Bank Audi

LEBANON REAL ESTATE SECTOR

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PROPERTY SECTOR AT A CROSSROAD, MIRRORING POLITICO-ECONOMIC OUTLOOK

Slower demand for realty as mirrored by contracting property transactions this year

Demand for realty in Lebanon slowed down in 2022 after developers paid off most of their debts to banks and payment by check phased out, and as the country's real estate market became a fully dollarized cash-only or fresh dollars market. The value of property sales transactions, which have peaked in 2020 and expanded by 8% in 2021, posted a yearly contraction of 18% during the first seven months of the year 2022. Concomitantly, the number of sales operations fell by 15% year-on-year during the first seven months of 2022, following a 34% rise in 2021.

Slowdown in the realty supply market as projects' halt continues

At the level of market supply, the development of new residential buildings has been halted since the beginning of the crisis. In parallel, a number of buildings under construction were interrupted. The few developers trying to complete their construction projects are those who have apartments sold before 2019. Developers are actually falling behind in the projects amid the huge increase in the price of building materials and the reduced purchasing power of both developers and buyers. Within this environment, cement deliveries in 2021 accounted for a mere 1,951 thousand tons in 2021, 39% below the 2019 figures.

Market pricing almost extensively undertaken in fresh US dollars

Most of property owners are increasingly seeking to sell the remaining stock in fresh US dollars since they don't have much loans left to settle in local dollars. By end-July, the banks' FX loan portfolio stands at US$ 12.6 billion, against circa US$ 40 billon prior to the crisis onset in October 2019. While the quasi totality of sellable real estate are now being priced in fresh US dollars, the fresh dollar buyers are scarce, which put adverse effects on price trends. This comes after a reduction in real estate prices in fresh dollars by more than 50% since the onset of the crisis back in 2019. The 50% average cut is uneven across regions, as some regions have witnessed a decline by 70% amid the lack of buyers in fresh dollars and some other regions are faring relatively well, with an average decline not exceeding 30% in fresh dollar terms. Beirut is faring relatively better than farther regions that are more impacted by the loss in purchasing power.

Property sector at a crossroad looking forward

Looking forward, the real estate sector is at the mirror image of the overall country outlook. In the event of a positive politico-economic scenario, real estate demand would be considerably up, raising with it property prices. Such a scenario revolves around forming a Cabinet imminently, to be followed by Presidential elections by end-October, and to be followed by a full fledge agreement with the IMF on the basis of the Staff-level agreement reached in April. The other scenario is the lingering status-quo scenario, which revolves around the failure to agree on Cabinet formation, the phased postponement of Presidential elections, the absence of reforms, the failure to abide by the IMF prior actions requirements and the lack of a final program with the Fund. This scenario would lead to hefty depreciation of the national currency amid excessive LL money creation, hyperinflation in consumer prices and huge socio-economic pressures on households. For the real estate sector, this means excess of supply over demand for property and corollary further contraction of real estate prices in fresh dollar terms in the market.

Probability of near term politico-economic breakthrough lower than the opposite

At this point in time, it seems that the probability of the "hoped for" politico-economic breakthrough happening in the foreseeable future is relatively lower than the opposite, which suggests possible further forthcoming strain for Lebanon's economic environment in general reducing the near term likelihood of the real estate market marrying its pent up demand outlook and its awaited corollary price rally at large.

Real estate sector outlook uneven across regions

As to the sector outlook by region, more strain and corollary price contraction is foreseen in the regions that count on domestic income. In fact, in the event of a further currency depreciation in the absence of the favorable scenario, a further erosion is expected in purchasing power for LL income, which might generate more real estate sale to meet basic needs, putting further pressure on property prices. As to regions that attract expatriate investment into their properties, they will be faring better with the relatively sustained inflow of fresh inflows from outside.

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MARKET DEMAND

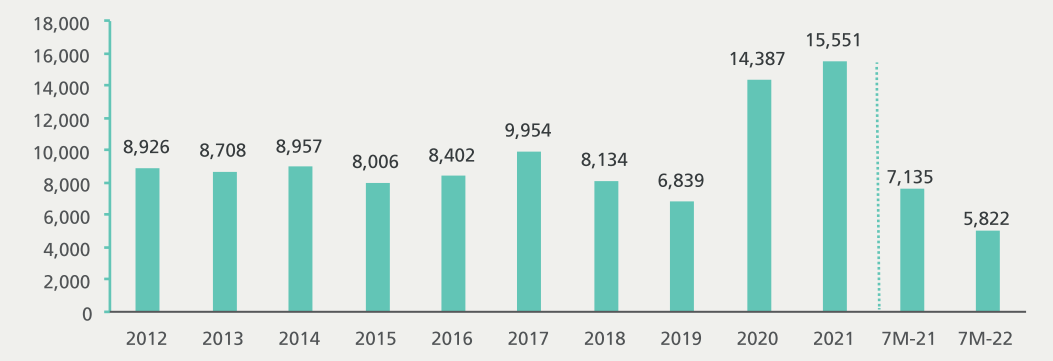
Slower demand for realty as mirrored by contracting property transactions this year

Demand for realty in Lebanon slowed down in 2022 after developers paid off most of their debts to banks and payment by check phased out, and as the country's real estate market became a fully dollarized cash-only or fresh dollars market.

Lebanon's real estate market, which was perceived as a safe haven at the onset of the economic and financial crisis as depositors sought to avoid haircut on their placements, entered into expatriates' radar screen after realty prices were adjusted downwards in fresh dollars. Concurrently, some resident buyers rushed to close their deals before the Parliament's approval of the 2022 budget.

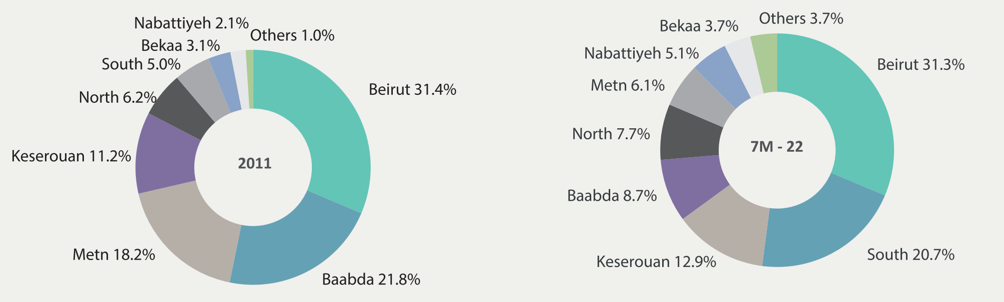
Putting this in figures, the value of property sales transactions, which have peaked in 2020 (+110.4%) and expanded by 8.1% in 2021, posted a yearly contraction of 18.4% during the first seven months of the year 2022. Concomitantly, the number of sales operations fell by 15.3% year-on-year during the first seven months of 2022, following a 33.9% rise in 2021.

PROPERTY SALES TRANSACTIONS VALUE (US$ MILLION)



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

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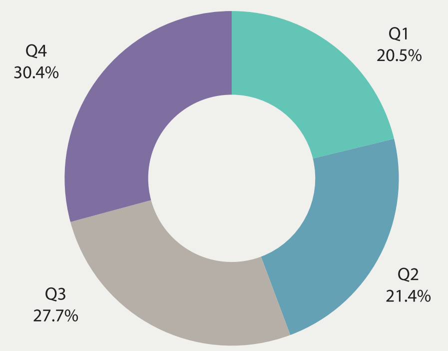
SEASONALITY ANALYSIS: PROPERTY SALES BY QUARTER (2012-2021)



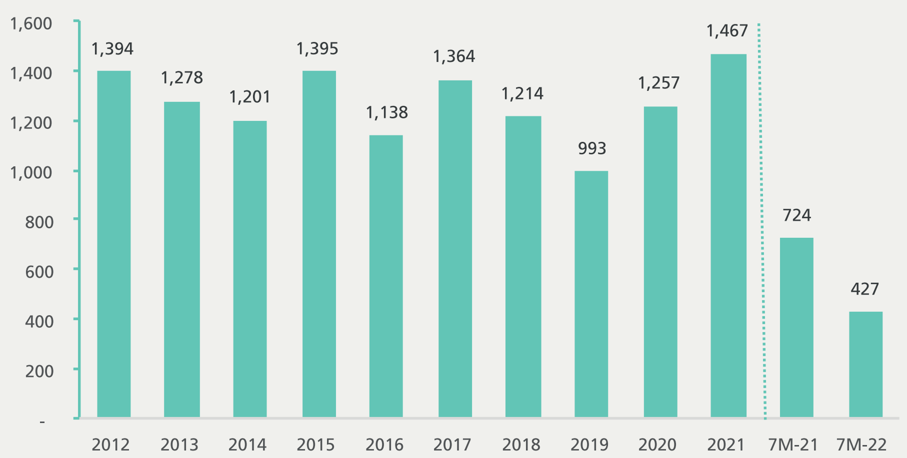
Sources: General Directorate of Land Registry and Cadastre, Bank Audi's Group Research Department

Most regions recorded a decrease in the value of sales transactions, with the most significant movements coming as follows: Metn (-68.7%), Baabda (-64.1%), North (-20.3%), Bekaa (-21.5%), Keserwan (-10.6%) and Beirut (-4.3%). As for the breakdown of the value of property sales, Beirut continued to capture the highest share over the first seven months of 2022 with a share of 31.3%, followed by the South with 20.7%, Keserwan with a share of 12.9%, Baabda with 8.7%, North with 7.7%, Metn with 6.1%, Nabattiyeh with 5.1% and Bekaa with 3.7%.

As prices of apartments were slashed by half roughly on average relative to pre-crisis levels in fresh dollars terms, Lebanon's residential market saw a resurgence in expatriate demand after pandemic. However, demand from foreigners contracted this year. This was reflected by a 41.0% year-on-year fall in sales to foreigners during the first seven months of 2022, following a 16.7% rise in 2021 and a 26.6% surge in 2020, as per the latest statistics published by the General Directorate of Land Registry and Cadastre.

Amid a dollarized cash-only real estate market and persistent sluggish business activity, the demand for offices remained limited this year, noting that rents in Beirut were reduced by half when compared to

NUMBER OF PROPERTY SALES TO FOREIGNERS



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

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pre-crisis levels in fresh dollars. Within this context, it is worth mentioning that the rental yield has risen slightly from pre-crisis levels.

On the other hand, land has seen a decline in sales activity in 2021 and 2022. Solidere, the largest real estate company in the country that has land plots available for sale across the Beirut Central district mainly, recently declared that revenues from land sales reached US$ 85 million in 2021 as compared to US$ 382 million in 2020, which marks a 78% yearly drop. This is mainly explained by two factors: First, all sale transactions occurred fully in fresh dollars in 2021 instead of mainly local US dollars in 2020; Second, some closed deals over the year 2021 were not registered during the same year and were brought forward to 2022 due to the strike called by public sector workers, according to company sources.

Looking forward, dire domestic economic and financial conditions would continue to weigh on activity in the real estate market, noting that the relaunching of subsidized loans dedicated to the purchase, construction and reconstruction of homes, which have been at a standstill for more than three years, may provide a shy support to demand for realty in Lebanon.

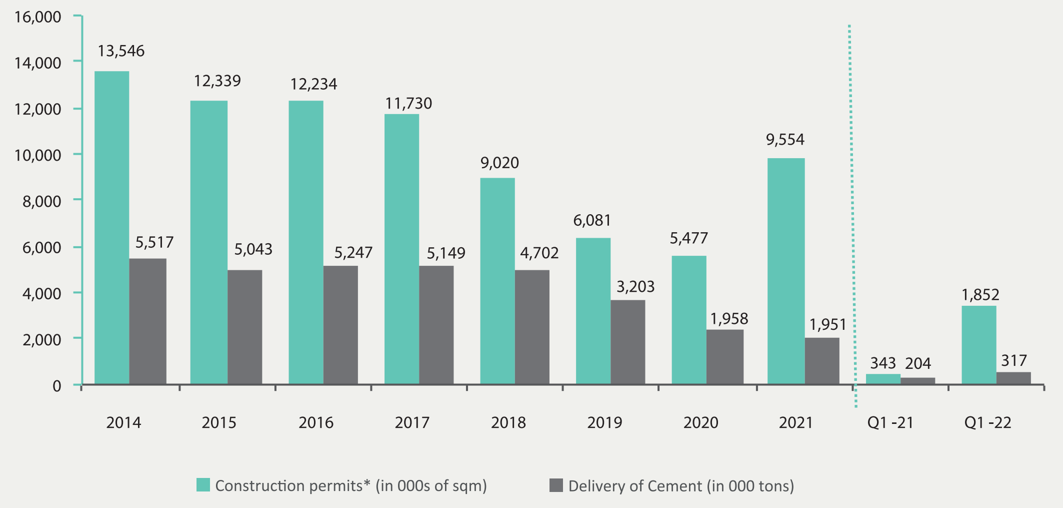
MARKET SUPPLY

Slowdown in the realty supply market as projects' halt continues

At the level of market supply, the development of new residential buildings has been halted since the beginning of the crisis. In parallel, a number of buildings under construction were interrupted. The few developers trying to complete their construction projects are those who have apartments sold before 2019.

According to Ramco, the banking restrictions, the devaluation of the Lebanese currency and changes in payment methods have disrupted the sector. Since then, the new housing sector in Beirut has been in turmoil.

CONSTRUCTION PERMITS & CEMENT DELIVERIES



**YTD figures are for first two months*
Sources: Order of Engineers of Beirut and Tripoli, BDL, Bank Audi's Group Research Department

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The latest statistics released by the Order of Engineers of Beirut and Tripoli reveals contradicting trends. After a series of declines over the past couple of years, construction permits went back to increase during 2021. In details, the latter, an indicator of forthcoming construction activity, posted a three-digit year-on-year rise during the first two months of 2022, showing a questionable interest in the construction sector noting the increasing prices due to the volatility of the parallel exchange rate market and the instable socio-economic and political situation. In fact, construction permits covered an area of 1,851,847 square meters in the first two months of 2022, against an area of 342,961 square meters in the first two months of 2021. This followed a yearly hike of 440% registered in the aforementioned period of 2021. However, this does not reflect the reality at the level of established projects.

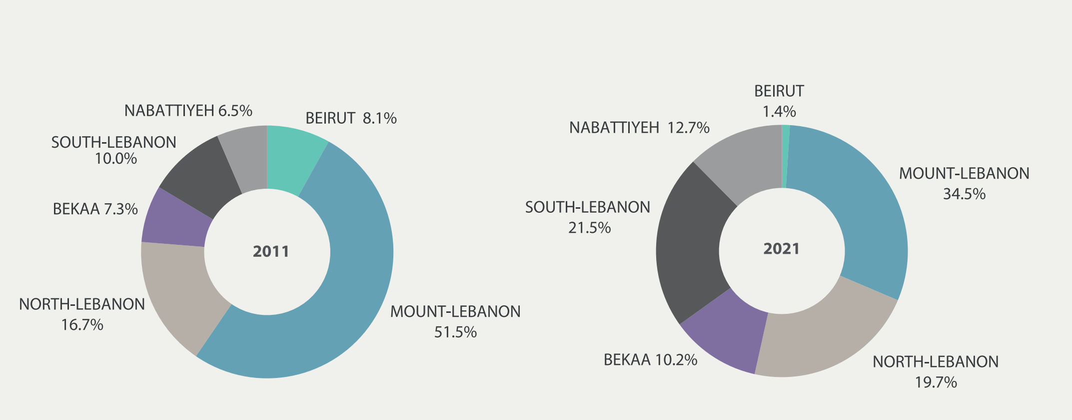
In fact, developers who purchased properties in previous years are rushing to obtain a permit payable in Lebanese pound, before the expected hike in the official rate, which is still at LP 1,507.5 per dollar, while the latter is sold at nearly LP 35,000 on the parallel market. So, this is not about a sudden boom in the sector. It is quite the opposite, as per Ramco.

As for the breakdown of construction permits, Mount-Lebanon continued to capture the highest share in newly issued construction permits in the first two months of 2022 with a share of 31.5%. It was followed by South-Lebanon with 23.6%, the North-Lebanon with a share of 23.3%, Nabattiyeh with 10.8%, Bekaa with 10.1% and Beirut with 0.8%.

However, cement deliveries, a quasi-indicator of current construction activity, rose by 56.0% in the first quarter of 2022 when compared to the same quarter in 2021. This reflects that some work at the level of development is being done. The work at many construction sites is yet significantly slow, and this is done mainly to reassure the people who bought off-plan.

In sum, the implications of the crisis that hit Lebanon at the level of market supply, resulted in developers quickly falling behind in the projects they had started before 2019. This is due to the huge increase in the price of building materials and the reduced purchasing power of both developers and buyers.

BREAKDOWN OF CONSTRUCTION PERMITS BY AREA



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

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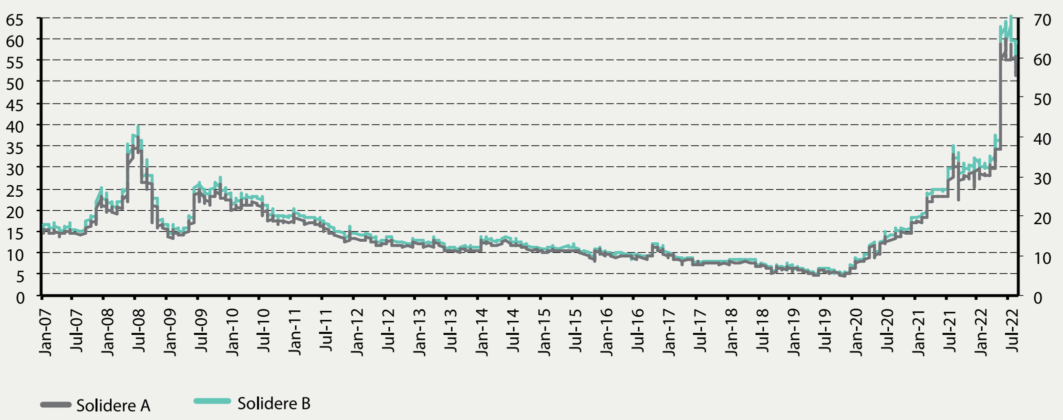
MARKET PRICES

Market pricing almost extensively undertaken in fresh US dollars

Over the past three years, real estate prices in fresh US dollars has witnessed a noticeable downward trend. While the quasi totality of sellable real estate are now being priced in fresh US dollars, the fresh dollar buyers are scarce, which put adverse effects on price trends. This comes after a reduction in real estate prices in fresh dollars by more than 50% since the onset of the crisis back in 2019. The 50% average cut is uneven across regions, as some regions have witnessed a decline by 70% amid the lack of buyers in fresh dollars and some other regions are faring relatively well, with an average decline not exceeding 30% in fresh dollar terms. Beirut is faring relatively better than farther regions that are more impacted by the loss in purchasing power.

On the other hand, the rise in real estate prices in local bank dollars is directly tied to the uncertainty facing the system, in addition to the inefficient interplay between supply and demand. The succession of events in Lebanon over the past three years - starting from the economic/monetary crisis, to the State's default on its Eurobond payment, to the Corona virus Pandemic to the explosion of Beirut port, to the diplomatic rift with GCC countries and to the delay in constitutional milestones such as presidential elections and Cabinet formation– all have adverse effects on the perceived financial stability and on the

EVOLUTION OF SOLIDERE SHARE PRICES



Sources: Beirut Stock Exchange, Bank Audi's Group Research Department

observed value of lollar deposits in the market place.

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 real estate sellers regaining upper hand in negotiating a lollar transaction, sellers have been demanding significantly higher prices in lollars that exceeded 300% and 400% in some cases.

The increase in real estate prices in lollar terms is well portrayed by the evolution of Solidere prices, as Solidere shares reported a rise from US$ 7.3 at end-2019 to US$ 18.5 at end-2020, to US$ 33.0 at end-2021 and to nearly US$ 46 today. The upward trend in Solidere prices was driven by the important demand registered on those shares in search for a safe haven from the perceived more risky financial investments.

Today, most of property owners are increasingly seeking to sell the remaining stock in fresh US dollars since they don't have much loans left to settle in local dollars. By end-July, the banks' FX loan portfolio stands at US$ 12.6 billion, against circa US$ 40 billon prior to the crisis onset in October 2019.

The breakdown of the market between residential, commercial and office real estate shows that the crisis is impacting more commercial and office market relative to the residential market. This is due to the lack of business activity within the country over the past couple of years, with the real economy shrinking from a US$ 52 billion GDP prior to the crisis to a circa US$ 22 billion GDP today.

While the market for rentals is at the mirror image of a country in crisis, it has relatively atypical characteristics. In fact, landlords are trying to search for fresh dollar payers for rentals, rather than lollars or Lebanese Pounds. Those targeted tenants are searched for among Lebanese with foreign income, or employees at international organizations or diplomats. Given the scarcity of such profiles relative to the multitude of rentals offered, this has put those tenants in a strong negotiating position, which ultimately lead to a noticeable drop in negotiated rentals. This is amplified by the fact that offers are numerous in view of the fact that a large number of ex-depositors have bought apartments that they don't need and are now seeking to rent them in an market of a multitude of vacant apartments. Within this environment, there has been rent reduction recorded relative to 2019 in the vicinity of 20% to 30%, though not at the same pace of real estate price decrease. This has lead to a net rise in rental yields at large since the onset of the crisis.

MARKET OUTLOOK

Property sector at a crossroad looking forward

Looking forward, the real estate sector is at the mirror image of the overall country outlook. Lebanon is actually at a crossroad today with two politico-economic scenarios looking forward: Recovery or collapse. Indeed, Lebanon faces two alternatives: Either recognizing the reality and the deep crisis that Lebanon endures and thus facing them, which means taking the right measures and implementing the required reforms that would put Lebanon on the right track. Or leaving things as is and extending the denial phase which would push Lebanon further in the red.

In the event of a positive politico-economic scenario, real estate demand would be considerably up, raising with it property prices. Such a scenario revolves around forming a Cabinet imminently, to be followed by Presidential elections by end-October, and to be followed by a full fledge agreement with the IMF on the basis of the Staff-level agreement reached in April.

Such a final agreement with the Fund is actually contingent upon the realization of the prior actions requested by Lebanese authorities, namely Parliament approval of an appropriate emergency bank resolution legislation, the initiation of an externally assisted bank-by-bank evaluation for the 14 largest banks by signing the terms of references with a reputable international firm, the Parliament approval of a reformed bank secrecy law, the completion of the special purpose audit of the BdL's foreign asset position, the Cabinet approval of a medium-term fiscal and debt restructuring strategy, the Parliament approval of the 2022 budget, the unification by BdL of the exchange rates for authorized current account transactions, and the implementation of formal capital controls.

In case such prior actions are ensured on behalf of Lebanese authorities, a final agreement between Lebanon and the Board of Directors of the IMF would materialize, helping Lebanon to get out with time of its acute economic/financial crisis. This bodes well for the real estate sector in a country with limited property supply and with pent up demand awaiting the normalization of the politico-economic situation.

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The other scenario is the lingering status-quo scenario, which revolves around the failure to agree on Cabinet formation, the phased postponement of presidential elections, the absence of reforms, the failure to abide by the IMF prior actions requirements and the lack of a final program with the Fund. This scenario would lead to hefty depreciation of the national currency amid excessive LL money creation, hyperinflation in consumer prices and huge socio-economic pressures on households. For the real estate sector, this means excess of supply over demand for property and corollary further contraction of real estate prices in fresh dollar terms in the market.

At this point in time, it seems that the probability of the "hoped for" politico-economic breakthrough happening in the foreseeable future is relatively lower than the opposite, which suggests possible further forthcoming strain for Lebanon's economic environment in general reducing the near term likelihood of the real estate market marrying its pent up demand outlook and its awaited corollary price rally at large.

As to the sector outlook by region, more strain and corollary price contraction is foreseen in the regions that count on domestic income. In fact, in the event of a further currency depreciation in the absence of the favorable scenario, a further erosion is expected in purchasing power for LL income, which might generate more real estate sale to meet basic needs, putting further pressure on property prices. As to regions that attract expatriate investment into their properties, they will be faring relatively better with the sustained inflow of fresh inflows from outside.

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