

## Lebanon: Real Estate Overview

December 2007

### Research Highlights:

Examining the trends and developments concerning the real estate sector in Lebanon

### 1. Executive Summary

Real estate sector investments in Lebanon remain robust despite recent wars and political turmoil. Arab investors have remained committed to maintaining businesses in Lebanon despite hard conditions prevailing in the country, with the real-estate sector in particular staying noticeably active. This coupled with; rising cost of construction materials and scarce availability of land resources in major cities such as Beirut have triggered the price appreciation despite all the war condition and political turmoil. Prices in some suburbs such as Beirut have almost doubled within a span of one year.

Lebanon's GDP grew at a rate less than 2% p.a. till 2002. However, the growth rate of GDP touched 5% in 2004, only to fall by 5% in 2006. The value of property transaction grew at a CAGR of 15.4% over the period 2002-2005, compared to a decline of 6.3% over the period 1997-2001. The market size measured with value of property transaction currently exceeds \$3 Bn per year.

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The real estate growth has been supported by inflow of Arab capital, rise in tourism sector, availability of long-term mortgages, low inflation rates and favorable laws.

Arab FDI plays a major role in Lebanon real estate development as approximately 50% of it is directed towards large property developments. The total Arab FDI flow to Lebanon has increased at CAGR of 40% over 2002-2006. Furthermore, growth in tourism (in particular Arab tourism, since the aftermath of 9/11) led to a sharp rise in investment on new hotels, villas, and apartments. The new amended laws eased the legal limits on foreign ownership of property. These factors combined with low inflation rates, reduced interest rates, high liquidity in the banking sector, and availability of long-term mortgages provided strong platform for the growth of the real estate sector in Lebanon.

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Currently, supply is outstripping the demand in residential segment with vacancy rate of approximately 5%. However, with increasing demand, we expect the vacancy rate to come down below 4%. We expect the demand in the residential segment to be approximately 926,000 housing units by 2010, while supply would be around 967,000 units during that period. This indicates reduction in the vacancy rates from current level. Similarly, the demand in the office segment (primarily the demand for quality office space) and retail segment is also expected to remain firm with small regain in market confidence after the summer war of 2006, leading to low vacancy rates.

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We believe that Lebanon real estate and construction sector offers strong potential for growth, after slowdown characterizing second half of 2006. The growth would be primarily driven by increasing investment from the Arab investors and rising tourism sector. The trend is likely to continue in near future as the Middle East economy is likely to do well, riding the price waves of its oil pool. However, the growth potential could be negatively impacted by political turmoil and prolonged war situation.

## 2. Overview of Real Estate sector in Lebanon

Real estate accounts for 15% of the GDP

Real estate is one of the most important sectors in the Lebanese economy, representing 15% of the GDP. This sector is linked to other sub-sectors such as construction & building materials, cement, iron and steel. The sector is highly reliant on the country's touristic potential.

The real estate sector has gone through ups and downs during the last ten years, reflecting the trend in the economy. Real estate activity has moved in correlation with the country's post-war economic cycle. In the post-war years (1992-1996), reconstruction was massive and real estate played an even more predominant role in economic growth. However, the sector witnessed a slump over the period 1996-2000 due to the economic slowdown and recession in the Lebanese economy. Consequently, construction permits, a leading indicator of building activity, contracted by 14.2% over the period 1996-1998 and by 26.4% during the recessionary period of 1999-2000. However, the sector began to revive between 2000-2004, aided by reconstruction work in the South, following the end of Israeli occupation. The sector has also benefited by sustained upturn in the tourism industry, which led to a sharp rise in expenditure on new hotels, villas, and apartments. In 2006, the sector enjoyed strong first half, with growth coming particularly from Gulf-funded commercial projects in the downtown Beirut. However, the sector was adversely affected by the summer 2006 war and political turmoil.

The real estate sector in Lebanon is characterized by highly atomized supply with very few institutional players (Investors and developers). However, during 2005 and 2006, the market witnessed entrance of major regional players (such as DAMAC, ADIH and Dubai Investment Bank).

## 3. Demand & Supply

### a) Demand

Property sales to Arab investors in Beirut downtown amounted to 1 Mn sqm in 2005

In the last five years, Lebanon has witnessed an unprecedented growth in demand for the properties primarily attributed to growing Arab investments, following the September 11 2001 terrorist attack on US. The holdings of raw land in Lebanon by Gulf Corporation Council (GCC) investors increased to 2 Mn square meters (sqm) in 2005 from 0.5 Mn sqm in 2002, with a special concentration in the Beirut Central District (BCD). Sales of property to Arab investors in the Beirut downtown district in 2005 alone amounted to approximately 1 Mn sqm. These sales exceeded all non-Lebanese Solidere (The Lebanese company for the Development and Reconstruction of Beirut Central District) property sales in the past seven years. Land owners thus enjoyed the land appreciation, resulting from this increased demand. The land prices have increased on average by 40% for the last 2 years in Beirut. The growth in the demand of the Lebanon's real estate and construction sector is well supported by increase in the value of property transaction in the last five years. The value of property transaction has grown at a CAGR of 10.0% over the period 2002-2006 to reach \$3,155 Mn at the end of 2006 (Refer exhibit 1).

### Exhibit 1: Value of property transactions (2002-2006)

	Value of Property transactions in \$ Mn			
	2003	2004	2005	2006
Value of transactions in \$ Mn	2,893	2,899	3,312	3,155

Source: Banque du Liban

**Exhibit 2: Value of property transactions (2000-2006\*)**

Value of Property transactions in Million LBP						
Cities	2001	2002	2003	2004	2005	2006*
Beirut	740,904	956,041	1,017,653	1,643,290	1,618,008	524,289
Baabda, Aley, Chouf	553,986	706,227	934,007	1,043,763	1,143,805	362,041
Kesrwan, Jbeil	333,416	388,920	374,978	369,338	449,079	158,560
Metn	521,406	698,619	629,532	639,871	1,001,335	224,326
Tripoli, Akkar	149,499	172,834	140,559	177,801	180,177	69,218
Batroun, Koura, Ehden, Bsharri	87,119	93,117	79,592	89,289	137,257	39,855
Bekaa	100,854	107,381	101,530	149,761	114,962	37,614
Saida	122,374	138,404	1,025,494	178,816	255,193	35,878
Nabatieh	25,512	40,350	37,411	54,161	68,688	20,830
<b>Total</b>	<b>2,635,070</b>	<b>3,228,975</b>	<b>4,338,756</b>	<b>4,348,063</b>	<b>4,968,504</b>	<b>1,472,611</b>

Source: Infopro \*Up to April 2006.

**During first four month of 2006, the value of property transaction increased 44% y-o-y to \$976.9 Mn**

Furthermore, the value of property transactions increased year-on-year by 44% to \$976.9 Mn during the first four months of 2006. The number of real estate transaction has also gone up by 20% during the period 2000-2005 (Refer exhibit 3). In 2006, total property transaction increased 3.7% when compared to 2005.

**Exhibit 3: Number of Real Estate transactions (2000-2006)**

Number of Real Estate transactions							
	2000	2001	2002	2003	2004	2005	2006
Number of transactions	48,874	53,990	53,770	55,415	59,082	58,789	60,553
y-o-y growth	5.8%	10.5%	-0.4%	3.1%	6.6%	-0.5%	3.0%

Source: Databank of Lebanon

Property taxes, another coincident indicator of real estate demand, rose by a significant 75.6% year on year (y-o-y) from \$46.8 Mn (LL70.5 Bn) to \$82.1 Mn in the first four month of 2006. This increase can be primarily attributed to a 164.2% rise in property taxes collected in Beirut. Demand was mainly concentrated on Beirut city centre on upper and high-end apartments. However, since the second half of 2006, the demand is witnessing a downward trend in the wake of the Israeli summer war.

**Some positive indicators have emerged, with number of property transaction increasing by 25.4% y-o-y in 1Q 07**

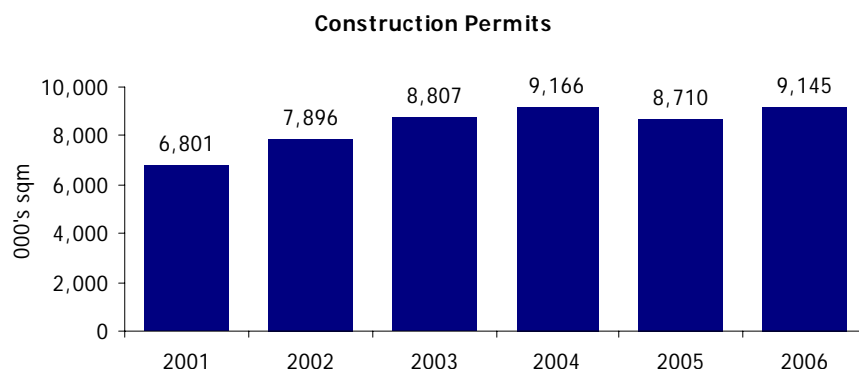
After the stagnation characterizing the fourth quarter of 2006, some positive indicators have emerged, stemming mainly from the local market. According to the Directorate of Real Estate, the number of property transaction registered a y-o-y increase of 25.4% to reach 36,721 in 1Q 07. On the other hand property tax receipt dropped by 23% y-o-y to \$46.9 Mn. Likewise, the value of property transaction and the average value of property transaction both went down 16.7% and 33.6% y-o-y respectively in 1Q 07. This indicates the trend of the demand for less expensive real estate.

**Construction permit grew by 5.0% y-o-y in 2006, despite political turmoil**

**b) Supply**

Construction permits and cement delivery are the main indicators of property development and supply. Despite the war and political turmoil construction permits rose by 5.0% y-o-y in 2006 to 9,145,000 of sqm in 2006 (Refer exhibit 4). This is due to the strong growth witnessed by the sector in the first half of the year.

**Exhibit 4: Growth in Construction Permits (2001-2006)**

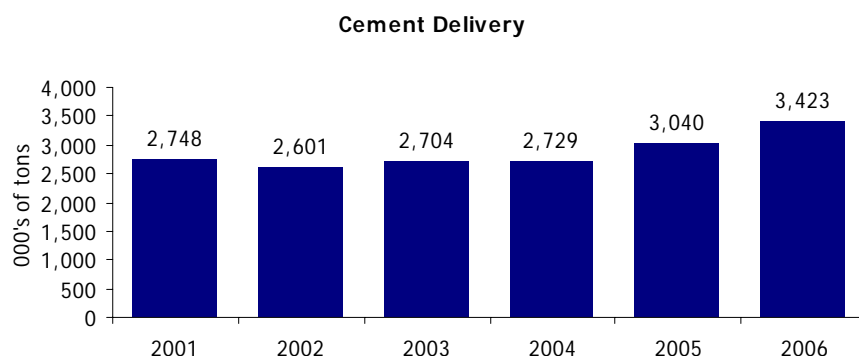


Source: Markaz, Banque Du Liban

**Cement delivery has increased by 10.5% during 2001-2005**

Cement delivery that reflects current level of activities in the construction sector increased by 10.5%, during 2001-2005. Total cement delivery enjoyed a 12.6% y-o-y increase in 2006 to reach 3,423 thousands of tons (Refer exhibit 5).

**Exhibit 5: Growth in Cement Delivery (2001-2006)**



Source: Markaz, Banque Du Liban

During 1Q 07, cement delivery grew by 12% y-o-y on account of the reconstruction work of war damaged property and infrastructure. Most of the developers have declared their intention to start or continue their projects after the summer war. However, the current political instability is strongly affecting the sector. Investors and developers are currently waiting on side lines and no new developments have been launched.

**c) Drivers of Real Estate and Construction sector**

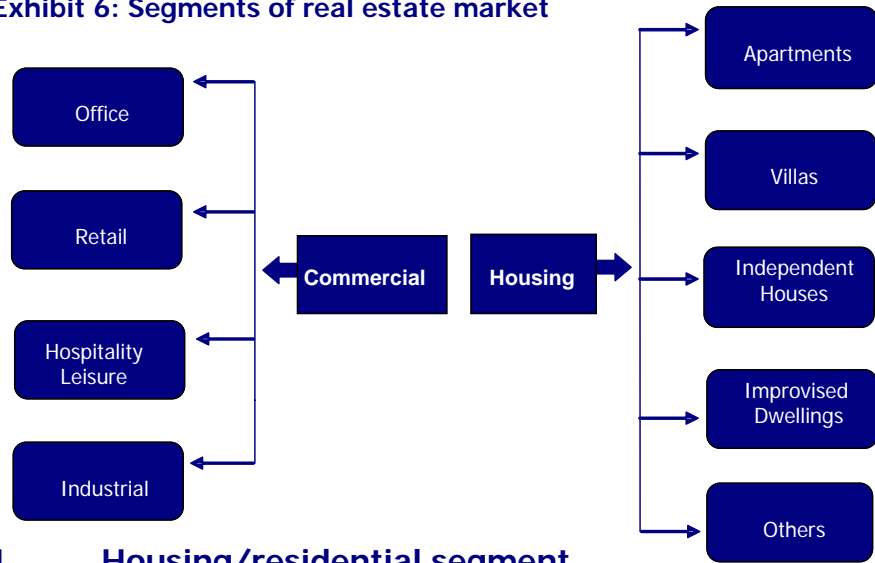
**Low interest rates, high liquidity in the banking sector, availability of long-term mortgages, and favorable laws indicating towards positive outlook for the sector**

Demand Driver	Signal	Justification
Low interest rates	Positive	The Loan rate in Lebanon has been falling consistently for the last five years. It has fallen from 16.8% (average lending rate in LL) in 2001 to 10.1% in 2005 due to the low level of inflation in the county. Consumer Price Index (CPI) has consistently been below 3% since 2000. The inflation rate in 2005, as measured by the percentage change in the CPI, dipped to 0.3% from 3.0% of 2004 levels.
High Liquidity in the banking sector and availability of long term mortgages	Positive	Lebanese banks have enjoyed high liquidity in the last five years with growth in trade and positive economic conditions prevailing in the Middle East region. This is evident from the fact that total deposits in LL (M2) with Lebanese bank grew at a CAGR of 6% over the period 2001-2006 to reach \$15,579Mn at the end of 2006. High Liquidity with banking sector coupled with wide availability of mortgage financing through Public Housing Authority and commercial banks has boosted the growth of real estate financing in the country.
Favorable laws for foreign ownership and low tax rates	Positive	The new amended laws for foreign ownership eased the legal limits on foreign ownership of property to encourage investments in real estate sector. The new law abolished discrimination for property ownership between Arab and foreign nationals, and lowered real estate registration fees from 6% for Lebanese and 16 % for foreigners to 5% for both Lebanese and foreign investors. (Refer exhibit 6 for detailed explanation)
Political instability	Negative	The political turmoil in Lebanon could negatively impact the investors confidence and foreign investment in the real estate sector. This in turn could negatively affect the growth of the Real estate and construction sector.

**Political instability could negatively impact the potential growth in the real estate sector**

#### 4. Components of the real estate market

Exhibit 6: Segments of real estate market



Occupancy in apartments represented the majority of the residential market at approximately 73% in 2005.

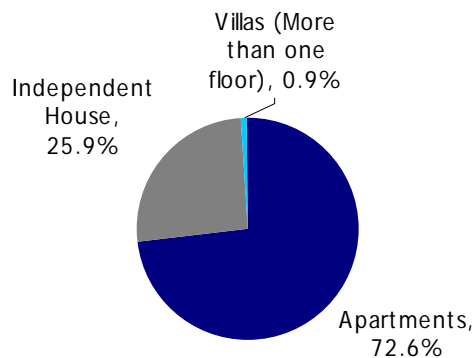
#### I. Housing/residential segment

##### a) Structure

The Structure of the housing market in Lebanon can be primarily classified in to Apartments, Independent houses and villas. The residential market in Lebanon is primarily concentrated in Beirut (11.5%), Mount Lebanon (42.1%), Northern Lebanon (18.4%) and Bekaa (11.6%), together accounting for 83.6% of the total residential market in 2004. This is primarily due to the wide availability of buildable residential areas and the strong tourist potential in these regions. Occupancy in apartments represented the majority of the residential market at approximately 73% in 2005 (Refer exhibit 8).

Exhibit 7: Housing occupancy by type 2004

Housing occupancy by type



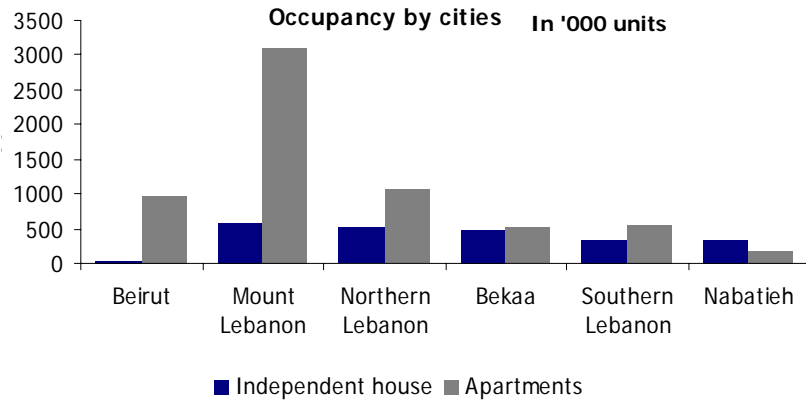
Residential market is concentrated in Beirut, Mount Lebanon, Northern Lebanon and Bekaa

Source: Central Administration of Statistics

Mount Lebanon dominates both the apartment and Independent House ((A conventional (traditional) building of one room or more, on one line or scattered, and may be surrounded by a fence)) segment, followed by Northern Lebanon, as they are favorite tourism destinations. Mount Lebanon accounted for 48.5% and 25.0% of the total apartment and Independent House, respectively in 2004. The number of apartments and independent houses in Bekaa are approximately the same (Refer exhibit 9).

**Exhibit 8: Housing occupancy by type 2004**

Demand for the furnished apartments and villas from Arab nationals has increased with Lebanon reemerging as tourist destination



Source: Central Administration Statistics

A nationwide survey of living conditions by Central Administration of Statistics in 2004, revealed that 70 % of the population owns a home. Renting accommodation is seen mainly in the Beirut and suburb areas.

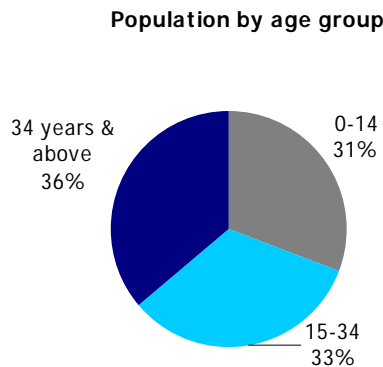
**b) Demand and Supply in the residential segment**

In the recent years, Lebanon has reemerged as a tourism destination, thus boosting the demand for furnished apartments and villas. In the last few years, demand for high-end luxury apartments from Arab Gulf nationals, particularly in Beirut and resort mountains has witnessed unprecedented growth. This led to demand for temporary and permanent residences. Furthermore, the demand for temporary and permanent residences has also been rising from Lebanese expatriates. Demand for small-and medium-sized apartments (with a price ranging from \$70,000-\$150,000) picked up in the past few months in some of Beirut's suburbs and regions outside the capital. This is primarily due to rising demand from newly wed couples or Lebanese expatriates in the Arab Gulf. In addition, changing lifestyle, growing dual-income households and favorable demographics (Refer exhibit 10) have led to demand for housing targeting upper-middle income households. The residential segment is also experiencing rising demand for rental. Sales of residential properties targeted the middle-income population.

Demand for the small-and medium-sized apartments have picked up

Changing lifestyle, growing dual-income households and favorable demographics augurs well for demand in residential segment

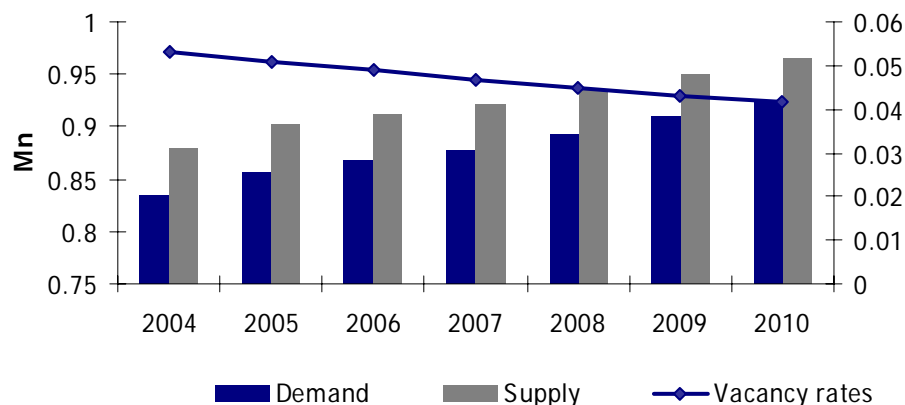
**Appendix 9: Population by age group**



Source: InfoPro

The growth in the demand for residential units in Lebanon during last few years can be explained from our demand-supply analysis model (Refer exhibit 11).

**Exhibit 10: Housing demand-supply (2004-2010)**



Source: Markaz estimates

While the demand for total housing units stood at 833,000 units in 2004, supply stood at 880,000 units, indicating a surplus rate of 5%. However, in the last couple of years, the increasing demand for residential units has led to the fall in surplus rate to below 5%, at the end of 2006. We believe that, Lebanon will require approximately 926,000 units by 2010, while the supply would be approximately 967,000 units. This would translate into an addition of 14,500 units annually, resulting in a surplus rate of 4% by 2010 (Refer Markaz methodology in Appendix 3).

With limited supply of property in Beirut and increasing demand from rich Arab nationals; majority of the future residential supply would be concentrated towards high-end luxurious units. On the other hand, the supply of the smaller, mid-range apartments would be concentrated in areas such as Meten, Bekaa, and the North region of the Lebanon. Going forward, the outlook for residential market is strongly related to the evolution of the political situation in the Lebanon. We believe, if the political situation in the country stabilizes, the residential segment holds strong growth potential.

### c) Prices and rentals

The growth in demand, scarce availability of land in major cities such as Beirut and rising construction cost for the residential units in Lebanon has been reflected in the prices and rentals. While the prices for small and medium apartments rose by 20-30%, the prices for the high end apartments in prime locations has more than doubled in the last couple of years (2004-2006). Average annual housing rents have increased by approximately 30% in the last two years.

**Exhibit 11: Apartment prices across Beirut 2007**

Area	Prices in USD/sqm
MAR ELIAS STREET	1,300-1,800
HAMRA STREET	1,400-2,000
ABDELWAHAB INGLIZI	2,800
Clemenceau	2,000-3,260
Ashrafieh	1,600-2,400
Downtown Seafront (600-1000 sqm)	5,000-6,000
Downtown Seafront (250-500 sqm)	3,400-4,750

Source: Sodeko-Gestion

The surplus rate is expected to fall to 4% by 2010

Prices and rentals have witnessed upward trend on the back of growth in demand and rising construction cost

Downtown Beirut proved to be the most expensive in Lebanon

The average price of the apartments with size of 600 sqm ranges between \$5,000-\$6,000 per sqm

The average prices for apartment across the major streets in Beirut have witnessed significant appreciation in last couple of years. For instance, average apartment prices in MAR ELIAS STREET are now in the range of \$1300-\$1,800 per sqm compared to \$900-\$1,200 in August 2005. The current prices in HAMARA STREET and ABDEL WAHAB INGLIZI ranges between \$1,400-\$2,000 per sqm and 2,800 per sqm respectively, compared to \$950-\$1,350 per sqm and \$1,200 per sqm in August 2005 (Refer exhibit 12). The current average, prices of apartment with size of 600-1000 sqm in downtown seafront area of Beirut ranges between \$5,000-\$6,000 per sqm. Similarly, prices for smaller and medium size apartments (size 250-500 sqm) in downtown area reached \$3,400-\$4,750 per sqm. Furthermore, according to Hayek Group (Engineers and Real Estate Developers), the prices for residential buildable areas in Achrafieh rose on average from \$500 per sqm in 2005 to \$1,200 during 2007. While the prices for buildable areas in Clemenceau jumped from \$600 per sqm in 2005 to \$1,047 per sqm in 2007, the prices in Jnah rose from \$700 per sqm to \$1,040 over the same period. In downtown Beirut, prices for buildable areas increased from \$1,100 per sqm to \$3,000 per sqm over the same period- by far the most expensive prices in Lebanon (Refer exhibit 13).

#### Exhibit 12: Prices of Buildable residential areas (2005-2007)

Areas	Prices in USD/sqm	
	2005	2007
Achrafieh	500	1,200
Clemenceau	600	1,047
Jnah	700	1,040
Downtown Beirut	1,100	1,700

Source: Hayek Group

However, it is to be noted that the surge in the prices of building materials such as iron and cement during the past few years, have also contributed to a systematic increase in the prices of properties. It can be explained from the fact that construction cost index increased by almost 18% during 2006. This is primarily due to shortage in material and labor in Lebanon and international increase in price of metal such as iron and steel.

#### d) Financing

With Lebanon banking sector expanding in to retail, the availability of housing finance has witnessed growth

##### I. State of Real estate financing market in Lebanon

Historically, commercial banks in Lebanon have followed conservative lending policies. The banks were much concerned about the risks inherent to long-term loans in an economy, which is not used to retail lending. However, with Lebanon banking sector expanding in to retail banking in recent years, the availability of housing finance has witnessed growth. This is evident from the fact that loans to construction sector reached \$2.76 Bn as at December 2005. This accounted for 15.5% of the total utilized credits extended by the banking system to the private sector. Furthermore, credit extended for real estate renting, accounting for 4.73% of total private sector credit as at December 2005. However, the proportion of commercial bank's loans to construction sector has declined from 22% in 2003 to 15.5% as at December 2005. This is primarily due to growth in alternate source of financing over the same period. However, the importance of the construction sector to the Lebanese economy is reflected by the fact that bank credits to the sector are second only to trade and services.

**Financing at low interest rate from public housing authority bodes well for the growth in demand for housing**

## **II. State of Public Financing by Housing Authority**

There are two public housing agencies in Lebanon- the Housing Bank, established in the 1970s, and the Public Housing Authority, established in 1997. The state sponsored housing bank provides loans to individuals, especially with low-income for purchase, construction and repair of housing. The Housing Bank provides low interest apartment loans to people with incomes ranging from \$460 to \$1,975. Most of these loans are subsidized by commercial banks and in coordination with Banque du Liban.

The Public Housing Authority is designed to help needy families and has agreements with 13 commercial banks. The repayment period is up to 30 years. During the first half of the period, the mortgage holder repays the capital but no interest. Since its inception, financing by Public Housing Authority has witnessed gradual growth. The total amount of loans provided by the banks under the public housing finance has increased by 5.9% over the period 2002-2004 to reach approximately LL537.5 Bn (\$353.6 Mn) at the end of 2004. We believe that the increasing availability of concessional finance from public housing authority augurs well for the growth of the real estate sector.

## **II Commercial segment**

### **A. Office**

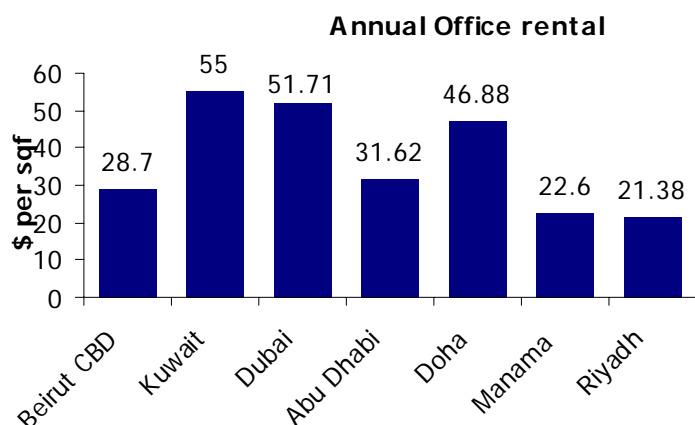
The demand for modern office space in Lebanon has increased in recent years from local as well as multinational firms, especially following the Iraq war. Demand is driven by major Lebanese and foreign companies, embassies and government agencies looking for international standard premises. A good number of these organizations (major banks and financial institutions, embassies) have moved their headquarters to the Beirut Central District (BCD) and to a lesser extent to other key central markets such as Achrafieh and Ras Beirut.

According to RAMCO real estate consultants, there is approximately 350,000 sqm of office space in BCD. Another 100,000 sqm of office space is in pipeline which is scheduled for completion by 2008. Offices in Beirut fall into three main categories of size, with the multi-nationals and international banks opting for 2,000 sqm to 5,000 sqm. Medium-size concerns settle for 500-1,500 sqm while the smaller businesses, by far the majority, operate in offices of around 100 sqm. Developers prefer selling to renting but that is slowly changing, especially in the Beirut Central District and the region's urban centers. This is because, foreign companies and new local businesses prefer rental as it offers greater flexibility.

**Office rental in Beirut remained firm at \$28.7 per sq foot in 2006**

Positive business sentiment began to return and demand levels for office space (especially for prime office space) have shown upturn. The Prime office space remains in short supply and there is virtually no vacancy for good quality office space. Consequently, although the rental levels in Beirut CBD remain unchanged in 2005 and in the first half of 2006, it stood firm with annual rental of \$28.7 per square foot in 2006 (Refer exhibit 14). Kuwait city proved to be the most expensive city in the Middle East region followed by Dubai (\$51.71 per sqf) and Doha (\$46.88 per sqm).

**Exhibit 13: Annual office rental in Beirut and Major GCC cities region \$/sqf (2006)**



Source: Cushman & Wakefield

**Overall vacancy rate in Beirut CBD remain unchanged at 10% in 2006**

Furthermore, according to Cushman & Wakefield (a leading global real estate consultant) the overall office vacancy rate in Beirut CBD remained unchanged at 10% in 2006. However, it stood below the average vacancy rate of 11% in the Africa and Middle East region (Refer exhibit 15).

**Exhibit 14: Office vacancy rates across major cities 2006**

Cities	Office vacancy rates
Beirut CBD	10%
Dubai	2%
Abu Dhabi	2%
Doha	1%
Riyadh	2%
Tel Aviv	5%
Sandton CBD	2%
Ramat Hahayal CBD	20%
Johannesburg CBD	12%
Cape Town CBD	5%
Durban CBD	13%
Herzliya CBD	12%

Source: Colliers International, Cushman & Wakefield

**The selling price of the class 'A' property in Beirut CBD has increased by more than 30% in the last three years**

The shortage of quality office space in Beirut CBD has also pushed the Commercial property prices (Refer exhibit 16). According to an estimate the selling prices of class 'A' property in Beirut CBD has increased by more than 30% in the last three years. However, the rise in selling price is just not due to short supply, but also due to constant increase in construction and building material cost in recent years.

**Exhibit 15: Average office sale price across Beirut \$/sqm 2007**

Areas	\$/sqm
Ashrafieh	2,500
Hamra	1,800-2,200
Clemenceau	1,600-2,000
Mazraa	1,600
Verdun	1,800-2,400

Source: Sodeco-Gestion Real Estate Company

We believe the rentals for the quality office space in Beirut to remain at current level, with supply levels expected to remain unchanged over 2007. However, the rentals for the low quality office space in Beirut (Hamra or Verdun) and outer areas may witness a downward pressure with persistent oversupply and high vacancy rates.

#### Drivers of the office segment

Demand Driver	Signal	Justification
Favorable Regulations and free economy	Positive	The openness of the Lebanese economy coupled with favorable regulations relating to foreign investment across major economic sectors, are likely to see entry of more foreign multinational companies in the country. This augurs well for the potential growth of office real estate segment.
Political instability	Negative	If the political turmoil in Lebanon continues, it could restrict the growth of new business opportunities and foreign investment across the major growth sectors of the country. This in turn, could discourage the entry of foreign companies and negatively impact the office real estate segment.

Openness of the Lebanese economy coupled with favorable regulations augurs well for the office segment

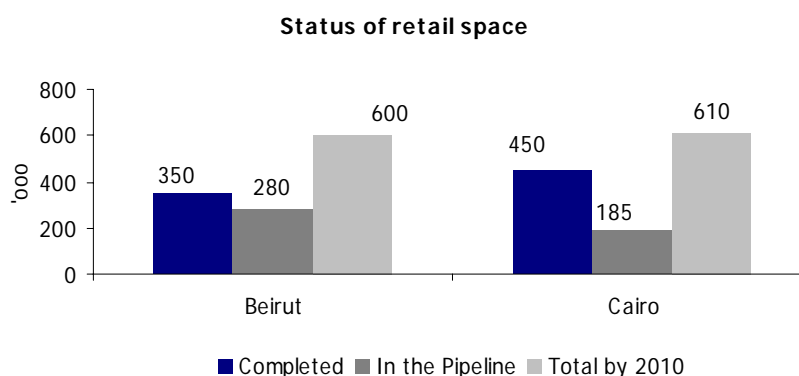
#### B. Retail

The Lebanese retail real estate market is witnessing a major transformation through consolidation and improved standards. Shopping malls are the modern day version of the retail real estate market in Lebanon. The Lebanese retail market is primarily concentrated in Beirut and its northern suburbs, which were massively developed during the war years. Beirut has turned out to be one of the premier retail and shopping hubs in the MENA region and the Beirut Central District (BCD) has attracted major international retail brand names. The increasing presence of foreign players such as Geant, Spinney's, and BHV/Monoprix has led to the gradual building up of retail space in Lebanon. According to Retail International approximately 350,000 sqm of GLA retail space in Beirut was available by 2005. Another 280,000 sqm of GLA is in the planning phase, of which approximately 250,000 is expected to be delivered by 2010 (Refer exhibit 17). Beirut is set to become key regional retail destination outside the GCC in the next five years with total offering of retail space expected to reach 600,000 sqm by 2010.

There is gradual building up of retail space in Beirut with increasing presence of foreign players

Total offering of retail space in Beirut is expected to reach 600,000 sqm by 2010.

#### Exhibit 16: Status of Retail space in Beirut and Cairo



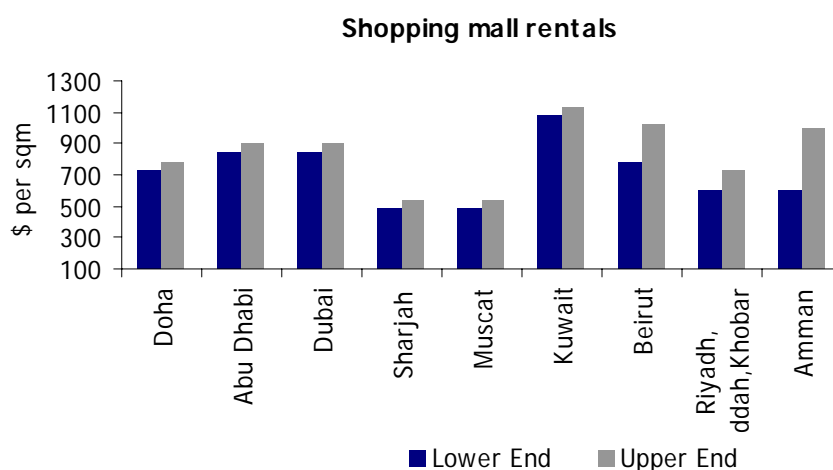
Source: Retail International

The retail rentals in the prime locations of Lebanon have witnessed upward trend in the last couple of years. The average rental in shopping malls in Beirut stood at \$780-1020 per sqm at the end of second quarter of 2006. This stood high compared to other major cities in GCC region (Refer exhibit 18). Average Upper end rental in shopping malls in Beirut stood second highest after Kuwait at the end of second quarter of 2006.

However, the rentals started witnessing downward pressure in the second half of 2006 with summer war and political turmoil.

**Exhibit 17: Rentals in the malls across GCC Mid year 2006**

Average Upper end rental in shopping malls in Beirut stood second highest after Kuwait at the end of second quarter of 2006.



Source: Retail International

We believe, the retail rentals and prices could witness upward trend in the short to medium terms. This can be primarily attributed to the increasing demand for new and modern retail development in the light of small regain in market confidence, due to a certain relief in political climate within the country. However, if the political instability in the country persists, the retail real estate market may witness a fall in rentals and prices in the medium-to long term.

**Drivers of the retail segment**

Investment in the construction of shopping centers and malls is increasing

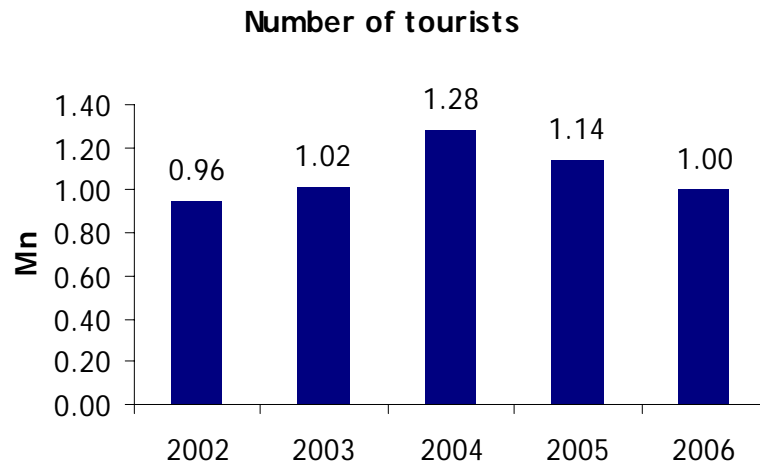
Demand Driver	Signal	Justification
Consumer dynamics	Positive	The growth in Arab tourism coupled with increasing number of rich Lebanese expatriates has led to the increase in demand for western products, air-conditioned department stores and malls. Consequently, investments in construction of shopping centers and malls are on the rise, driving the demand in retail real estate sector.
Favorable Regulations	Positive	Lebanon's free market economy has encouraged many foreign multinational companies such as Geant, Spinney's and BHV/Monoprix to enter the retail sector of the country. This has led to the number of multinationals setting hypermarkets and shops in the Lebanon

### C. Hospitality & Tourism

Hospitality and tourism sector plays key role in the Lebanese economy as it affects other sub-sectors such as real estate and construction. The real estate and construction sector in Lebanon is closely reliant on the country's touristic potential. The tourism sector in Lebanon has witnessed a revival in recent years. The number of tourists visiting Lebanon reported an average annual growth rate of 6% over the period 2002-2005 to reach 1.14 Mn at the end of 2005 (Refer exhibit 19).

**Exhibit 18: Number of tourists visiting Lebanon (2002-2006)**

Tourism sector has witnessed revival in the recent years with increasing number of Arab tourists



Source: Ministry of Tourism

The boom in tourism was mainly due to a notable rise in Arab tourists over the same period. Lebanon witnessed heavy influx of Arab tourists due to the aftermath of September 11, 2001, which deterred Arab nationals from visiting western countries. However, the number of tourists visiting Lebanon declined by 12% in the year 2006 with fresh start of war in the second half of 2006. The growth in number of tourists visiting Lebanon, has led to the increase in investments within this sector in recent years. The hospitality sector grew fast with an average of 1,000 to 1,200 new rooms entering the market between 1992 and 2006 period. The total number of hotel rooms in Lebanon increased at CAGR of 4.9% to reach 16,471 in 2006. Despite such fast growth, demand still exceeded supply during holidays and especially during the summer season. According to the article Emerging Lebanon 2005 produced by the Oxford Business Group, hotel occupancy rates reached 71% during 2004 before plummeting to just 30% in 2005. Hotel occupancy was about 90% in Jul-06 (pre Israeli attack); however, post attack it has come down to as low as 20%. However, with recent small regain in market confidence and relief in political climate, numbers of tourists visiting Lebanon are expected to increase gradually. This is expected to encourage investment in hotel and tourism infrastructure in the medium to long term. According to an estimate, approximately 2500 hotel rooms are expected to be added in Lebanon by 2009. The Investment in the hotel sector is expected to reach \$600 mn by 2009. However, if the political instability and war situation continues to persist, the potential growth in the country's tourism industry would be hindered. This could negatively impact investments in tourism infrastructure.

Growing tourism in Lebanon offers opportunity to invest in hotel infrastructure

Demand Driver	Signal	Justification
Strong government and private sector initiatives	Positive	Government and private sector in Lebanon have been promoting the country as a tourist destination through promotional campaign and development of tourism infrastructure. Furthermore, the government has proposed tax relief and other measures to help its tourism industry recover from direct and indirect losses (caused by political instability and war), which the tourism minister estimated are around \$1 Bn.
Political instability	Negative	The political turmoil in Lebanon could negatively impact the foreign investment (Primarily Arab investment) in the tourism sector. This in turn could negatively affect the growth of Real estate and construction sector.
Appreciation of Euro against dollar	Positive	The recent appreciation of the Euro against the US dollar made traditional European destinations more expensive, as the national currencies of the Arab Gulf countries are generally pegged to the US dollar. As a result, individual Arab investors who used to spend their holidays in Europe and the US have increased the frequency of their holidays in Lebanon

Political turmoil could negatively impact foreign investment

#### D. Industrial segment

The industrial sector in Lebanon has benefited from the free market economy of the country and lesser barriers to entry as compared to other Arab Countries. There is no restriction on foreign participation in this sector. The country's Manufacturing Value Added (MVA) per capita stood at \$287 which was 7<sup>th</sup> in the Arab countries after the six members of the Gulf Corporation Council (GCC). However, it is still substantially lower than developing country's average of \$908. The industrial sector in Lebanon has also benefited from the strong government support. For instance, the government reduced the required company contribution to 'National Security Fund' and also cut custom duty to take care of high tariffs. Furthermore, Investment Development Authority (IDA) has established programs to encourage exports. As a result, Lebanon has seen upsurge in industrial exports from US\$759.4mn in 2001 to US\$1,645mn in 2005. The growth in country's export has boosted the investment in the development of warehousing, logistics facilities and other industrial properties. This is evident from the fact that industrial sector in Lebanon has invested about \$1 Bn in development of new buildings and equipment in the last ten years.

The growth in exports likely to boost the demand for warehousing and logistics facilities

We believe, the industrial property segment in Lebanon holds strong potential as major drivers of industrial activity indicates a positive outlook. However, it could be hindered by the restrictive licensing system and relatively high cost of skilled labour, certainly in comparison with competitor bases such as Dubai. Furthermore, Political instability and war situation also act as a deterrent. For instance, Israeli bombing destroyed 15 factories- all in the Beqaa valley in the July-August 2006 conflict. This could discourage the investment in the industrial property segment within the country.

### III. Role of FDI in the real estate sector

Real estate sector investments in Lebanon remain robust despite recent wars and political turmoil. Arab investors have remained committed to maintaining businesses in Lebanon despite hard conditions prevailing in the country, with the real-estate sector in particular staying noticeably active. Arab FDI flows to Lebanon are one of the major performance indicators of the real estate sector, due to the fact that major proportions of such flows (Approximately 50%) are assigned towards large property developments. Although the total Arab FDI in Lebanon declined in the second half of 2006, on the back of summer war and political turmoil, it still managed to rise by 40% in 2006 (Refer exhibit 20) when compared to 2005 figures.

Arab investors have remained committed to maintaining businesses in Lebanon despite hard conditions prevailing in the country

#### Exhibit 19: Total and Arab FDI in Lebanon in \$ Mn (2002-2006)

	2002	2003	2004	2005	2006
Arab FDI in Lebanon	650	850	1,050	1,780	2500*
Total FDI in Lebanon	1,737	2,015	1,863	2,573	4500*
% Arab FDI	37.4%	42.2%	56.4%	69.2%	55.6%

Source: Investment Development Authority of Lebanon (IDAL) \* Estimated by IMF, IDAL

### IV Solidere and the major real estate projects

Solidere is one of the largest listed real estate companies in the MENA region. It is the largest developer in Lebanon with land bank of built-up area estimated at more than US\$ 4 Bn at current market prices. Solidere was primarily established for the development and reconstruction of Beirut Central District (BCD). Solidere has been playing a crucial role in the real estate sector through reconstruction of the BCD.

The reconstruction of BCD is comprised of two phases. The first phase included infrastructure, rehabilitation works, land treatment and restoration of archeological sites over the period 1994-2004. Currently, Solidere's future endeavors focus on the completion and development of several projects under second phase in BCD of Beirut.

Solidere is one of the largest listed real estate companies in the MENA region.

#### Solidere's future projects

##### a) Phoenician Village

The project is part of second phase of Beirut City Centre redevelopment (Phase II) project of Solidere, in the Martyrs' Square axis northeastern section. The project is a high-density, mix used project. It involves development of four towers comprising upscale residential, cultural facilities, hotel, corporate offices, with retail facilities on the ground floors. The development is planned to create an important visitors destination.

##### b) Beirut Gate

The development of Beirut Gate is a part of second phase of Beirut City Centre redevelopment (Phase II) project of Solidere. The project is a mix development of residential, offices, retail and cultural activities. Out of a total 178,506 sqm total floor space, the residential developments represents 78%, offices 6% and cultural activities 16%. The project is expected to be completed by 2009, with an estimated cost of \$600 Mn.

**c) Wadi Abou Jamil:**

The development of Wadi Abou Jamil is a part of second phase of Beirut City Centre redevelopment (Phase II) project of Solidere. The project involves several residential developments, currently under construction. For instance, Courtyard residential development, which involves development of three residential buildings over 5,096 sqm. Furthermore, development of Mina El Hosn offering 1,788 sqm of floor space over five floors, two duplexes and one flat is also under construction.

**V Conclusion**

The real estate and construction sector in Lebanon began to revive between 2000-2004, aided by reconstruction work in the South, following the end of Israeli occupation. The sector has also benefited by sustained upturn in the tourism industry, which led to a sharp rise in expenditure on new hotels, villas, and apartments. However, the sector was adversely affected by the summer 2006 war and political turmoil.

**With the increase in demand, we expect the vacancy rate to come down below 4%.**

The real estate growth has been supported by inflow of Arab capital, rise in tourism sector, availability of long-term mortgages, low inflation rates and favorable laws. Currently, supply is meeting demand in residential segment with surplus of approximately 5%. However, with increasing demand, we expect the surplus to come down below 4%. Similarly, the demand in the office segment (primarily the demand for quality office space) and retail segment is also expected to remain firm with small regain in market confidence after the summer war of 2006, leading to low vacancy rates.

Going forward, we believe Lebanon's real estate and construction sector offers strong potential. We expect as fundamentals for the real estate and construction sector to remain sound. This is primarily driven by increasing investment from the Arab investors and rising tourism sector. The trend is expected to continue in near future as the Middle East economy is likely perform well on the back of rising oil prices. However, the growth potential could be negatively impacted by political turmoil and sustained instability.

### Appendix: 1 Macro Economic indicators

	2002	2003	2004	2005	2006
Nominal GDP (US\$ Mn)	18,462	19,895	21,768	22,052	20,900
Nominal GDP Growth Rate (%)	8.20%	7.80%	9.40%	1.30%	-5.2%
Per Capita GDP (US\$)	5,049	5,370	5,799	5,799	5,497
Consumer price inflation (%)	3.6	3.1	2.2	2.4	5.0
Population (Mn)	3.5	3.5	3.5	3.6	3.6
Current-Account balance (US\$ Mn)	-4,385	-4,997	-4,122	-1,881	-2,045
LL Deposit Rate (%)	9.8	7.8	7	7.7	7.5
LL Lending Rate (%)	16.1	11.3	10.5	10.1	10.4
Money Supply M3 (US\$ Mn)	37,707	42,577	46,957	49,034	50,851

Source: Banque Du Liban, IMF, Data Bank Lebanon, IIF

### Appendix: 2 Distribution of Bank credit by sector (%)

	2000	2001	2002	2003	2004	2005
Trade & services	43.78	44.46	45.11	45.34	44.18	42.5
Construction	22.39	20.74	19.26	17.33	17.2	15.49
Industry	12.64	12.96	12.57	13.82	14.27	14.84
Advances to individuals	11.85	12.42	13.33	15.01	16.12	17.42
Financial intermediaries	2.92	3.18	3.16	3.39	3.48	4.17
Agriculture	1.61	1.34	1.4	1.39	1.09	1.27
Others	4.81	4.9	5.17	3.72	3.66	4.32
Total	100	100	100	100	100	100

Source: Banque Du Liban

### Appendix 3: Markaz Methodology for Demand Supply Analysis

#### General assumptions/ Key parameters considered

##### 1. Population:

- Previous and current population,
- Future growth rate, forecasted population (2007-2010) on the basis of guidance of Banque Audi.

##### 2. Family size of the residents

##### 3. Housing vacancy rates (2005-2010)

#### Methodology explained

For the purpose of forecasting housing demand, we have broadly taken into account macro economic variables. The variables are: Population growth and average unit size in Lebanon. To arrive at the total housing demand: (a) we forecasted the total Lebanese population on the basis of rational assumptions and data available from the Data Bank of Lebanon. Similarly, (b) we forecasted the average household size of Lebanese population.

#### Key Assumptions:

- a) Total population is expected to grow by 1.2% in 2007 and at an annual average rate of 1.8% over 2008-2010 (Based on Banque Audi estimates).
- b) The average size of household is assumed to be 4.2 (A Banque Audi estimates)

To arrive at the supply of total housing unit, we have forecasted the addition (new housing units) to existing supply since 2004.

- a) To forecast the new supply, we have taken in to account the vacancy rates till 2010.
- b) We have assumed that the vacancy rates could decrease by a little more than 20%, resulting in an oversupply gap of just below 4%. (Based on Banque Audi guidance)
- c) Based on the vacancy rates we have calculated the oversupply till 2010.
- d) Using total demand and oversupply we arrive at the total supply.

#### **Appendix 4: Regulatory Developments**

The law No. 296 dated April 3 2001 (which amended law No. 11614 of 1969) relating to Foreign acquisition of property has the following salient features:

- 1) As per the new law the real estate registration fees has been lowered from 6% for Lebanese and 16 % for foreigners to 5% for both Lebanese and foreign investors.
- 2) The law permits foreigners to acquire up to 3,000 sqm of real estate without a permit and can acquire more than 3,000 sqm with Cabinet approval.
- 3) Cumulative real estate acquisition by foreigners can not to exceed 3 % of total land in each district. Furthermore, Cumulative real estate acquisition by foreigners in the Beirut region can not to exceed 10 % of the total land area.
- 4) The law prohibits acquisition of property by individuals not holding an internationally recognized nationality. This is primarily relevant to Palestinian refugees residing in Lebanon.

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