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WHAT ARE THE CONDITIONS FOR A POSITIVE SCENARIO FOR LEBANON'S REALTY SECTOR?

Real estate demand in Lebanon showing mixed performance amid market dollarization and expatriate appetite

The past year presented a turning point for demand in the Lebanese real estate market as transactions became fully dollarized, with sellers phasing out purchases using banking checks and amid a drastic devaluation of the Lebanese pound against the US\$. In turn, the number of potential buyers in Lebanon dwindled bringing the demand in the market down towards a sluggish performance despite some expatriate appetite. With the subsequent dollarization of sales in 2022, a 7.7% decrease year-on-year was noted in the value of sales transactions in the realty market against the year prior, a decrease that accentuated seemingly further in 2023.

Supply activity increasingly sluggish in the Lebanese property market

The supply of new real estate in the Lebanese market has been sluggish since the start of the economic crisis in 2019. With changes in payment methods, the devaluation of the Lebanese pound, the surge in raw material prices as a result of the Russo-Ukrainian war and the lack of real estate financing, few construction projects remain active in Lebanon, with those initiated prior to 2019 consisting of the majority. This trend has led to the quasi interruption of a deal of ongoing construction projects in the country as well as a decrease in forthcoming construction projects within the sector. The latest figures provided by the Order of Engineers and Architects of Beirut (OEAB) showed that a drop by 57.8% year-on-year in construction permits, an indicator of forthcoming projects, was recorded during the first half (H1) of 2023 against figures from the same period of the year prior. Construction permits for H1 2023 recorded 1,994,718 m2, down from 4,730,280 m2 in H1 2022.

Market pricing exclusively undertaken in fresh US dollars amid scarce buyers

While Lebanon is reeling under an unprecedented sovereign-financial-monetary crisis, which is ongoing for the fourth year, and given that most property owners have settled their bank debts, the totality of real estate is currently priced in fresh US dollars, with sellers requiring either payment in cash or via transfer from abroad. Residential unit prices in fresh US dollars have been slashed by 30% to 60% since the onset of the crisis in October 2019, depending on the proximity to capital and the household purchasing power. This is mainly attributed to (1) the sharp depreciation of the Lebanese pound against the US dollar on the parallel FX market, which has eroded the purchasing power of citizens, (2) the lack of interest from Arabs to invest in the Lebanese real estate market, (3) the protracted multilayered political vacuum and (4) the absence of bank lending activity. However, the residential market started to witness an uptick in prices over this year, moving up by circa 10% over a 12-month period, as property owners found themselves in a better negotiating position after settling their bank debts, and were not in rush to sell their units.

Here are the requirements for a positive scenario for Lebanon's real estate sector

Looking forward, the main requirements for a positive macro scenario in general and for Lebanon's real estate sector in particular revolves around a smooth transition of power at the Central Bank, the election of a President of the Republic as soon as possible, the formation of a credible and efficient cabinet, the ratification of a full fledge program with the IMF and the materialization of international assistance for Lebanon from the IMF, from donor countries and from international institutions. If Lebanon goes in this direction, it can move to significant growth close to double digit, the Lebanese Pound would stabilize, inflation rates would be contained, the balance of payments would shift back to surplus, BDL reserves would be reinforced and real estate prices would bolster. Meanwhile, it looks like the strong tourist sector this year and in particular the large incoming of Lebanese expatriates from abroad has provided a relative support to the real estate sector in some of the regions of interest, a support that remains timid in nature when compared to the slump that the sector had witnessed since the onset of the economic/financial crisis in 2019. For the property sector to regain its pre-crisis conditions, investors would have to join in significant volumes which is not the case for the time being. Those still await a net improvement in the country's politico-economic outlook that would reduce investor risks at the horizon and safeguard their property investment perspectives in the medium to long term.

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MARKET DEMAND

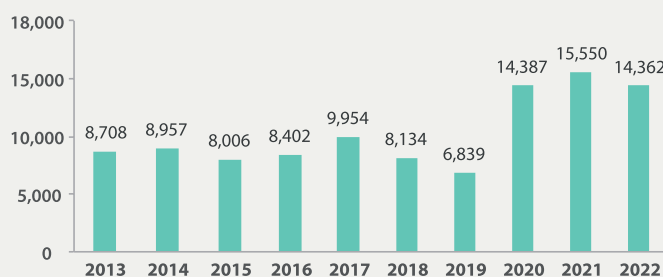
Real estate demand in Lebanon showing mixed performance amid market dollarization and expatriate appetite

The past year effectively presented a turning point for demand in the Lebanese real estate market as transactions became fully dollarized, with sellers phasing out purchases using banking checks and amid a drastic devaluation of the Lebanese pound against the US\$. In turn, the number of potential buyers in Lebanon dwindled bringing the demand in the market down towards a sluggish performance.

With the subsequent dollarization of sales in 2022, a 7.7% decrease year-on-year was noted in the value of sales transactions in the realty market against the year prior. This comes following a 110.4% year-on-year jump in the value of sales transactions in 2020 and an additional 8.1% year-on-year increase in the value of sales transactions within the Lebanese realty market in 2021 as buyers rushed to buy property using bank checks, as per data from the Directorate of Land Registry and Cadastre.

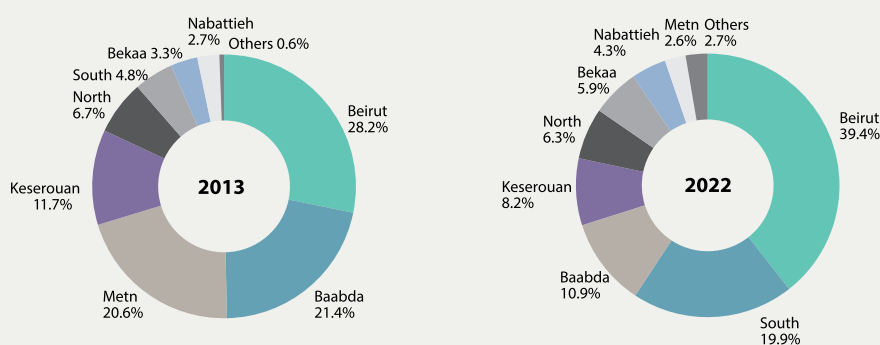
As a result of the decline in demand for property paired with a stunting of supply within the market, the value of realty in Lebanon decreased drastically with estimates slashing prices by almost half since the start of the crisis. However, the dire state of purchasing power within Lebanon outweighed the devaluation in property. In turn, instead of local demand for real estate increasing because of the drop in prices, the profile of interested buyers within the market changed. The demand within the Lebanese realty market has started to depend on expatriates, locals with fresh US\$ accounts and investors wanting to pour their liquid money among others. These components led to a marginal restarting of purchasing activity in the Lebanese realty market.

PROPERTY SALES TRANSACTIONS VALUE (US\$ MILLION)



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

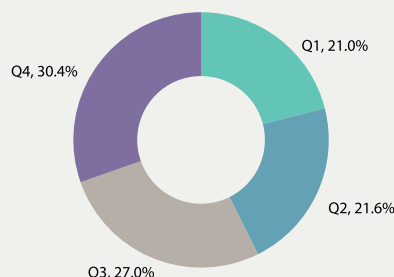
PROPERTY SALES TRANSACTIONS VALUE BY REGION



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

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SEASONALITY ANALYSIS: PROPERTY SALES BY QUARTER (2013-2022)



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

In details, appetite within the expatriate community belonging to the middle class grew towards apartments valued between US\$ 250,000 to US\$ 300,000 with transactions made in Ashrafieh based on a payment of US\$ 1,500/m². Additionally, upper class clientele who have the capacity to pay multiple millions of dollars were attracted to products that are more luxurious. Transactions of US\$ 2 million to US\$ 4 million were recorded in 2023 in Beirut's city center and its more aesthetic parts. The sale of these products was usually based on a payment exceeding US\$ 4,000/m².

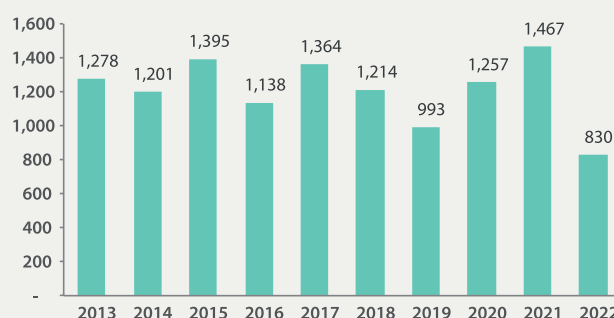
The logic behind these purchases is the expected increase in value of property due to an absence of new projects within the country. However, this restarting of demand is not equal in all parts of Lebanon creating a noticeable rift in pricing between regions.

Concurrently, investors possessing liquidity in fresh foreign currency are opting for investment in real estate. This interest in the realty market comes as interest revenue on real estate investment towards studios or surfaces of circa 100 m² stands between 3-4% of their value per annum in certain regions when rented. The interest revenue from renting can even exceed this level for furnished, well-maintained apartments in quality buildings.

Looking at the purchase and rental of office spaces, activity in this sub-sector remains slow within Beirut with the majority of activity coming from international organizations working within the country. However, these organizations along with other potential clients are more and more attracted to new products on the outskirts of the capital. Within this region, quality office space is available within newly built buildings and at a lower cost. Therefore, vacant office spaces in Beirut are plenty, with relatively low optimism towards the future prospects of this sector within the city.

It is worth mentioning that the Arab Fund for Economic & Social Development has approved a loan to the Lebanese Banque de L'habitat for KWD 50 million (US\$ 164 million) in a bid to restart housing loan activity in the country. This will allow the bank to dish out housing loans ranging from US\$ 40,000 to US\$ 50,000 for Lebanese households looking to purchase realty in the country. This move might help somewhat quick-start demand activity within the country's real estate market again.

NUMBER OF PROPERTY SALES TO FOREIGNERS



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

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MARKET SUPPLY

Supply activity increasingly sluggish in the Lebanese property market

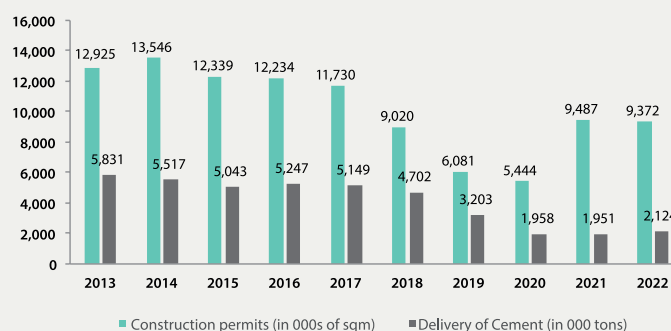
The supply of new real estate in the Lebanese market has been sluggish since the start of the economic crisis in 2019. With changes in payment methods, the devaluation of the Lebanese pound, the surge in raw material prices as a result of the Russo-Ukrainian war and the lack of real estate financing, few construction projects remain active in Lebanon, with those initiated prior to 2019 consisting of the majority. This trend has led to the quasi interruption of a deal of ongoing construction projects in the country as well as a decrease in forthcoming construction projects within the sector.

The latest figures provided by the Order of Engineers and Architects of Beirut (OEAB) showed that a drop by 57.8% year-on-year in construction permits, an indicator of forthcoming projects, was recorded during the first half (H1) of 2023 against figures from the same period of the year prior. Construction permits for H1 2023 recorded 1,994,718 m², down from 4,730,280 m² in H1 2022.

It is worth noting that according to data from the Order of Engineers and Architects of Beirut and Tripoli, construction permits in 2022 recorded a slight decrease of 1.2% year-on-year against figures from the year prior. This, at face value, shows a continuous strong performance between the two years as 2021 presented a strong base effect. However, this contradicts the trend seen in realty market supply. This comes as the main driver for this performance is the rush from some to obtain construction permits at the official FX rate of LP 1,507.5/US\$ before its inevitable increase which took place at the start of February 2023 up to LP 15,000/US\$.

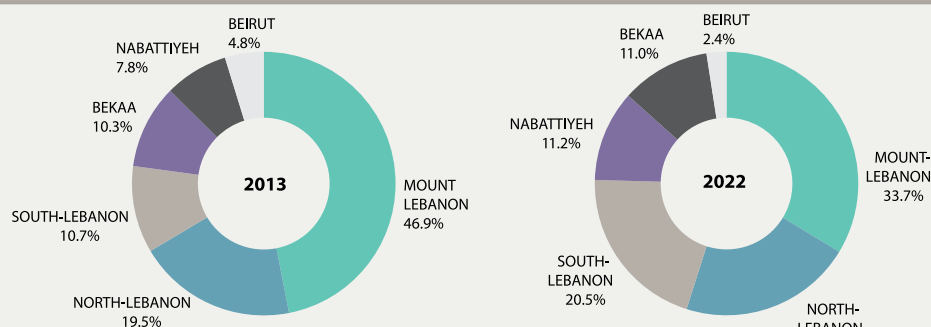
Looking at the regional distribution of construction permits in H1 2023, Mount Lebanon took the lion's share with 38.6% of total (769,815 m²). South Lebanon and Nabattiye followed Mount Lebanon with

CONSTRUCTION PERMITS & CEMENT DELIVERIES



Sources: Order of Engineers of Beirut and Tripoli, BDL, 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

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29.6% (590,530 m²) and 16.0% (318,414 m²) of total respectively. The Bekaa region came in fourth with 12.0% (240,050 m²) of total construction permits. The region of Beirut had a contribution of 3.1% (64,014 m²) of total, followed by North Lebanon with a marginal contribution of 0.6% (11,895 m²) of total, according to the Order of Engineers and Architects of Beirut (OEAB).

In parallel, at the level of cement deliveries, an indicator of ongoing projects, a year-on-year increase of 8.9% was recorded between 2022 and 2021, as released by the Central Bank of Lebanon. Cement deliveries reached circa 2,124,346 tons in 2022, up from 1,950,662 tons in the year prior, reflecting an improving trend within this component of construction activity in Lebanon. However, this improving trend in cement deliveries does not reflect an increase in construction of new projects. The main driver for cement deliveries regaining momentum is the supply to constructors who had sold apartments prior to the crisis.

It is worth noting that confidence in Lebanon's real estate sector, a major driver to the sector's recovery, depends heavily on the country's internal stability. Therefore, the absence of state intervention to stabilize the economy and the absence of real estate financing pose downward risks towards the real estate market's supply in Lebanon.

In sum, as a result of inflation in raw material prices, the devaluation of the Lebanese pound, low demand due to slashed purchasing power, the changing of payment methods as well as a lack of financing for real estate, the supply of real estate in Lebanon's realty sector has continued to note a sluggish performance. Supply activity within the market is almost completely coming from the continuation of projects initiated prior to the crisis with little forthcoming projects being undertaken.

MARKET PRICES

Market pricing exclusively undertaken in fresh US dollars amid scarce buyers

While Lebanon is reeling under an unprecedented sovereign-financial-monetary crisis, which is ongoing for the fourth year, and given that most property owners have settled their bank debts, the totality of real estate is currently priced in fresh US dollars, with sellers requiring either payment in cash or via transfer from abroad.

Residential unit prices in fresh US dollars have been slashed by 30% to 60% since the onset of the crisis in October 2019, depending on the proximity to capital and the household purchasing power. This is mainly attributed to (1) the sharp depreciation of the Lebanese pound against the US dollar on the parallel FX market, which has eroded the purchasing power of citizens, (2) the lack of interest from Arabs to invest in the Lebanese real estate market, (3) the protracted multilayered political vacuum and (4) the absence of bank lending activity.

However, the residential market started to witness an uptick in prices over this year, moving up by circa 10% over a 12-month period, as property owners found themselves in a better negotiating position after settling their bank debts, and were not in rush to sell their units. For instance, prices of low-end apartments with an area of 130 m² in Gemmayzeh, Mar Mikhael and Monnot reached currently US\$ 1,700/m², while prices of furnished studios with an area of 90 m² in touristic areas hit US\$ 3,000/m².

The new prevailing equation in the realty market is revolving around: scarcity of buyers in fresh US dollars because of the lack of liquidity and eroded purchasing power; and sellers asking for payment in fresh US dollars exclusively. Under these circumstances, citizens with fresh buffers and expatriates were the major market players, since they found a "buy opportunity" in the Lebanese residential market.

Concurrently, given the incapacity to take out loans, Lebanese with foreign income, or employees at international organizations or diplomats have been seeking to rent residential units. However, the scarcity of such profiles relative to the multitude of rentals offered has put those tenants in a strong negotiating position, which ultimately led to a noticeable drop in negotiated rentals. In fact, the monthly rental cost

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of an apartment is currently hovering between US\$ 150 and US\$ 300, compared to a monthly rental cost of circa US\$ 1,000 prior to the crisis. Within this context, property owners unveiled that they are finding difficulty to rent apartments worth US\$ 500 or more per month.

As to the commercial real estate, the demand followed an upward streak over the past few months in line with a slight upward correction in the domestic economy, and as government estimates unveiled a real GDP growth of 2% in 2022 (4% projected for 2023) following two years of severe contractions. The Food & Beverage business, which came under pressure during the pandemic crisis, started recently to rebound with new restaurants opening their doors, resulting into an increase in rental costs. For instance, the rental cost per square meter in some areas like Gemmayzeh and Mar Mikhael has risen from US\$ 150 to a current level of US\$ 250-US\$ 300, as per realty specialists.

Having said that, the revival of the real estate market henceforth hinges on improved political, financial, banking and security conditions and a progress in the implementation of much-needed reforms, in addition to the resumption of real estate financing.

MARKET OUTLOOK

Here are the requirements for a positive scenario for Lebanon's real estate sector

Looking ahead, Lebanon's property sector is at the mirror image of the overall country outlook that is actually at a crossroad today amid two politico-economic scenarios looking forward: Recovery or collapse. In light of this paradox, it is hoped for that political authorities would rise above their narrow interests, foster their common grounds, reduce differences and bickering, and embark onto settlement and reforms.

In the event of a positive politico-economic scenario, real estate demand would be considerably up, raising with it property prices. But in case the adverse scenario materializes, real estate demand would contract, sale offers would accentuate, putting further pressure on real estate prices and market conditions at large.

The main requirements for a positive macro scenario looking forward revolve around a smooth transition of power at the Central Bank, the election of a President of the Republic as soon as possible, the formation of a credible and efficient cabinet, the ratification of a full fledge program with the IMF and the materialization of international assistance for Lebanon from the IMF, from donor countries and from international institutions.

If Lebanon goes in this direction, it can move to significant growth close to double digit, the Lebanese Pound would stabilize, inflation rates would be contained, the balance of payments would shift back to surplus, BDL reserves would be reinforced and real estate prices would bolster.

However, in the absence of such a "breakthrough" scenario, the country could witness a deterioration in its economic landscape, rise in unemployment, currency collapse, hyperinflation with huge socioeconomic pressures on households and with corollary adverse effects on the property sector in particular.

With respect to the property 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 sustained inflow of fresh inflows from outside.

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Meanwhile, it looks like the strong tourist sector this year and in particular the large incoming of Lebanese expatriates from abroad has provided a relative support to the real estate sector in some of the regions of interest, a support that remains timid in nature when compared to the slump that the sector had witnessed since the onset of the economic/financial crisis in 2019. For the property sector to regain its pre-crisis conditions, investors would have to join in significant volumes which is not the case for the time being.

Those still await a net improvement in the country's politico-economic outlook that would reduce investor risks at the horizon and safeguard their property investment perspectives in the medium to long term.