently prevailing conditions in the local realty market, notably constrained demand and a growing stock of unsold flats, have been warranting efforts on behalf of developers to seal a sales deal. With clients becoming pickier than ever and having the luxury of being able to choose from an increasingly wide pool of units available for sale, developers have had a tough time not throwing in some sweeteners. Those discounts are getting more easily obtainable and are believed to have averaged close to 20% in the country today, although this varies between one area and the other and sometimes between one developer and the other within the same area or neighborhood. Discounts granted on asking prices are not as significant as they seem given that they are in fact discounts relative to peaks attained at the end of the real estate boom of the second half of the past decade, period during which realty prices registered a double-digit increase on average per annum.

- **Flagging commercial market activity over the past year**
Lebanon's retail market registered a downbeat performance so far this year, within the context of subdued economic growth impacting retail activity and some gap between landlords' asking rents and businesses' willingness or ability to pay. Some shop owners are still asking rents above fair value, which is keeping some commercial space empty. The domestic office market more or less stabilized over the past year, with a deceleration of new supply after a handful of new projects had been seen on the market three or four years ago. Office rents were on the downside relative to last year, given the increased amount of office stock available on the market.

- **No breakthrough before the absorption of the large stock of unsold flats**
While the days of frenetic market activity and rising prices are nowhere near us especially given the large stock of unsold apartments, the realty market today presents perhaps one of the most interesting investment opportunities in recent years. That is, taking advantage now of lower prices and investing for the future. The Lebanese property market has gained in price attractiveness relative to some major markets worldwide that already witnessed price recoveries from the global financial crisis. Bargaining today and getting a good deal is a golden opportunity for buy-and-hold investors to ride the next wave of price increases way before it actually starts.

Bank Audi sal - Group Research Department - Bank Audi Plaza - Bab Idriss - PO Box 11-2560 - Lebanon - Tel: 961 1 994 000 - email: research@banqueaudi.com

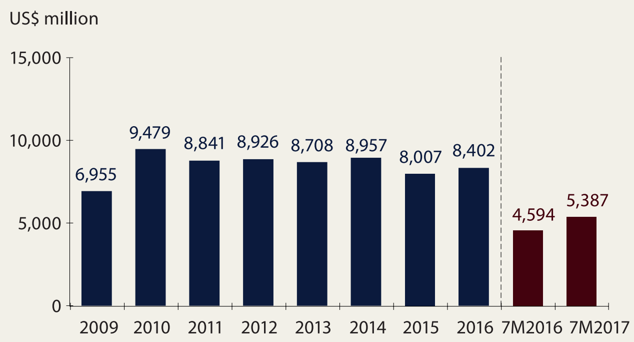
RESIDENTIAL MARKET

Improved domestic political climate helped prop up sales from a low 2016 base

The Lebanese real estate sector has to some extent benefited since the start of 2017 from the amelioration of the domestic political environment. In a period marked by a well-contained security situation, the Lebanese political landscape saw the election of a new President in October 2016 and the formation of a national unity cabinet at the end of last year. Subsequently, all State institutions saw a return to life, with lawmakers meeting more frequently and passing new laws. During 2017, Lebanese political factions finally agreed on a new electoral law governing parliamentary elections.

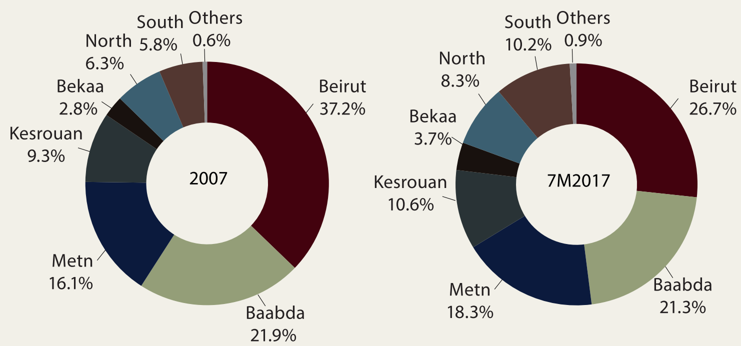
All this helped improve sentiment in the market and lead to an upturn in real estate market indicators relative to last year. For instance, the number of real estate sales rose by 14.9% in this year's first seven months after barely nudging up last year, and the number of sales to foreigners in particular progressed by 23.4% annually over the same period after a contraction in 2016. This favored a 17.3% growth in the total value of real estate sales over the first seven-month period as per official figures.

PROPERTY SALES TRANSACTIONS VALUE



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

PROPERTY SALES TRANSACTIONS VALUE BY REGION



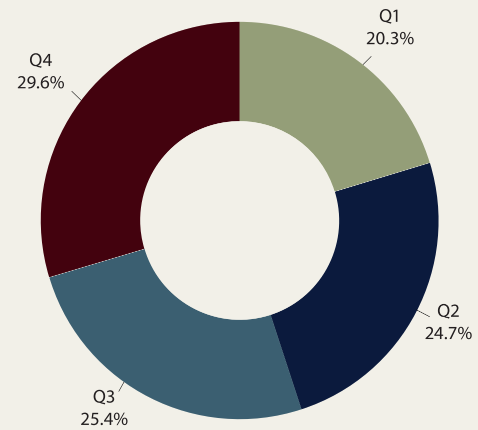
Sources: Real Estate Registry, Bank Audi's Group Research Department

Demand is for the overwhelming majority domestic, stemming from the resident sector, even though expatriates are seeking yet without purchasing as they did in the boom era. Apart from unfavorable regional conditions, expatriates and/or foreigners are enticed by some lucrative buying opportunities in advanced economies where prices had reached lows post-global financial crisis and where interest rates are still today at ultra-low levels.

Two remarks come to mind when gauging those indicators. First, one must keep in mind that activity ameliorated from a low 2016 base, and that sales remain well below highs attained in 2010. Second, the fact that all types of properties are included in those figures and that properties are registered upon delivery rather than at the actual sealing of the deal (sometimes pre-construction phase) does represent some caveat, but the official figures do give some indication on the prevailing market dynamics.

The banking sector, under the impulse of continued BDL support in the form of subsidized loans to productive sectors of the economy, has been supporting households by allowing them to benefit from long-term loans at historically low rates. It is yet true that within the context of constrained demand dictated by household budgets and the reality of still high prices (despite discounts), banking loans channeled towards housing somewhat slowed. They remain healthy at circa US$ 1 billion per annum over the past couple of years (2015 and 2016), but are around a third lower than the 2010-2014 period average.

SEASONALITY ANALYSIS OF PROPERTY SALES: 2008-2016



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

PROPERTY SECTOR FINANCING

US$ million	2010	2011	2012	2013	2014	2015	2016
Property sales transactions	9,479	8,841	8,926	8,708	8,957	8,007	8,402
o.w. Built property estimate*	4,542	4,089	4,219	4,191	4,353	3,987	4,243
Housing loans portfolio	4,511	5,982	7,269	8,535	9,879	10,917	11,927
New housing loans	1,706	1,471	1,287	1,266	1,344	1,038	1,010
Avg lending ratio	37.6%	36.0%	30.5%	30.2%	30.9%	26.0%	23.8%
Avg self financing ratio	62.4%	64.0%	69.5%	69.8%	69.1%	74.0%	76.2%

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

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

New supply decelerating amidst relatively constrained buyer appetite

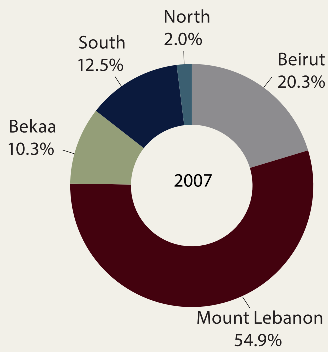
Developers are adapting more and more to restrained budgets and focusing on smaller units, with a flurry of apartments/studios below 150 sqm (often between 60 sqm and 100 sqm) seeing the light. Bachelors and new households do seek them, while some families are sacrificing the much-used to large spaces to be able to afford a new home or at least to buy one not too far from their workplaces.

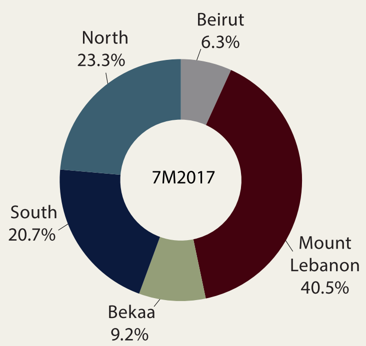
This must have been a non-negligible factor behind the stagnation of new supply indicators. In fact, cement deliveries, a coincident indicator of supply, retreated by a yearly 1.6% in this year's first seven months. Data from the Order of Engineers of Beirut and Tripoli show that the total area of new construction permits slightly rose by 4% in this year's first seven months after contracting by a small 0.9% in full-year 2016.

Developers used to be able to sell the majority of units available before the end of construction works, whereas nowadays more or less half the units only are gone before the end of construction. Some have been forced to divide large areas being built into smaller ones to remain able to sell, given the great difficulty in slashing prices substantially due to the sticky realty price structure.

As a matter of fact, recent surveys point out to a significant decline in the surface of apartments built and sold over the past few years. A recent InfoPro Research survey shows that among apartments sold out by the first half of 2017, around half have a surface below 150 sqm, almost double the percentage in 2012. This is followed by medium-sized units, while large flats are accounting for only 20% of units sold. In parallel, a recent Ramco Real Estate Advisers survey noted that the average area of apartments under construction in Beirut reached 198 sqm, 8% lower than in 2015 and extending the drop to as much as 36% in seven years.

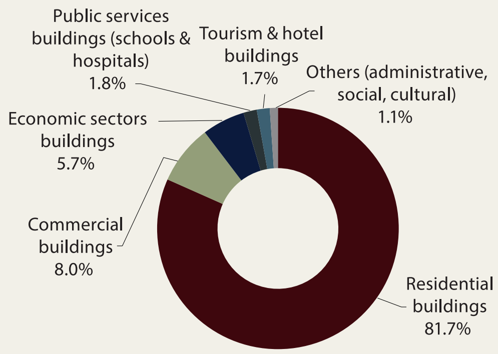
BREAKDOWN OF CONSTRUCTION PERMITS BY REGION





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

CONSTRUCTION PERMITS (AREA) BY USAGE PURPOSE (2016)



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

Continuation of price discounts relative to end of boom era peaks

The currently prevailing conditions in the local realty market, notably constrained demand and a growing stock of unsold flats, have been warranting efforts on behalf of developers to seal a sales deal. With clients becoming pickier than ever and having the luxury of being able to choose from an increasingly wide pool of units available for sale, developers have had a tough time not throwing in some sweeteners. The days where flats were selling like hotcakes or so to speak are over for the time being, and developers are aware of such dynamics.

Some developers have tried to lure buyers or rush them by mentioning that the election of a new President and the government formation would lead to a rise in prices, but that has not been the case. It is true that the improving political conditions have somewhat favored sales, but there is a very large stock of apartments put up for sale across the country as well. This means that flats for sale outnumber buyers and that consequently developers are forced to grant some discounts to entice investors.

Those discounts are getting more easily obtainable and are believed to have averaged close to 20% in the country today, although such an average must be taken with a grain of salt as this varies between one area and the other and sometimes between one developer and the other within the same area or neighborhood. Estimates derived from the Bank Audi Real Estate Department figures show that the average price per square meter in Lebanon declined by circa 22% relative to peaks attained towards the end of the boom era, noting that the current database comprises a total of 6,172 separate residential valuations distributed (unevenly) across the entire Lebanese territory. While the figures associated with the database probably do not exactly reflect the situation of the markets at large, they do give a fairly accurate picture of the general trends of the residential realty market.

Asking sales prices have barely nudged down however, as some developers are not fond of publicizing price drops. Anyhow, the discounts granted on asking prices are not as significant as they seem given that they are in fact discounts relative to peaks attained at the end of the real estate boom of the second half of the past decade, period during which realty prices registered a double-digit increase per annum.

To clarify further why price drops cannot be drastic and are limited to those discounts, we need to recall three important factors. First, demand for lodging in Lebanon is driven by end-users who are in actual need for a home, rather than by speculators who buy and sell whenever it suits them. There are speculators operating in the country's property market, but they are outnumbered by inhabiting buyers. Second, the majority of developers' money used in a realty project does not stem from debt. They do take bank loans, but rely on self-financing and more particularly on pre-sales. This is why most of them can grant some discounts to finish with their available lodging stock but are in no way in dire need to sell at depressed prices and reimburse lenders. Third, Lebanon is narrow in size and empty land plots are getting scarcer. Since land is one of the three main components of an apartment price (along with construction costs and developers' margins), its relative price stability does not really cause downward pressures on end-user apartment prices.

Speaking of price components, margins have taken the biggest hit of course. It is mainly through reducing margins that developers are granting those discounts. It is yet worth noting that in recent years, the more favorable Euro/USD FX rate (many sanitary items and materials are imported from Europe), lower oil prices (affecting transportation) and abundance of Syrian workforce (impacting labor costs) have somewhat caused downward pressures on construction costs, which have almost stagnated both last year and so far this year.

RETAIL MARKET

Continued downward pressures on activity despite ameliorating political situation and touristic season this year

Lebanon's retail market registered a downbeat performance so far this year, within the context of subdued economic growth impacting retail activity and some gap between landlords' asking rents and businesses' willingness or ability to pay. Some shop owners are still asking rents above fair value, which is keeping some commercial space empty.

Rents across the capital city retail space were on a downward trend relative to last year. Some areas across downtown Beirut witnessed rent declines of between 10% and 20%, while rents in Verdun saw the most significant drops of 20% to 40%, as per Ramco Real Estate Advisers. The latter can to some extent be attributed to the opening of ABC Verdun, which piled up pressure on individual shops in the area, and is drawing demand towards this large scale retail rub. Gemmayze witnessed a 10% drop in rents, noting that downward pressures also did not spare malls across Beirut. Relative to the previous couple of years' noticeable expansion, the Badaro retail landscape, which mostly consists of F&B outlets, has somewhat stabilized over the covered period.

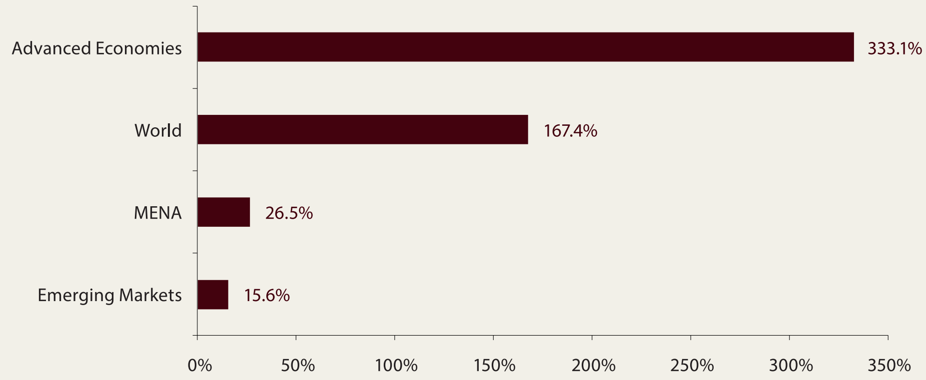
On the other hand, rents in Hamra and Mar Mikhael proved more resilient, almost maintaining their previous year's levels. Hamra remains the top commercial destination in Lebanon, with a flurry of shops and F&B outlets, and benefits from a very high pedestrian traffic. Mar Mikhael is perhaps the capital city's preferred entertainment destination, and is a renowned nightlife hotspot.

Echoing such trends, the latest global survey of the most expensive retail locations around the world issued by Cushman & Wakefield and covering the 12 months to June 2016 (last available survey) reflect the observed drop in rents across retail space in Lebanon. The survey also shows that the most expensive retail location across countries falling in the MENA geography were on average 27% above that of Beirut. Furthermore, rents of the emerging markets' most expensive retail spots stood 16% above that of Beirut and the global average was almost 1.7 times that of Lebanon's capital city.

Having said that, the retail market landscape is still seeing the opening of F&B areas and clusters outside the capital city. Following the opening of a number of F&B dedicated areas/clusters in Hazmieh, Dbayeh and Naccache among others, new supply is set to come on stream with further F&B projects in Metn, Achrafieh, and Beirut Corniche in the near future among others. Alongside the recent opening of ABC Verdun mall and a couple of other retail centers, more malls are expected to open in the North and South of the country, adding yet more retail space to the Lebanese commercial property market.

RETAIL RENTS 12 MONTHS TO JUNE 2016*

RELATIVE TO MOST EXPENSIVE BEIRUT LOCATION



* derived from most expensive retail location in each country

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

OFFICE MARKET

Fewer office space under construction relative to last few years

The domestic office market more or less stabilized over the past year, with a deceleration of new supply after a handful of new projects had been seen on the market three or four years ago. Office rents were on the downside relative to last year, within the context of the increased amount of office stock available on the market.

The Beirut Central District (BCD) remains a primary office destination in Lebanon, while witnessing a slight rents decline of 5% to 10% relative to last year, as per Ramco Real Estate Advisers. Parts of the latter area has been suffering from strict security measures surrounding it, which constrained business activity. The Hamra office market was somewhat more affected than the BCD's, while the new projects expected to come on stream in the near future are concentrated in the periphery of the Achrafieh area.

A few suburban areas imposed themselves in the past couple of years as sought-after office destinations, such as Sin el Fil, Dbayeh and Antelias, but were impacted by downward pressures this year given the important new office stock. The areas had in fact emerged as enticing office destinations in the country, offering modern space and interesting amenities to companies seeking a presence in strategic areas or not too far from the capital city.

Over the past couple of years, the office market has been relatively stagnating and the number of new projects is decelerating. Prices are shrinking and some buildings recently completed post low sales ratios. Municipal Beirut has 32 projects currently under construction, down by 6% from the previous year, and representing 191,528 square meters of total office stock, as per a Ramco Real Estate Advisers survey released earlier this year. This follows an 8% drop between 2015 and 2016. It is worth noting that only six projects were launched in 2016. This reflects a weakening developer appetite for office projects in Beirut as opposed to more dynamic developments in the nearby suburbs. Demand for office space did not follow the mushrooming supply of the past few years, and the market has reached some sort of saturation in this sense.

A look at new office space under construction shows that Beirut Central District has a total of 31,449 sqm of office space which makes up 16.4% of new office space, as per Ramco Real Estate Advisers. Two of these projects are located on the southern periphery of BCD, along Ring Road. Moreover, about 61% of the projects under construction in Beirut are located in Achrafieh, where 20 projects are currently underway. Eleven projects are located on the periphery of Achrafieh, in the neighborhoods of Corniche el Nahr, Adlieh, and Badaro.

Eight office projects are under construction in the western part of Beirut. The supply of office space in this area makes up 43,421 sqm, comprising 22.7% of the total office stock. This is due to the launching of new projects in Jnah, Ramlet el Baida, and Unesco, where more than 17,500 sqm of office space are on the sales market.

While new supply is somewhat decelerating, the currently prevailing demand conditions (namely subdued economic growth and sluggish investment conditions) and relatively large stock of offices already available over the past few years are likely to warrant the continuation of downward pressures on the office market in the near term.

MARKET OUTLOOK

No breakthrough before the absorption of the large stock of unsold flats

Straight forwardly put, the major antagonistic questions on the lips of real estate observers today, especially investors, relate to the outlook on prices in the domestic market. When are prices going to resume their upward trend? Conversely, are discounts on asking prices going to increase further?

With regards to the second question, and while we believe we clarified things earlier in the report, we would like to insist on the fact that realty prices in Lebanon have followed a staircase-like trend in the past two and a half decades: they either increase or remain stable but do not fall tangibly. The emphasis here is on the word tangibly as the discounts observed lately have raised some eyebrows. Those discounts in the current conditions have to take into account the peaks attained in recent years and that serve as a base for current discounts. Asking prices have not really changed in the last few years, and thus can be considered as practically equal to 2010 peaks, confirming the prevalence of the flat stage of the staircase. Bear in mind that those peaks represented a double-digit rise on average per annum during the boom era, i.e. for several years. So even today, real estate prices post-discounts are high by historical standards. This is precisely why there is a persistent disparity between per capita income in the country and realty prices, especially in Beirut.

But to argue that prices would hence inevitably fall drastically due to the large stock of flats for sale on the market is false. We already argued that the only component of apartment prices that developers have leverage on is their own margin, which they already reduced. Some might be willing to squeeze it further, but this would be on a case-by-case basis as it is unlikely that the majority of them would forego their gains just to sell rather than wait. After all, they already bought the land and incurred (at least partly) construction costs. Therefore, there is not much room left, generally speaking.

With regards to the first question, the answer is: not anytime soon. At least not before the stock of unsold apartments is gone. And that would most likely be not before reaching a political settlement in neighboring Syria. For developers to get rid of their properties, there would have to be a sufficient stream of sales in the market over a sustained period of time. And for that to happen, it would mostly likely take non-residents to participate actively as well in the buys and add some volumes to the sales. Lebanese expatriates and also foreigners (mainly Arab investors) would have to make a move and be active in the market again.

And for that to happen, investment conditions must improve further. Of course, the improved domestic political climate is welcome, but not enough in itself to trigger massive sales. However, a regional/international political settlement to the war in Syria and a return to stability in the Near East region would allow non-resident Lebanese, Arab and international investors to think again of Lebanon in terms of property investments.

Obviously, this would all depend on global risk appetite, oil price levels (for Arab investors) and other external factors but others things held constant, a resolution to the conflict in Syria would pave the way for a return of investments to Lebanon. But even then, the large stock of properties for sale would take some time to disappear, and it is most likely only then that downward price pressure could fade away.

While the days of frenetic market activity and rising prices are nowhere near us, the realty market today presents perhaps one of the most interesting investment opportunities in recent years. That is, taking advantage now of lower prices and investing for the future. The Lebanese property market has gained in price attractiveness relative to some major markets worldwide that already witnessed price recoveries from the global financial crisis. Bargaining today and getting a good deal is a golden opportunity for buy-and-hold investors to ride the next wave of price increases way before it actually starts.

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