



Riyadh real estate market overview 2018





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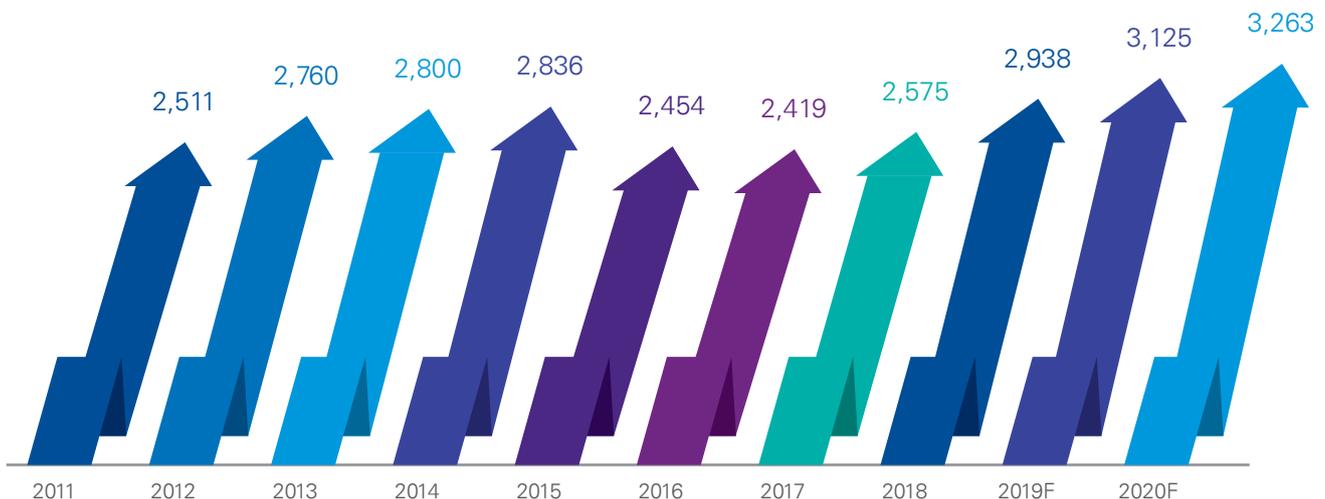




Macroeconomic overview

Macroeconomic indicators

Saudi Arabia GDP growth (SAR Bn)



Source: Ministry of Finance, General Authority for Statistics

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.

Saudi Arabia's GDP witnessed relatively an exponential growth between 2011 and 2014. The nominal GDP rose at a CAGR of 4.1 percent per annum during that period. However, due to the decrease in oil price since late 2014, the country has not been able to keep up with the same pattern of GDP growth. The nominal GDP registered a decrease of 13.5 percent in 2015 and 1.4 percent in 2016 compared to the previous respective year.

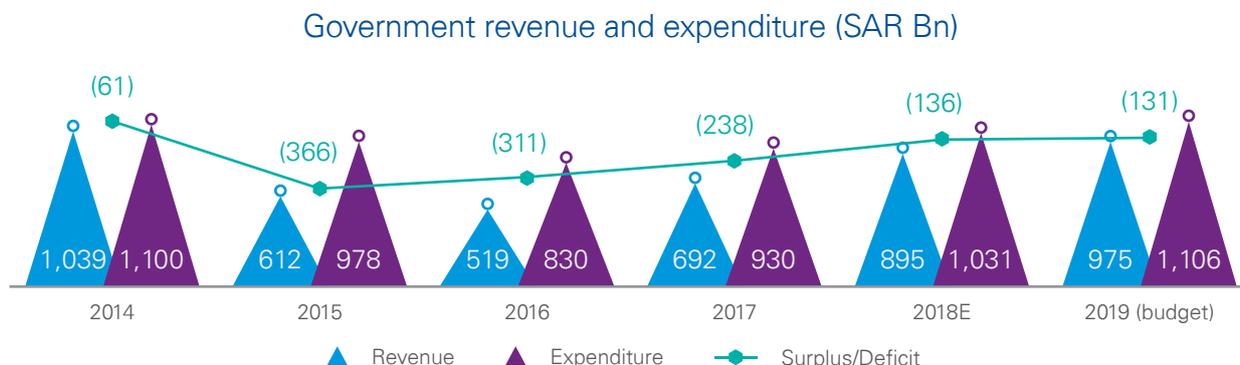
Being an important contributor to the country GDP, the real estate sector has also been impacted by the economic slowdown.

Nevertheless, this has come as a blessing in disguise as the government is now embarking upon implementing structural changes to the economy and moving toward economic diversification.

The announcement of "Vision 2030" and "National Transformation Program (NTP)" are major restructuring plans initiated by the government attempting to minimize the Saudi economy dependence on oil revenues.

The economy has bounced back and the nominal GDP has witnessed an upsurge of 6.4 percent and 14.1 percent in 2017 and 2018, respectively, backed by the government's initiatives to diversify the economy.

Government revenue and expenditure

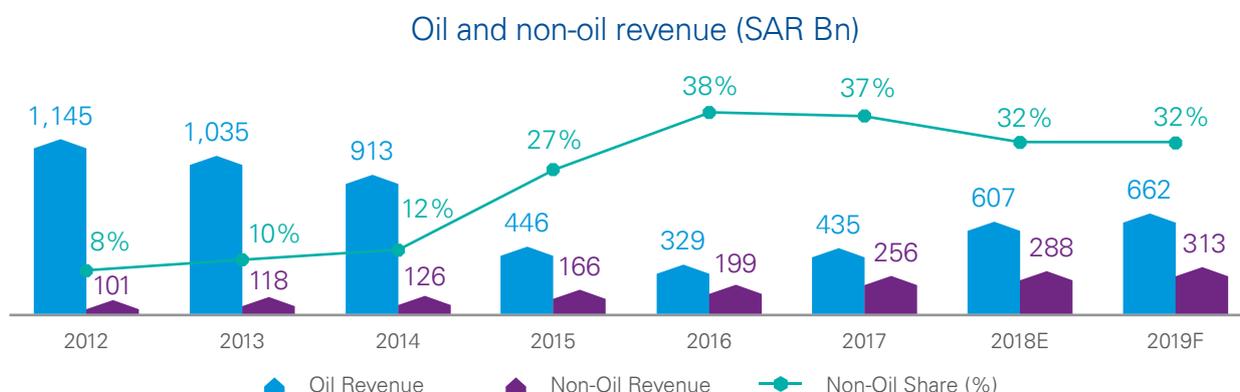


Source: Ministry of Finance

After four years of continuous budget surplus, Saudi Arabia recorded a budget deficit in 2014, due to higher government spending and sharp decline in global oil prices.

Actual revenues during 2018 amounted to SAR 895 billion, while expenditures reached SAR 1,031 billion, hence causing a deficit of SAR 136 billion. It is lower than the budgeted deficit of SAR 195 billion as total revenues increased by 14.3 percent, while total expenditures increased by 5.4 percent.

Despite fiscal deficits realized since 2014, the government has been prioritizing investments in non-oil sectors to enhance sustainable and strong economic growth.



Source: Ministry of Finance

Historically, the economy of Saudi Arabia has been dependent on oil revenues, as the average contribution of the non-oil revenues constituted only 10 percent of the total revenues between 2012 and 2014. Given the decline in oil prices, the government is undertaking major initiatives to broaden the revenue base, thus reducing the dependency on oil revenues. The non-oil revenue grew at a CAGR of 19.1 percent between 2012 and 2018. Furthermore, it is expected to reach SAR 313 billion in 2019, an increase of 8.7 percent over SAR 288 billion in the previous year. A surge in non-oil revenue reflects the government's ongoing efforts toward diversifying its income streams and reducing dependency on oil.

Going forward, the non-oil revenues are expected to be primarily driven by higher VAT collections. With an aim to widen the tax net, the corporate-tax-eligibility threshold is expected to be reduced; the threshold for VAT registration for entities will fall from the current SAR 1.0 million annual revenue to SAR 375,000 per annum. Increase in the non-oil revenue will enable the government to sustain its fiscal spending and endure the generation of continuous economic growth.



Residential sector overview

Introduction

Riyadh is the capital and the largest city of Saudi Arabia, with a total population of 6.5 million, whereas the population of Riyadh province is around 8 million. Its location along the center of the Arabian Peninsula, coupled with increasing economic activities, makes it a preferred business destination for both Saudis and non-Saudis who live and/or work in the city.

Riyadh has experienced high geographical expansion toward the northern side, due to the availability of developable lands with modern infrastructure and the proximity to newer and modern developments in the city. Low to moderate residential expansion is being witnessed toward the northern and eastern sides of the city as a result of the recent initiatives led by the Ministry of Housing (MoH) to stimulate the sector.

The market is currently characterized with a low homeownership rate as a result of affordability constraints, shortage in supply of residential units targeting lower and middle-income segments, and large non-Saudi base population staying in rented homes.

Nonetheless, the continuous efforts of the MoH to provide housing solutions and the implementation of various initiatives (such as its support for new building materials and techniques to increase efficiency and effectiveness) are expected to improve performance of the real estate sector and its contribution to the economy as a whole, increase the home ownership rate, and create an attractive environment for both local and international investors while enhancing their confidence.

Supply

With a current supply of about 1.3 million residential units in the city, Riyadh is expected to receive an additional supply of 30,000 residential units by 2019, which comprises a 2.3 percent increase over and above the current stock.

Based on KPMG research, a significant amount of existing supply is being delivered in the form of small to medium-size projects targeting lower-income and middle-income families. Most of the key upcoming mega development projects such as the Avenues and ITCC include a residential component targeting middle to upper class income families.

Sakani housing program, one of the MoH initiatives, provided around 300,000 residential products during 2018 including subsidized loans, developed residential lands and residential units in Riyadh.

Some notable upcoming residential projects in Riyadh are presented in Table 1.1

The majority of the new supply is focused toward the north and the east of the city while the center is becoming saturated with various developments, and vacant land parcels are becoming more scarce.

Table 1.1: Key upcoming residential projects

No.	Project name	Units	District	Developer/Owner
1	Al Dhahia Compound	327	Ar Rimal	Al Akaria
2	Ajmakan	640	Al Khozama	Sondos Real Estate
3	Rafal Sky Garden	309	AlMohammadiyah	Rafal
4	Mirabilia Villas	14	Shams Ar Riyadh	Dar Al Arkan
5	Murcia	169 (phase 1)	Airport Road	MoH
6	East Gate	2,129	Ar Rawdhah	Al Mozaini Real Estate Company — MoH
7	Ishraq Living	2,229	Al Aarid	Al Tahaluf — MoH

Note: This list is not exhaustive and the shortlisting was based on the likelihood of execution of the projects. Projects beyond the release date of this report were not included in the shortlisting process.



Performance

Villas

Since 2017, sale prices and rental rates of villas have seen a decline and are expected to continue to decline during 2019. The trend was first noticed after the implementation of the white land tax, which led to a cautious behavior from investors and end users, resulting in a considerable drop in activities in the sector.

Based on KPMG research, the northern and central areas of the city such as Al Ghadeer, Al Nada, Al Malga, and Al Wurud districts command the highest rental rates in Riyadh. The average rental rates of villas vary between SAR 70,000 and SAR 205,000 per annum in the northern, central and western sides, while rentals range between SAR 44,000 and SAR 155,000 per annum on average in the eastern and southern parts of the city.

For new villa developments, the sale price of villas located in the central part of Riyadh ranged between SAR 4,000 and SAR 6,500 per sqm. The sale prices of villas located in northern side were observed to be in the range of SAR 2,300 to SAR 5,500 per sqm. Villas in the south reached prices with values between SAR 1,800 and SAR 3,500 per sqm. Sale prices in the eastern part of Riyadh ranged between SAR 2,000 and SAR 4,500 per sqm. In the western part of Riyadh, villas have been observed to vary from SAR 2,000 to SAR 4,000 per sqm.

Apartments

Apartments sale and rental rates are under pressure due to economic slowdown and taxes such as the expat dependent levy. Moreover, the demand for apartments is not as high as villas, however, the popularity of apartments is increasing relative to previous years in Riyadh as a higher number of new developments are introducing apartments. The multi-dwelling model allows for more revenue generation potential and can easily transform to a rental model if the sale absorption is not fast enough.

New apartment developments with modern fixtures and fittings, in addition to a private basement parking, are still being considered as future investments. However, increasing utility expenses and the introduction of dependent fees were the main factors that compelled middle income non-Saudis to move their families back to their home countries.

Unlike villas, existing apartments in eastern and central parts of the city are more attractive in terms of location due to their proximity to the central business district. The land availability in the eastern part is relatively higher as compared to central areas and it mainly houses the mid-income segment.

For new apartment developments, central areas are still fetching the highest sale price in the city which vary from SAR 3,000 to SAR 4,700 per sqm. The sale prices of apartments located in northern side were observed to be in the range of SAR 2,000 to SAR 4,300 per sqm. Apartments in the south achieved prices with values between SAR 1,500 and SAR 4,000 per sqm. Sale prices in eastern part of Riyadh ranged between SAR 1,500 and SAR 3,600 per sqm. In the western part of Riyadh, apartments have been observed to vary from SAR 1,500 to SAR 3,000 per sqm.

Note: Please refer to page 23 for details of Riyadh zones.



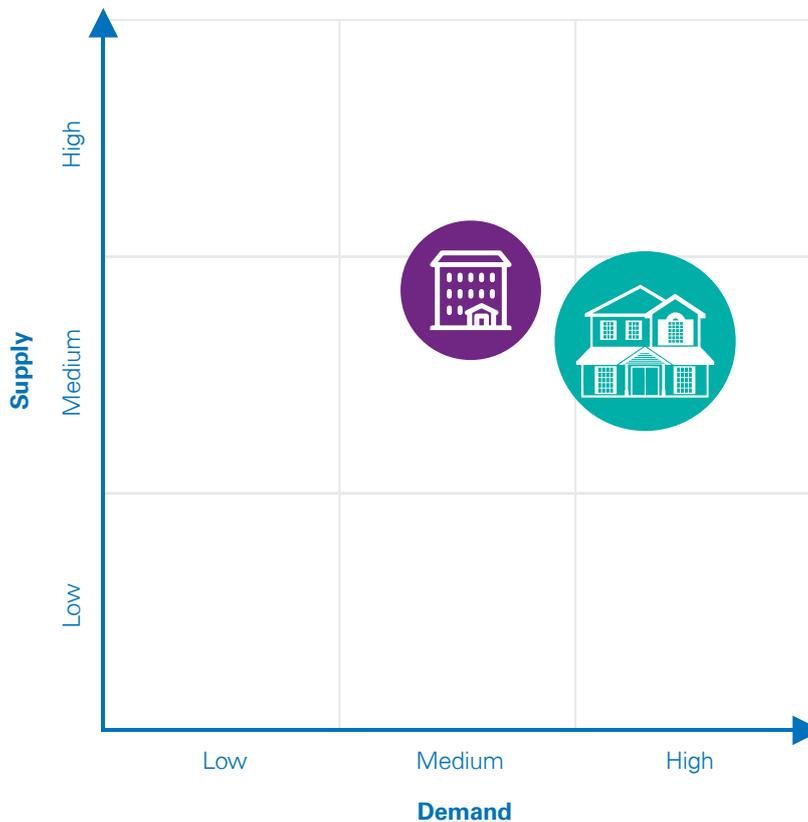
Source: KPMG Research and Analysis

Investment opportunities

Despite the current slowdown 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 and growing population, coupled with increasing urbanization and declining household size.

It is critical to note that the demand is mainly increasing for the affordable housing segment, whereas the supply is predominantly rising in the luxury or high-end segment. Hence, there exists a mismatch among the residential segment, as the demand is not being catered by offering more affordable housing units. Therefore, the MoH is targeting to bridge this gap through the development of more affordable housing projects.

The demand for villas remains high due to cultural preferences in Riyadh as seen in the figure below.



Apartments



Villas





Retail sector overview

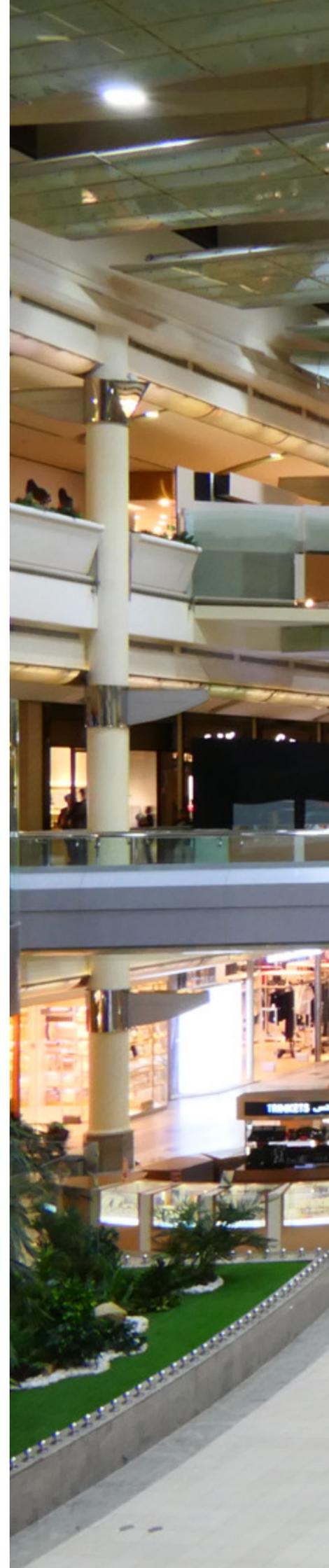
Introduction

According to KPMG research, Riyadh’s retail sector performance is leading compared with other real estate sectors. After the establishment of the Real Estate Investment Traded Funds (REITs) and other governmental initiatives, new opportunities are available in the market, therefore a lot of investors and developers have announced new projects along with the expansion of existing projects.

Consumer preferences have changed with cinemas returning to Saudi and the rise of e-commerce. Retail operators are expected to implement new methods that combine shopping with entertainment to attract more footfall to their space and distinguish their retail space from other offerings in the market.

The new address for fine dining lovers is Prince Turki Ibn Abdul Aziz Al Awwal Road, since a number of small to medium national and international cuisines and coffee shops are opening and some existing food and beverage retailers are willing to expand.

Figure 3.1: Types of retail supply





Supply

In 2018, we witnessed the opening of Riyadh Park, a super regional mall located at the intersection of Northern Ring Road and Al-Khair Street. Along with this, some community malls and strip retail centers have been witnessed in distributed areas in Riyadh.

On the other hand, some major ongoing retail developments are expected to be completed in the coming years as shown in Figure 3.1.

Riyadh's total supply of retail space in 2018 reached over 2.1 million sqm of GLA after the addition of new retail space. 2019 is expected to witness an additional supply of 320,000 sqm of GLA and by considering the upcoming retail space, we can expect that by 2019, these major retail projects will contribute around 2.4 million sqm of GLA as shown in Figure 3.2. Moreover, Riyadh's total retail space is expected to reach up to 2.7 million sqm by 2021.

Figure 3.2: Retail supply (sqm of GLA)



Source: KPMG Research and Analysis

Performance

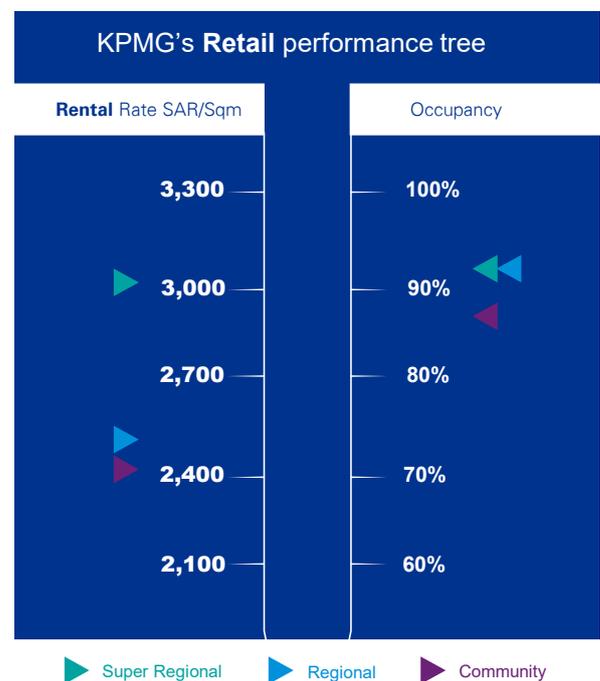
In the second half of 2018, the Ministry of Labor and Social Development (MLSD) decreased the Saudization percentage of 12 specific subsectors from 100 percent to 70 percent which will impact the retail performance in the short term.

Based on KPMG research and analysis, the market continues to be strong despite the effect it experienced from the introduction of the VAT in January 2018. On the other hand, lower consumer purchasing power led to a decrease in rental rates by 5 percent and 10 percent across different areas of the city.

Regional and super regional malls have higher rental rates than community malls because of higher footfall. Community malls rental rates range between SAR 1,000 to SAR 3,700 per sqm. By the end of 2018, average vacancy rates increased to 15 percent across all mall categories, and we expect that the rents will remain under pressure until the end of 2019.

However, we assume that the growth of the entertainment sector in Riyadh will have a positive impact on the retail sector that will strengthen the market.

Prince Turki Ibn Abdul Aziz Al Awwal Road, Northern Ring Road, King Abdul Aziz Road and Abi Bakr As Siddique Road are the new destinations for the upcoming retail developments and shopping centers.



Source: KPMG Research and Analysis

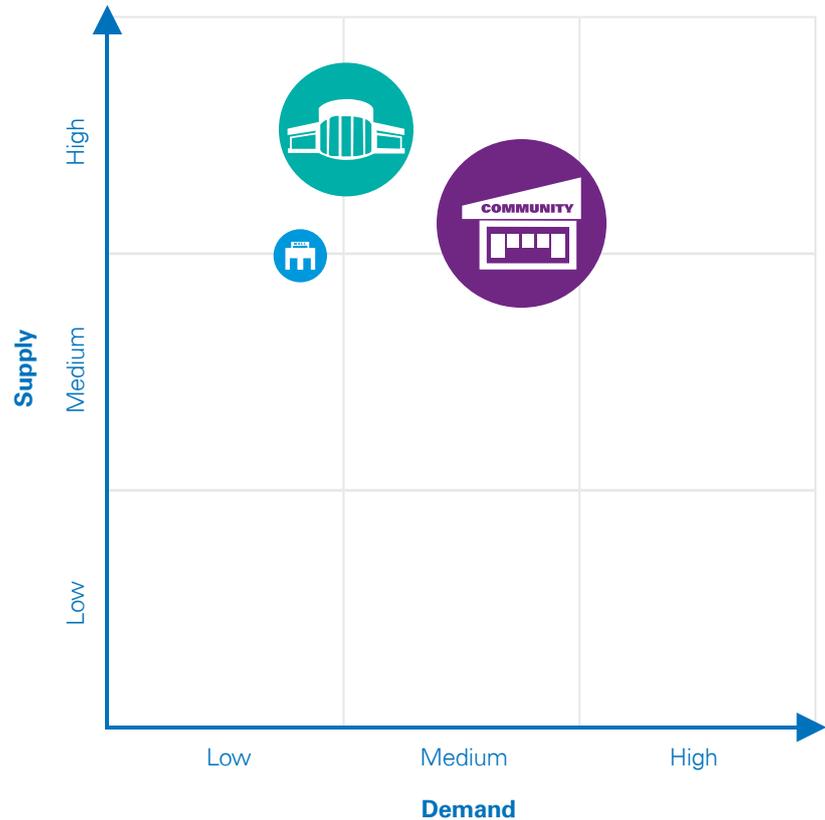
Investment opportunities

Although a high amount of retail space is expected to enter the market, there is still demand for retail space in Riyadh, particularly in newer residential areas toward the northern side of the city. This demand stems from the increasing number of international brands willing to open stores in the city since with the opening up of the economy and rising awareness of international brands within the general public, there is higher acceptance of these international brands in the market.

According to KPMG research and analysis, there is a potential for the development of community centers which can cater to the demand generated by surrounding neighborhoods. Furthermore, the development of super regional malls can also be considered for future investments but it should be equipped with modern leisure and entertainment facilities.

It is noteworthy that the size of the opportunity is small because of forthcoming supply in the pipeline, which can lead the market to an oversupply situation. In addition, current economic and market conditions should be considered before introducing any future development.

Due to the expansion of the city toward the northern and eastern sides, these locations are ideal for development of retail space primarily due to lack of quality retail offerings within the area. With new residential communities being set up, we expect the new population in the area to feed into the demand for retail space, increasing the success of any retail development in the area.



Super regional mall



Regional mall



Community mall/center



Source: KPMG Research and Analysis





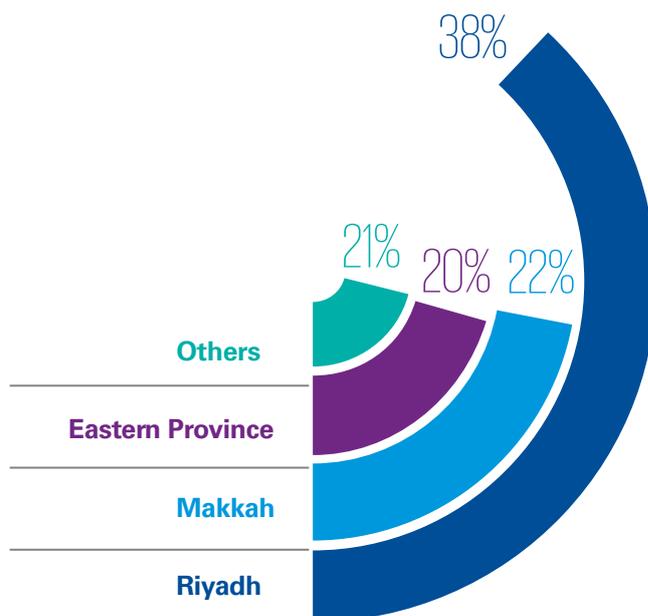
Office sector overview

Introduction

Riyadh is the most popular urban city and business hub in Saudi Arabia, holding 27 percent of the labor force and over 2 million sqm of office stock. Based on KPMG research, the following factors are expected to support the office sector in the coming years:

- One of Vision 2030's main pillars is empowerment of the private sector and enhancing its contribution to the economy.
- Saudi nationals working in the private sector coupled with influx of the expatriate workforce as Saudization is currently targeting B2C and not B2B employees who, in turn, occupy the various types of office spaces in Riyadh.
- Increasing participation of women in the workforce especially after lifting the ban on issuing driving licenses for women in the country.

Labor force distribution by province in 2018



Source: General Authority for Statistics





Supply

Historically, the growth of Grade A and B office spaces has been concentrated primarily on Olaya Street and King Fahad Road, but as a result of the lack of parking lots and increased traffic congestion, tenants are moving to other higher quality business hubs located across different parts of the city.

2019 is projected to witness a completion of 190,000 sqm of GLA to reach an office stock of 4.5 million sqm by the end of the year. Upcoming developments are scattered along different main roads predominantly in the northern side of the city such as the Riyadh Front development that includes smart offices. However, the most important upcoming office project in Riyadh is King Abdullah Financial District (KAFD) which has the potential to entirely transform the existing office market. KAFD is expected to open by October 2020.

However, post 2021, it is expected that the overall office supply would increase at a relatively lower rate than the historical rate owing to the oversupply conditions and the resulting decline in occupancies.



Performance

Riyadh Grade A office market average occupancy rate reached 82 percent in 2018. Nevertheless, since 2017, the market performance has seen a declining trend in both rental and occupancy rates due to the increase in supply while the demand has remained stable.

As soon as King Abdullah Financial District and Riyadh Front projects are completed, the current Grade A office segment will become oversupplied and unattractive to investors and developers.

In addition, we are expecting further decline in both rentals and demand for office space especially for Grade B office segment after allowing foreign investors to invest in the country. As new supply enters the Riyadh market, an increase in vacancy rates is expected to be seen.



Source: KPMG Research and Analysis

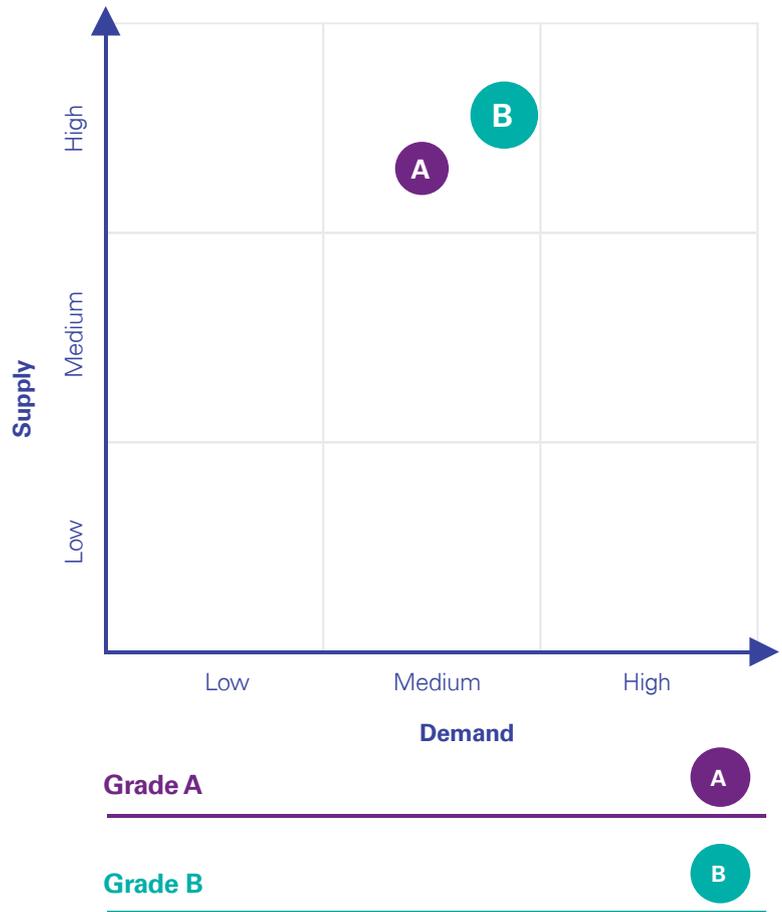
Investment opportunities

Supply has surpassed demand and led the market to be oversupplied. This trend is expected to continue due to bulk of upcoming supply, which is expected to put further pressure on the rents and occupancies.

The supply of Grade A office space in iconic developments such as KAFD and ITCC will take a considerable time to occupy the market, especially in current conditions where the international prices of crude oil are under pressure which limits the affordability of many businesses.

The market opportunity for Grade B developments is more than that of Grade A, where KPMG expects a number of tenants to relocate to Grade B offices to save costs, given the current economic conditions.

Given the expected future situation in the sector, KPMG does not recommend further investment as no development opportunities are identified for the office sector in Riyadh.



Source: KPMG Research and Analysis



Hospitality sector overview

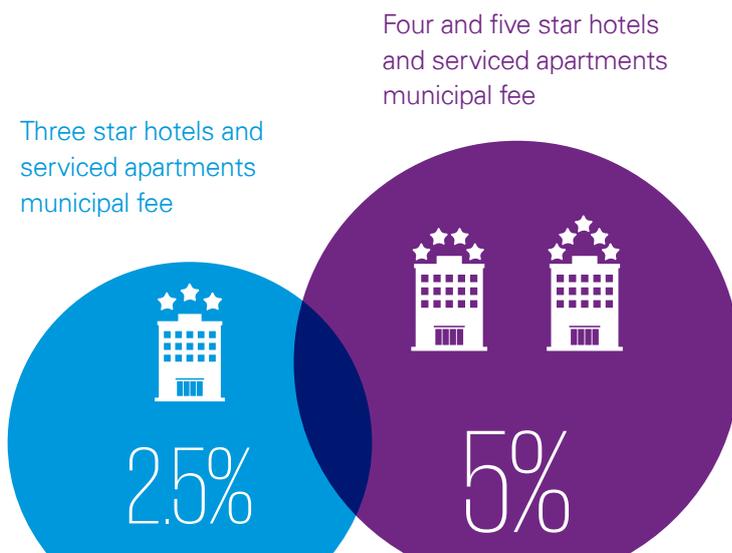
Introduction

Historically, corporate sector and business tourism were the demand drivers in Riyadh's hospitality market. After the introduction of Vision 2030, several projects related to leisure and tourism have been revealed to stimulate the economy.

Qiddiya Entertainment City, the first of its kind in the Kingdom, is expected to launch Phase One in 2022. It is located in southwest region of Riyadh with an area of 334 square kilometers, a mega entertainment, cultural, and sports project. Besides, it will soon become the world's largest entertainment city by 2030 exceeding Walt Disney in Florida.

The hospitality sector was included in applying a municipal fee which was introduced in February 2018 in Saudi Arabia, with a specific classification percentage depending on its segment as shown in Figure 5.1

Figure 5.1





Supply

Despite delays in several projects, 2018 witnessed a supply of 1,700 keys in three, four and five star hotels. These additions have brought the total supply to reach 13,500 keys in the Riyadh hotel market, and it is expected to reach 16,000 by the end of 2019 with a 20 percent increase in total supply. The future supply in the hotel market is expected to reach an increase of 52 percent in 2023 compared to the current supply.

Some of the prominent hotels that started operation in 2018 include the Marriott Hotel and Marriott Executive Apartments DQ, Radisson Blu Hotel & Residence DQ, and Hilton Riyadh King Saud University Residence. A new Marriot hotel was launched in 2018 as an airport hotel in Riyadh.

Performance

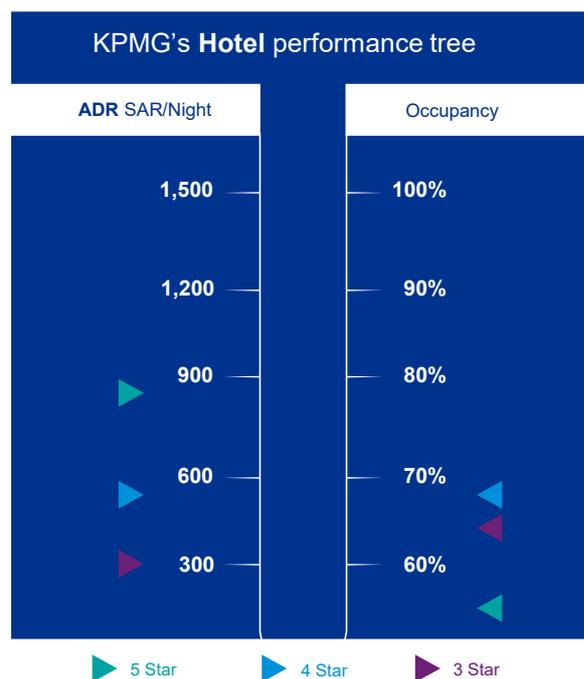
Limited improvement in performance is expected in 2019 compared to 2018, as the market has witnessed a moderate decline in both the occupancy rates and ADR while supply continues to increase.

The substantial dependence on business travel could contribute to softer performance, along with delivery of new hotel keys among the current economic slowdown.

The market observed an increase of about 6 percent in occupancy rate to reach a total of 53 percent in 2018, while ADR dropped by 10 percent, and RevPAR declined by 8 percent.

The hospitality sector is dependent on the Vision 2030 goal of increasing household spending on cultural and entertainment activities across the Kingdom, to increase the demand level from 2.9 percent to 6 percent to support local leisure travel.

Since a wide range of investment opportunities is offered in leisure and entertainment, the recovery of the real estate market in Riyadh is expected to be led by the hospitality and leisure sectors.



Source: KPMG Research and Analysis



Investment opportunities

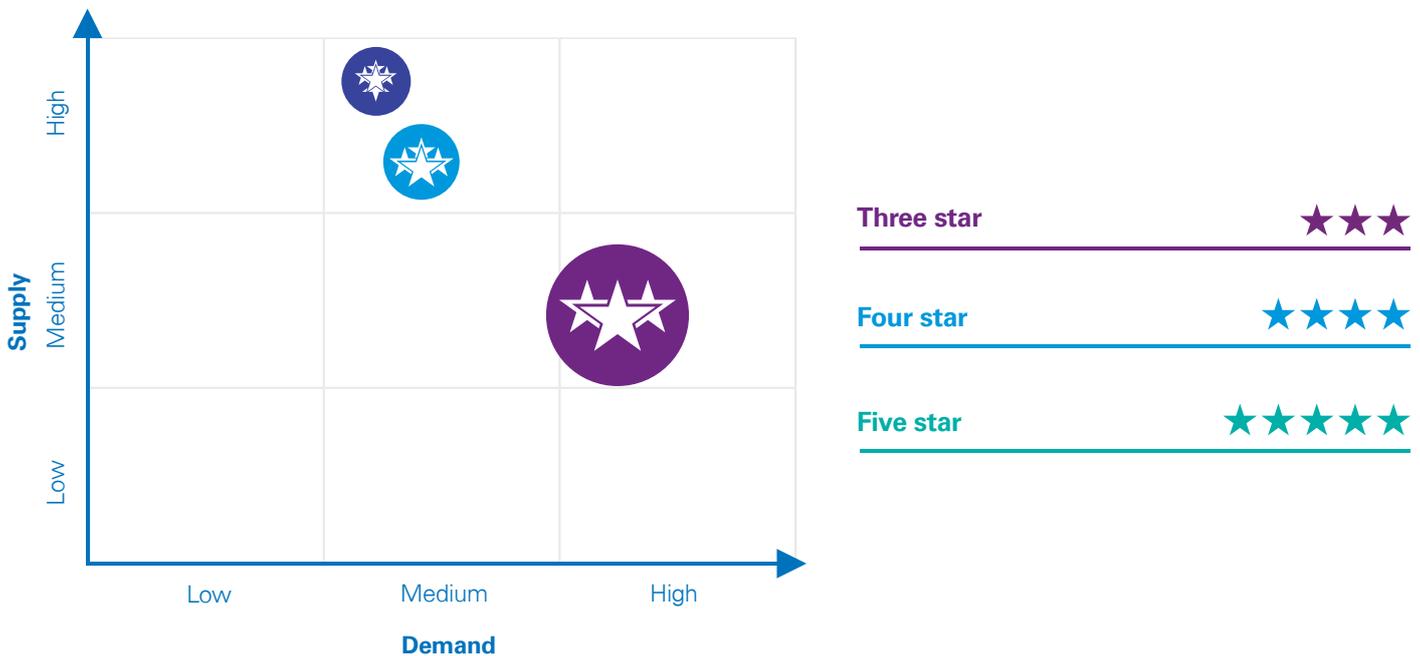
Although four and five star hotels enjoy higher ADRs, the high amount of upcoming hotels and different categories of keys within these hotels will put a downward pressure on the performance of this asset class.

Based on KPMG research, there is a shortage of three star hotels which have a high demand. All of the upcoming supply focused on four and five star hotels leaves a gap in the market for branded budget hotels.

With the increasing number of business travelers and budget constraints from companies, and given the current economic conditions, the demand for three star hotels is expected to continue growing.

Further demand stems from people who cannot afford to stay in costly four and five star hotels and choose to stay in unbranded hotels or service apartments due to lack of quality offering in this asset class.

Given the current economic conditions and shortage of supply for three star hotels, investments in this category can be considered.



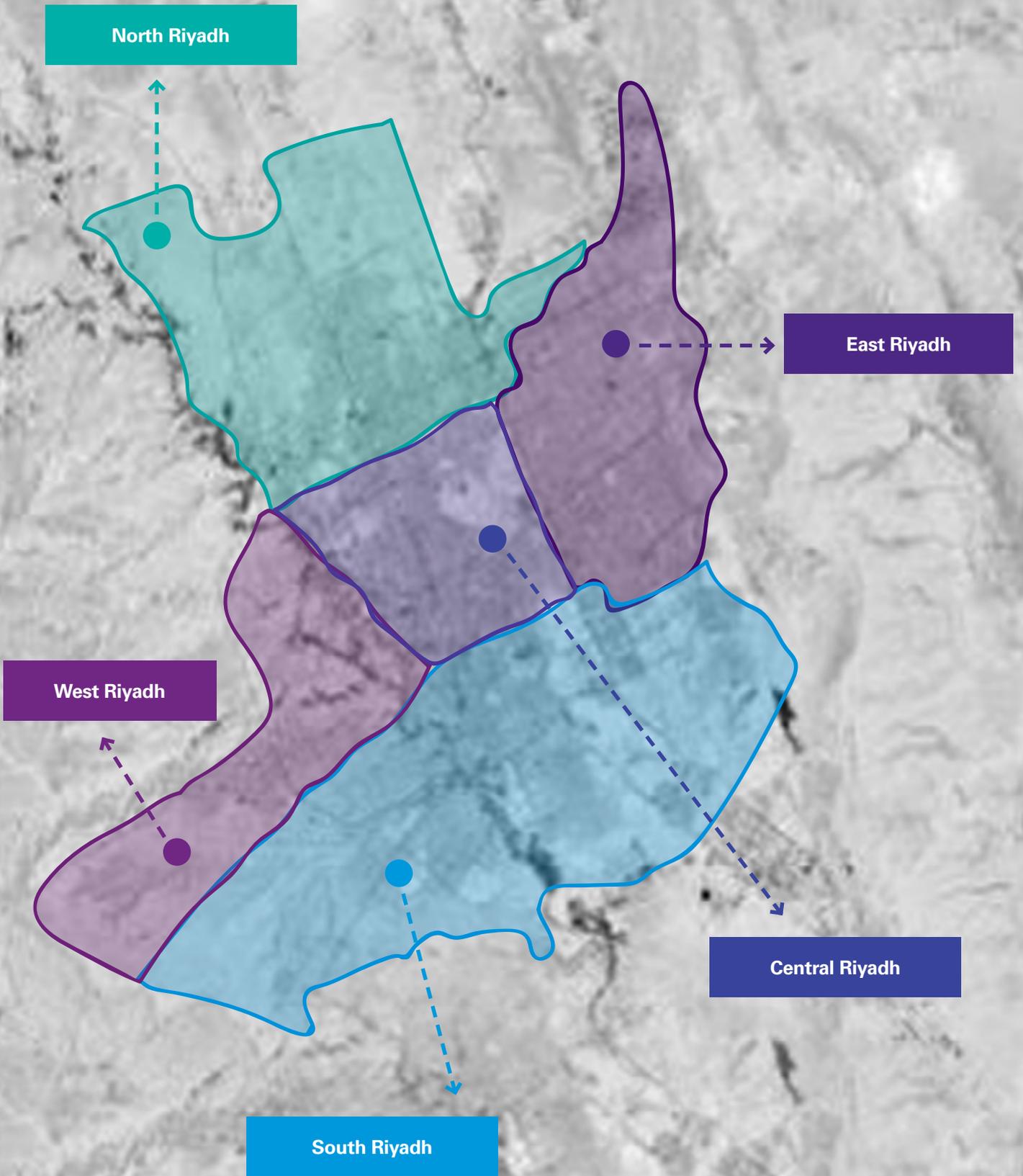
Source: KPMG Research and Analysis





Glossary of terms

Bn	Billion
CAGR	Compounded annual growth rate
GASTAT	General Authority for Statistics
EIU	Economist Intelligence Unit
MOI	Ministry of Interior
GCC	Gulf Cooperation Countries
GDP	Gross domestic product
GLA	Gross leasable area
NTP	National Transformation Program
Mn p.a.	Million per annum
SAR	Saudi Arabian riyal
Sqm/Sq.m.	Square meter
USD/US\$	United State dollar
YoY	Year on year
F&B	Food and beverage
KSA	Kingdom of Saudi Arabia
ME	Middle East
MENA	Middle East and North Africa
Sq. Km.	Square kilometer





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

01

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.

02

Financial modeling: 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

01

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.

02

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.

03

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.

04

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

01

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.

02

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.

03

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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