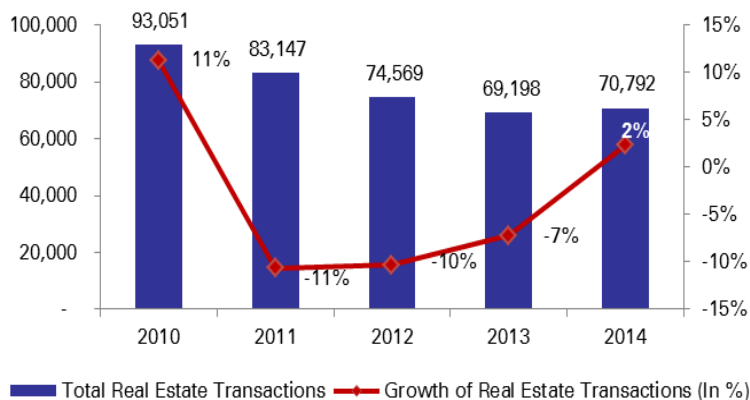


# Real Estate Activity in 2014: Sluggish Performance amid Intensifying Challenges



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## Evolution of Total Real Estate Transactions



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Source: Cadastre

For too long, real estate sector in Lebanon remained one of the core sectors to assess the economic health of the country and determine its forthcoming standing. The undeniable importance of real estate activity is reflected by the sector's substantial contribution to the country's Gross Domestic Product (GDP) which was estimated around 14% by 2013<sup>1</sup>. Yet, the lack of data in the sector undermines the valuation of real estate demand and supply. The size of current local demand cannot be assessed accurately as updated income distribution and housing ownerships are not available, noting that remittances from the large Lebanese diaspora contribute substantially to the uphold of domestic demand as well as the growth potential for the real estate.

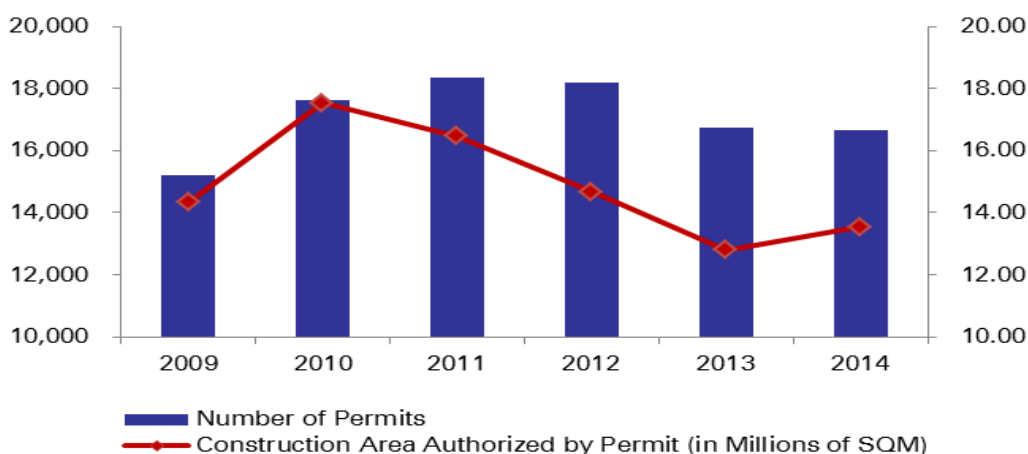
As a matter of fact, and similarly to the majority of Lebanon's economic sectors, real estate remained highly dependent on the country's political and security conditions. For instance, total real estate transactions (local and foreign) during 2010-2013 slumped 25.6% to 69,198. Actually, 2013's political factors have sent the "Political Stability and Absence of Violence" (PSAV)<sup>2</sup> index for Lebanon to the 14<sup>th</sup> lowest level among 214 countries. Lebanon's index kept revealing very low figures over the past 8 years, hovering between a lower band of 3 Percentile Rank (PR) in 2007 and a higher band of 8 PR in 2009 alluding to the country's persistent instability. The latest index of 2010 stood at 6 and steadied at this level till 2013. Worth mentioning, the index scores the variation of political stability in a country correspondingly to the occurring incidents and their weight as a Percentile Rank (PR) among all countries from 0 (lowest political stability) to 100 (highest political stability).

In 2014, mixed political signs shaped the local demand for real estate. In the first half of the year, activity in the Lebanese real estate market got little breathing space despite the escalating challenges that were undergoing in Lebanon and the region. Investors revealed optimistic prospects about the year and translated their hopes in both the construction and real estate markets. This resulted from the long-awaited Cabinet formation in February along with a firm security plan that managed to reduce security incidents in several Lebanese regions. However, the presidential vacuum that started by the end of May painted the second half of the year and was coupled with series of security incidents topped by the hostage of Lebanese soldiers by militants in Arsal in the first week of August.

<sup>1</sup> According to the national accounts of the Central Administration of Statistics (CAS)

<sup>2</sup> Index introduced by the World Bank, as a part of the yearly Worldwide Governance Indicators. It is defined as a tool to measure the "likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically motivated violence and terrorism."

Evolution of Construction Activity



Source: Orders of Engineers in Beirut and the North

### Construction Activity retreats in 2014 despite Global Economic Turmoil

The international bearish trend in oil prices, that reached in 2014 one of their lowest levels since 2010, could have significantly triggered down transportation costs in the construction industry especially when developers' projects are located far from the providers of construction materials.

In addition, construction costs were partly impacted by the Euro's depreciation. Noting that Lebanese developers heavily rely on the European building materials for design and decoration purposes (such as ceramic and marble from Italy and Spain), their imports from the Euro Zone became cheaper. Worth mentioning that, the European official currency almost saw a 12% yearly slump, by the end of 2014, from €/€ 1.37 to €/€ 1.21. In fact, the MSCI World Construction Materials Index reflected as well the situation and dropped 13.6% y-o-y, which could explain the potential drop in Lebanon's construction costs as the global decline of construction prices was imported to Lebanon.

Besides the repercussions of the Syrian crisis on the Lebanese real estate sector, contractors benefitted from the cheaper Syrian labor force. As several Syrian citizens were fleeing the country for employment at low wages, the local workforce was facing fierce competition while real estate developers were enjoying cheaper labor costs and fewer obligations (when it comes to social security), which contributed in decreasing their construction costs even more.

Yet, Lebanese developers witnessed several challenges in 2014 of which the changing demand, the scarcity of land, the volatility of workforce availability and the economic slowdown. Choosing the location for their units amid ongoing security developments across the country and centralization of projects in the capital was another burden for real estate suppliers. Several developers failed to survive the economic slowdown and were forced to exit the market. This has partly left room to the remaining players, which were mainly the biggest developers.

Cement deliveries, which are one of the earliest barometers of construction activity, posted a 7.0% y-o-y decline by November 2014 to 5.07M tons. Similarly, 2014 saw the number of authorized construction permits slightly slid by a yearly 0.36% to 16,663. However, the number of construction permits is not reflective of the precise volume of real estate supply in a specific time as applications are filed 6 months earlier and the execution of a permit is valid up to eight years from the date of issuance. Still, permits can disclose contractors' sentiments and expectations for the coming period.

## **Real Demand Remains Stagnant in 2014 despite Increasing Real Estate Transactions**

According to official data, the total number of real estate transactions (foreign and local) went up by 2.3% y-o-y by the end of 2014 to 70,792. Even though 2014's yearly increase followed 3 years of continuous drops, the total number of transactions remained well below 2011's and 2012's respective levels of 83,147 and 74,569. This explains that demand did not really improve in 2014 but slightly recovered from the very low base reached a year earlier. In addition, the number of real estate transactions reveals when ownership of the sold entities is recorded with the Cadastre in the Registrar of Deeds. In reference to an interview with the Executive magazine, Mr Jihad Ibrahim, general manager of Jamil Ibrahim Establishment, stated that the number of real estate transactions does not show when the transaction really took place as the time frame to handover a residential unit requires at least 3 years and the majority of sales happen during or before the project is initiated. Thus, the increase in the average value per transaction by the end of 2014 does not necessarily indicate a growing demand or even an increase in the prices of real estate projects.

In effect, 2 main types of apartments characterize the Lebanese real estate market: luxurious flats and affordable apartments that each had a divergent path in 2014.

### **1. Luxurious and Spacious Apartments Went Hand in Hand with Fading Foreign Demand**

Wealthy Lebanese citizens and Arab nationals were renowned for their consistent demand for luxurious spacious flats in Lebanon. Those apartments are usually above 220 Square Meters and are very well located, mainly in the capital Beirut.

However, the fact that the small Mediterranean country has a strategic location in the Middle East makes real estate demand for expensive apartments vulnerable to the slightest regional tensions that can upsurge. In fact, sales to foreigners slumped by a yearly 6.4% to 1,196 in 2014, the lowest level in 6 years.

Noting that GCC citizens constitute a substantial stake of the demand for luxurious apartments in Lebanon, their demand kept on dwindling following repeated warnings from their governments to avoid Lebanon due to the high degree of political uncertainty and security developments. Correspondingly, Lebanon's real estate projects were further losing foreign investors' appeal over the years, noting that the share of real estate sales to foreigners in 2014 stood at 1.7% compared to 1.8% and 1.9% in 2013 and 2012, respectively.

Lebanese suppliers were more cautious when initiating large-scale deluxe projects and preferred serving the existing local demand. On the other hand, the Syrian war also took its toll on the real estate developers that feared a probable extension of the conflict to Lebanon that could affect their projects and sales.

Even though several Syrian citizens fled their country heading to Lebanon, their demand was mainly concentrated in rentals and not real estate purchases. This can be explained by the fact that the wealthy Syrians leaving their country were looking for more secure countries, none of which was Lebanon. Thus, the ones targeting Lebanon were the middle-range families and those expecting to go back to Syria when the situation improves. Those could not afford buying real estate units in Lebanon, but rather rented apartments.

Thus, and with supply outpacing the demand for luxurious and spacious apartments, the latter's prices went down around 20% as buyers gained more freedom and time to negotiate their purchases. Worth mentioning that the time needed to sell an apartment has prolonged lately as buyers have the option to choose from the overflowing number of unsold apartments and negotiate for their own best interest.

## **2. Small Flats: Steady Demand from Low- and Middle – Income Households**

In 2014, demand for real estate was mainly restricted to basic housing on the expense of luxurious accommodation. With local demand being the one to rise over the year and with the majority of spacious apartments remaining unsold, local consumers were looking for small affordable houses. In fact, the average income of a Lebanese employee is relatively low and the maximum payment that the latter can settle is one third of its monthly income.

In addition, the subsidy that BDL provides to commercial banks for housing encourages demand for small apartments with area not exceeding 150 Square Meters (SQM). Accordingly, Lebanese buyers are looking for smaller flats that they can afford with their relatively low income. Thus, demand for such apartments is growing and was mainly behind the uptick of housing loans distributed in the financial sector that rose 8.8% y-o-y in H1 2014 to reach \$8.53B.

The rising number of unsold apartments made suppliers more cautious and alert about a potential mismatch between the existing demand and supply. Accordingly, and before initiating any new project, in-depth studies of the market are conducted to avoid any risk that could restrain developers from liquidating their projects. Defining the needs of real estate buyers became more essential in 2014 which have turned investments towards small and affordable apartments.

Given the scarcity of land and its effect on prices, developers were looking for new areas for their investments where they can benefit from larger plots thus reducing their costs. Despite the slump in the number of construction permits, the construction area authorized by permits (CAP) increased by a yearly 5.8% to reach 13,545,707 SQM in 2014. The increase in the CAP should not be regarded as an improvement in the construction sector but rather as a partial recovery from 2013's levels when it had shrunk by an annual 13%. In fact, developers became more oriented towards new type of projects to serve the changing demand. Given that only big contractors survived the economic slowdown, they became more interested in large scale projects (as they are built over large plots of land) featuring small apartments with numerous facilities at an affordable price.

Real estate contractors also tried in 2014 to spread their projects over new geographical areas where land is more abundant and less expensive to serve a more selective demand. Mount Lebanon kept on capturing the lion's share (48.9% of total permits) in terms of geographical distribution of projects given its relative proximity to the capital and thus the slightly lower prices in terms of land. However, the number of projects in Mount Lebanon area slightly slipped by 0.7% y-o-y in 2014 to 7,248 permits. Furthermore, the rising clashes in the Bekaa area (10.9% of total projects in 2014) and North of Lebanon region (14.4%) were behind the downturn in the number of projects from 1,776 and 2,196 to 1,617 and 1,984, respectively. Meanwhile, Beirut, that showed the lowest number of permits (given the scarcity of land) with a slight stake of 5.6% of the total, saw a 6.2% yearly rise in the number of construction permits to 839.

Additionally, the falling construction costs facilitated prices' decline of small apartments. Therefore, many developers were more open for price negotiations with some of them willing to offer approximately 10% to 15% of discount.

### **What about the Commercial Market in 2014?**

While maintaining their high levels, commercial rentals in Lebanon showed substantial declines in 2014. In details, and amid a slowdown in the residential market, investors were more oriented towards commercial projects. Those investments have become more income appealing in terms of sales and rents given the shortage in stock.

Cushman & Wakefield annual report showed that retail rents in the main Lebanese locations hovered between \$500 - \$1,600 per SQM/Year and considerably declined during 2014 around

15%-30%, partly on dropping investment sentiment. However, ABC Centre Achrafieh, which was 2014's most expensive retail location in Lebanon, preserved 2013's level of \$1,583 per SQM/Year. The Lebanese mall ranked 37th among 64 countries and stood just after Biblioteksgatan - Sweeden (\$1,636 per SQM/Year) and Rue Neuve - Belgium (\$1,750 per SQM/Year). ABC Achrafieh rental was higher than that of Grand Rue – Luxembourg (\$1,500 per SQM/Year) and Shopping Centre - Kazakhstan (\$1,330 per SQM/Year).

On the local front, Beirut Central District and Rue Verdun rental prices followed ABC Centre Achrafieh at respective prices of \$792 per SQM/Year (a 16.7% yearly decline) and \$633 per SQM/Year (a 20.0% y-o-y drop). Rue Hamra and Kaslik ranked fourth in Lebanon with similar rental price of \$554 per SQM/Year.

Finally, assessing real estate prices and the trend they followed in 2014 remains challenging on insufficient existing data that could be misleading. Despite the economic slowdown, the substantial decline in construction costs and the complications on the Syrian front that kept on weakening investors' confidence, property prices went in the same direction. Though, the decline in the prices of luxurious flats certainly took place at a faster pace than that of affordable apartments.

Real estate and construction activities have been struggling for several years to preserve their leading positions as core sectors in the Lebanese economy. Following 2008-2009 booming period, real estate was hindered starting late 2011 by pressures from the war in Syria and the fragile domestic situation. However, the strong fundamentals of the sector managed to slow down the retreat in activity up until 2014 when indicators began to stabilize.

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