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The economy of Saudi Arabia is characterized by a number of special features, the most important of which is that it is the biggest economy in the Middle East.

Subdued oil prices, coupled with relatively low external demand and the deal made by OPEC to cut oil output had a significant impact on the economy as it remains highly reliant on revenues from oil exports. Annual real GDP growth plunged from 6.8 percent in 2011 to only 1.7 percent in 2016 and further it has contracted by 0.5 percent in 2017 owing to fragile performance in the oil sector.

The decline in the growth rate has come as a blessing in disguise as the government embarked upon implementing structural changes to the economy and moving toward economic diversification. The announced ‘Vision 2030’ and ‘National Transformation Program (NTP)’ are major restructuring plans that attempt to minimize the Saudi economy’s reliance on oil revenues.

The continuous implementation of structural reforms is likely to strengthen the economic growth over the medium-term and GDP is expected to witness a growth of 2.7% in 2018.

The cost of living index registered a YoY average decline of 0.23 percent in 2017 compared to 3.6 percent increase in 2016. However, the inflation rate is expected to increase in 2018 due to the energy price reforms, and to the introduction of the Value Added Tax (VAT) among others.
Although Saudi Arabia has been recording budget deficits since 2014, it is worth mentioning that it has been a declining trend since then. The budget deficit in 2017 was SAR 230 billion, a reduction of 26 percent compared to the previous year. It should be noted that the deficit ratio as a percentage of GDP declined from 14.5 percent in 2015 to 8.9 percent in 2017. Furthermore, the government is contemplating to reach budget equilibrium by 2023.

The budgeted revenue for the year 2018 is SAR 783 billion, while expenditures are estimated to be SAR 978 billion.

The government is taking major initiatives to broaden the revenue base, thus reducing the dependency on oil. This is fairly evident from the exponential growth in non-oil revenue, which has grown at an 20.4 percent CAGR form 2012 to 2017, compared to oil-based revenue, which dropped at a 17.4 percent CAGR during the same period, resulting in 36.8 percent of non-oil revenue share in 2017.

Furthermore, the non-oil revenues are expected to experience growth due to the implementation of structural changes and economic reforms such as reduction of subsidies, revised expat levy, introduction of excise duty, revised energy prices and introduction of Value Added Tax (VAT).

Increase in non-oil revenue will enable the government to sustain its fiscal spending and generate continuous economic growth.
Residential sector overview
Introduction

Jeddah is the second-largest city of Saudi Arabia, with a population of ~4.2 million. Its location along the coast, coupled with increasing business activities, makes it a preferred choice for both local residents and expatriates.

Jeddah has experienced high geographical expansion toward its northern side, due to the availability of developable lands with modern infrastructure and the proximity to newer and modern developments in the city.

The market is characterized with low home ownership rate that is hampered by affordability constraints, shortage in supply of residential units targeting lower and middle-income segments, and large expatriate base population staying in rented homes.

The government has taken several initiatives to increase homeownership such as approval of the Mortgage Law, reinstatement of 15 percent down payment, provision of affordable housing units for deprived Saudi families and introduction of white land tax on undeveloped urban lands.

Supply

With a current supply of about 0.8 million residential units in the city, Jeddah is expected to receive an additional supply of 30,000 residential units by 2020, an addition of 3.7 percent in the current stock.

A significant amount of existing supply is being delivered in the form of small to medium size projects targeting upper-middle to high-income families. This disparity, between the affordability of the current supply and the majority of end-user demand has created an undersupplied lower-income residential market.

Al Ra’ida Development, owned by Public Pension Agency, is one of the most prominent under-construction projects in the city. It is anticipated to deliver 6,160 apartments and 1,180 villas in different phases.

Other notable upcoming residential projects in Jeddah are Gardenia Residences, Al Fareeda, Almayaar, Masharef, Diyar Al Salam Residence, and Jeddah Gate (Abraj Al Hilal – 2), among others.

A majority of the new supply is focused toward the north and east of the city as the city center has become saturated with limited availability of land, while seafront areas are in the city are expected to offer further high-end products in the future.
During the year 2017, the sale prices and rental rates of villas continued to decline. The trend was first noticed after the implementation of the white land tax, which led to cautious behavior from investors and end-users, resulting in a considerable drop in activities in the segment.

The western areas of the city, such as Ash Shati, Al Hamra, Az Zahra, As Salamah and An Nahdah districts command the highest sale prices and rental rates in the city. The average sale price of villas in these areas is SAR 7,000 per square meter, while medium-sized villas can be rented for SAR 120,000–150,000 per annum, depending on their size, location, accessibility, quality of construction, age of building and proximity to commercial areas, among others.

The average sale prices of standard villas vary between SAR 4,500 and SAR 5,500 per square meter in northern and eastern areas, while in the southern side, it is SAR 3,500 per square meter.

Unlike previous years when rental rates of apartments witnessed an upward trend, rentals rates observed a significant drop of around 10-15 percent during the year. This abrupt decline can be primarily attributed to the exodus of expat families, which increased the vacancy rate in the market. Increasing utility expenses and the introduction of dependent fees were the main factors that compelled middle income expats to move their families back to their home countries.

Similar to villas, the most expensive apartments for sale are located toward the western side of the city, primarily due to the larger size and luxurious nature of the developments.

The average sale prices of apartments in the city range between SAR 2,500 per square meter (southern side) and SAR 6,000 per square meter (western side). However, these prices can go up to SAR 10,000 per square meter in high-end projects that offer additional amenities and services, such as swimming pool, recreational facilities and premium finishing.
Despite the current slow down in the market and subdued performance during the last couple of years, the demand for housing units is continuously increasing, mainly driven by a large population, coupled with increasing urbanization and declining household size.

It is worth mentioning that the market is witnessing a mismatch between the existing supply that mostly targets upper-middle and high-income segments, and the actual demand that is being generated by middle and lower-middle income segments.

The demand for apartments and small-size villas/duplexes is expected to remain high as compared to large-size units. New villa projects are most suitable to be developed in the North Obhur region due to its high desirability and modern infrastructure. However, the eastern side is most suitable for new apartment developments due to its proximity to the city center and better connectivity with the city road network.
Retail sector overview
Introduction

Over the last decade, retail space supply in Jeddah has gradually shifted away from independent high street retail units towards new destination shopping centers. Recent trends indicate that organized shopping in the city, as a social activity, is becoming increasingly popular and mainstream.

Despite a slowdown in the growth rate during the last couple of years, Jeddah City has recorded the second-highest overall consumer expenditure in the country. Since 2012, the expenditures have grown at a CAGR of 4.7 percent. The growth in consumer spending is expected to impact the retail sector positively.

Furthermore, due to the expected increase in the number of pilgrims (as a result of the expansion of the Holy Mosque) and the open culture of Jeddah City, we expect the demand for quality retail space in Jeddah to continue rising.

Supply

Jeddah City is hosting around 1.3 million square meters of organized retail space, which includes recent completions, Yasmin Mall in 2016 and Red Sea Mall expansion during first half of 2017.

Jeddah’s organized retail supply is dominated by super-regional malls, accounting for 45 percent of the existing supply, followed by regional malls with 41 percent. The share of super-regional malls is expected to increase as most of forthcoming supply belongs to this category.

The supply is likely to be augmented by 38 percent in the coming 3–4 years as an additional half million square meter is expected to be delivered. The Jeddah Park, in the advanced stages of construction, is the most prominent forthcoming project and is expected to deliver ~150,000 square meter of quality retail space.

In addition, recently announced Al Rawdah Commercial Center (by SEDCO) and Al Marwa Plaza (by Al Andalus) will be adding to the quality retail space, once completed.
Jeddah retail developments are more vibrant and enjoy a higher footfall as compared to those in other major cities of the Kingdom, hence command premium rentals.

Jeddah’s retail market has witnessed strong performance in the last couple of years and rental rates of shopping malls has increased 5–7 percent annually.

However, 2016 was the first year when signs of the dwindling spending power of Saudi households have started to emerge. This affected the retail market adversely, and mall owners/operator could not increase the rental rates.

Moreover, during 2017, the market witnessed a modest decline of 4 - 5 percent in rentals. New upcoming supply (if delivered as announced) amid ongoing slowdown is likely to put more pressure on the rental rates.

A trend change in the rental rates of shopping malls has been observed. Currently, a couple of super-regional malls are testing the turnover-rent (percentage of revenue) instead of charging a fixed per square meter rental rate. This new trend is likely to counter the decline in sales leading to a win-win situation for both parties (tenants and mall owners/operators).
Investment opportunities

Despite the current slow down in the market, a high population base, coupled with high disposable income, is expected to play a vital role in the stability of the retail market. In addition, the permission of 100 percent foreign ownership in the ‘retail and wholesale’ sector will bring more investments to this sector. Subsequently, the demand for quality retail space is expected to surge with healthy ratios.

Mixing up retail mall with other real estate components such as hotel, office or residential could be a commendable idea to generate certain footfall. Red Sea Mall is the best example of this trend and recently Al-Andalus Property has built a first-class furnished apartment building beside Andalus Mall. Additionally, Jeddah Park Mall will be offering a hotel and furnished apartment units upon completion.

In order to generate footfall in the mall, new players should concentrate on uniqueness by offering high-quality retail space with innovative concepts. The planned development should be able to respond to the changing behavior of consumers.

Opportunity lies in the following segments:

- Medium sized community malls that cater to the demand generated by surrounding neighborhoods, and duly occupied by brands needed in that particular area.
- Super-regional malls that can serve as destination malls, equipped with advanced leisure facilities (such as kid’s fun zone, youth gaming zone, etc.), and food court and fine dining that offer unique variety of cuisines.
Office sector overview
Introduction

Jeddah, being the second most populous urban city and business hub in KSA, houses 50 percent of the province population and 13 percent of the country’s population. Moreover, 52 percent of its population is comprised of expatriates, who come to Saudi Arabia primarily for work. Furthermore, the following will have a positive impact on the demand for office space:

- Empowerment of the private sector and enhancing its contribution to the economy (one of the main pillars of Vision 2030).
- Saudi nationals working in the private sector coupled with influx of the expatriate workforce.
- Increasing participation of women in the workforce.

Supply

The characteristics of office supply in Jeddah are quite different as compared to that of the Riyadh market, where it is more diversified. Jeddah has historically been undersupplied with quality office space, however, in the last 4–5 years, the market has witnessed the completion of quality office buildings such as King’s Road Tower, The Headquarters Business Park and Zahran Business Center.

There was around 25,000 square meters of new office space completed during 2017, bringing the current stock to circa one million square meters.

Furthermore, it is expected that around 200,000 square meters of office space is due to enter in the market in the short to medium term. Besides the upcoming iconic Jeddah Tower, other prominent forthcoming office developments include Al Khair Tower, Ibrahim Center and Laliyan Towers.

Most of the recently developed and upcoming office buildings are located within new business districts that are comprised of Prince Sultan Street and King Abdulaziz Road.
The Jeddah office market saw relatively stable performance in 2016, with rentals and occupancies remaining unchanged. However, the year 2017 saw a declining trend in both rental and occupancy rates.

The rental rates of premium offices and Grade A office buildings observed a modest decline, while rentals of Grade B office buildings located at secondary locations witnessed a significant drop of 8-10 percent.

Considering the characteristics of the recently delivered and upcoming office buildings, we expect further reduction in rentals of Grade B office buildings with poor maintenance and limited amenities. Furthermore, the current slowdown in the economy and downsizing in several companies may shrink the demand for office space.

It is worth mentioning that it will likely be temporal as the government is actively working to bring foreign investment to the country that will generate more demand for office space. In addition, proposed infrastructure and other mega developments will support the demand for office space.

Performance

Source: KPMG Research and Analysis
Investment opportunities

As mentioned earlier, the market is lacking in high-quality office space and existing properties are enjoying healthy rentals and occupancy rates. The development of Grade A office space mixed with any other compatible asset class such as hospitality or retail will command high demand and is expected to enjoy higher occupancy and rental rates.

Such developments should ideally be located in the upcoming commercial and business districts of Prince Sultan Street and King Abdulaziz Road.

Although there are indications of demand for quality office space, the current economic and market conditions should be considered before introducing any future development.
Hospitality sector overview
Introduction

Jeddah is considered the gateway to the Holy Cities of Makkah and Madinah and the most cosmopolitan city in KSA. In addition, it is the second-largest business hub after Riyadh and a key leisure destination, frequently visited by domestic tourists.

Unlike Riyadh, where the hospitality market is dominated by business tourists, the Jeddah hospitality market is driven by both corporate visitors and leisure tourists. Moreover, being the gateway for Hajj and Umrah pilgrims, the hospitality market of Jeddah benefits from these religious tourists.

The city’s tourism is expected to benefit from the initiatives taken by the government, including airport expansion, Haramain Railway and investment in upgrading the leisure offerings.

Supply

Despite delays in several projects, 2016 witnessed a completion of six hotels, followed by five in 2017. These recent additions have augmented the total stock by 26 percent as compared to that in 2015. Major completions during this period include Ritz Carlton, Movenpick City Star Hotel, Hotel Galleria by Elaf, Roco Forte Assila and Ramada Corniche Hotel.

The Jeddah hospitality market is hosting more than 10,500 keys of 3, 4 and 5 star hotels, where the wider portion of existing supply, particularly 4 and 5 star properties, is clustered in the central and western sides of the city.

The city’s market is likely to witness the delivery of more than 5,000 hotel keys in the coming 2–3 years, which will increase the current hotel stock by 47 percent. A major portion of the upcoming supply comprises upscale 4 and 5 star categories. Some of the prominent hotels that will dot Jeddah’s skyline are Fairmont Jeddah Hotel & Resort, Kempinski, Radisson Blu, and Four Seasons Hotel.


Source: KPMG Research and Analysis
In 2016, the Jeddah hospitality market showed resilience and witnessed mixed performance; although occupancy rates dwindled, the average daily rate (ADR) observed a moderate growth.

During 2017, the market has softened and both occupancy rates and ADR observed a diminishing trend. This is mainly attributable to the decline in the number of corporate tourists, coupled with delivery of new hotel rooms amid the current economic slowdown. The market has witnessed a decline of about 8 percent in occupancy rate, while ADR remained relatively stable, dropping only 2-3 percent.

The market is expected to remain subdued in the short to medium term. Although the government’s initiatives to support the development of culture, leisure and entertainment projects in Jeddah may boost demand for hospitality projects, the market needs some time to absorb the existing and forthcoming supply.

Performance

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KPMG’s Hotel performance tree

<table>
<thead>
<tr>
<th>ADR (SAR/ Night)</th>
<th>Occupancy</th>
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<tbody>
<tr>
<td>1,500</td>
<td>100%</td>
</tr>
<tr>
<td>1,200</td>
<td>90%</td>
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<tr>
<td>900</td>
<td>80%</td>
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<tr>
<td>600</td>
<td>70%</td>
</tr>
<tr>
<td>300</td>
<td>60%</td>
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5 Star 4 Star 3 Star

Source: KPMG Research and Analysis
Investment opportunities

Given the concentration of forthcoming supply toward 4 and 5 star hotels, we expect a diminishing trend in occupancy rate and ADR due to increased competition in the upscale segment.

The announced/proposed midscale hotels represent only 10 percent of the upcoming supply, which will leave a huge gap in this segment. The midscale hotels located at strategic locations are likely to capture a wider share of the market.

The most suitable locations for offering midscale hotels in Jeddah are toward the east of the city near Haramian Railway Station, toward the north of the city close to the King Abdulaziz Airport, and upcoming mega projects including Jeddah Economic City and Prince Sultan Cultural Centre.
Glossary of Terms

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>Bn</td>
<td>Billion</td>
</tr>
<tr>
<td>CAGR</td>
<td>Compounded Annual Growth Rate</td>
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<tr>
<td>GASTAT</td>
<td>General Authority for Statistics</td>
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<tr>
<td>EIU</td>
<td>Economist Intelligence Unit</td>
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<tr>
<td>MOI</td>
<td>Ministry of Interior</td>
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<tr>
<td>GCC</td>
<td>Gulf Cooperation Countries</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>GLA</td>
<td>Gross Leasable Area</td>
</tr>
<tr>
<td>NTP</td>
<td>National Transformation Program</td>
</tr>
<tr>
<td>Mn</td>
<td>Million</td>
</tr>
<tr>
<td>p.a.</td>
<td>Per Annum</td>
</tr>
<tr>
<td>SAR</td>
<td>Saudi Arabian Riyal</td>
</tr>
<tr>
<td>Sqm / Sq.m.</td>
<td>Square Meter</td>
</tr>
<tr>
<td>SAR</td>
<td>Saudi Riyal</td>
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<tr>
<td>US$</td>
<td>United State Dollar</td>
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<tr>
<td>YoY</td>
<td>Year on Year</td>
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<tr>
<td>F&amp;B</td>
<td>Food and Beverages</td>
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<tr>
<td>KSA</td>
<td>Kingdom of Saudi Arabia</td>
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<tr>
<td>ME</td>
<td>Middle East</td>
</tr>
<tr>
<td>MENA</td>
<td>Middle East and North Africa</td>
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<tr>
<td>Sq. Km.</td>
<td>Square Kilometer</td>
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North of Jeddah

West of Jeddah

East of Jeddah

South of Jeddah
KPMG Real Estate Services

KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We have more than 173,965 outstanding professionals working together to deliver value in 155 countries worldwide. We work closely with our clients, helping them to mitigate risks and grasp opportunities.

KPMG in the Kingdom of Saudi Arabia is established through its member firm KPMG Al Fozan & Partners. The firm has been operated in the Kingdom of Saudi Arabia since 1992. It also operates through a national leadership with dedicated regional teams, which enable our network of professional talent, our technologies and our products and solutions to quickly come together to meet clients’ needs. The firm has grown to be one of the largest professional services firms in the Kingdom with more than 900 working professionals and three offices in Riyadh, Jeddah, and Al Khobar.

KPMG’s Real Estate team is led by seasoned professionals with over 100 years of combined Real Estate experience. The team provides different types of real estate advisory services across the Kingdom of Saudi Arabia through our three offices in Riyadh, Jeddah, and Al Khobar. The team is also supported by KPMG’s global network of member firms. KPMG’s Real Estate team provides the following services for Real Estate Developers and Investors.

**Strategy Advisory Services**

1. Strategy and business plans: The team is involved in developing Corporate Strategies and Business Plans for Real Estate clients in the start-up, growth, transformation, and mature stages. Strategy development includes setting goals/objectives, determining actions to achieve the goals, and helping clients mobilize resources funding to execute the actions.

2. Financial modelling: KPMG’s experienced Financial Modelling team develops custom models for Real Estate clients to be used for their Strategic, Financial, and day-to-day requirements. These models are delivered to clients with user manuals and training sessions to help ensure proper usage of the model.

**Development Advisory Services**

1. Highest and best use studies: Our professionals advise clients on the best development option that is financially feasible and appropriately supported by the market to generate the highest returns. KPMG provides research backed development options, scenario analysis, sensitivity analysis, and key financial returns/indicators.

2. Market research and analysis: KPMG’s Real Estate team assesses the market in order to advise on the most attractive sectors of the Real Estate market. The assessment is based on drivers like demand and supply and performance indicators like Lease Rates, Sale Prices, Occupancies, ADRs etc. The Market Analysis is based on both primary and secondary research conducted by our dedicated research team.

3. Financial feasibility studies: Combined with the market study, KPMG assesses the expected Financial Returns of specific Real Estate projects based on the parameters of the project and the market indicators. The Feasibility Study includes Market and Financial Analysis sections. KPMG’s Financial Feasibility Studies are frequently used by a number of banks as bankable documents; these can also be used by developers/investors to raise debt from banks.

4. Valuation services: KPMG’s Real Estate Team provides Valuation Services where the Entity Value is derived by using different valuation methods such as Comparables, Multiples, Asset Sale, and DCF valuation methodologies.

**Transaction and Financial Advisory Services**

1. Real estate sales: The Real Estate team is actively involved in bringing together Real Estate Developers with Real Estate Investors. The scope involves developing an Information Pack, which includes background, market, technical, and financial information about the company. KPMG’s Real Estate team can help clients with the sales process from inception to signature of a binding agreement.

2. Bank financing: The Real Estate team is also actively involved in preparing Information Packs used for bank financing. KPMG’s Real Estate team has a long track record of success in helping clients’ secure bank financing with our Information Packs.

3. PPP procurement and tendering: KPMG’s Real Estate team can lead the procurement and tendering processes of PPP projects on behalf of clients. The team has led several multibillion-dollar PPP projects in the region and has developed the relative PPP experience which can help ensure favorable financial closure of projects.
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