Jeddah real estate market overview 2018

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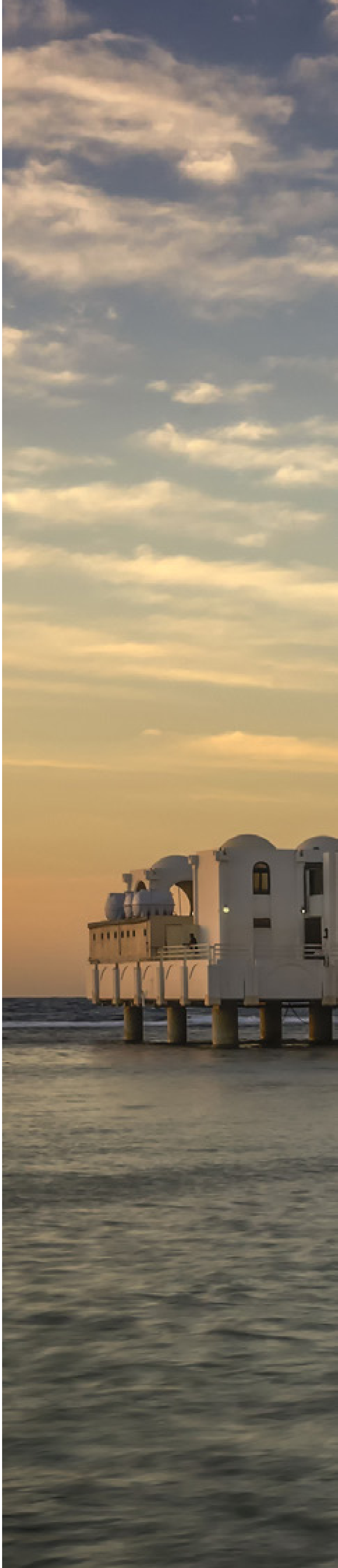
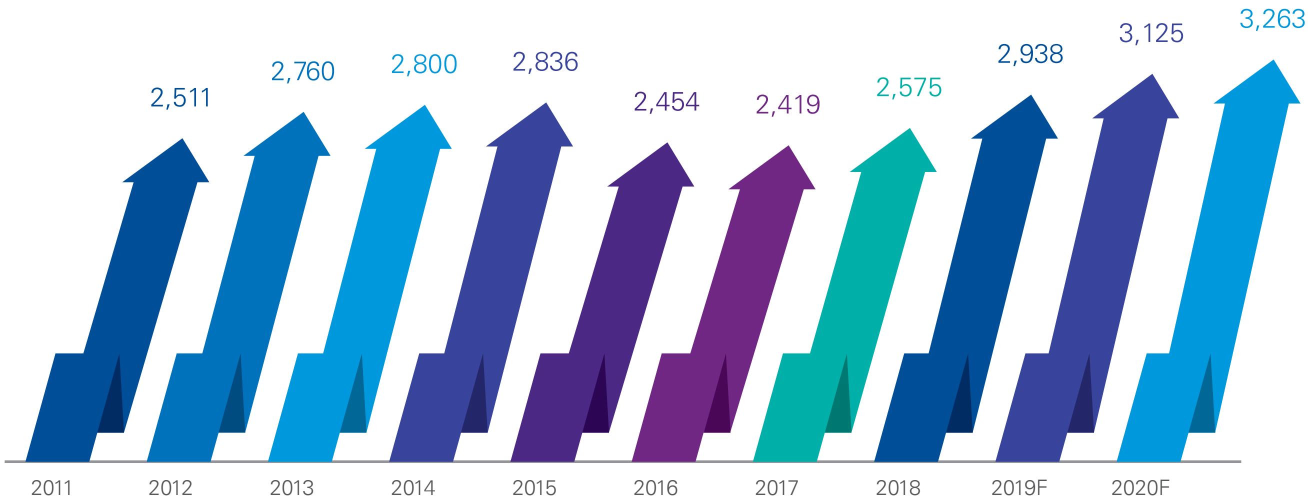


Macroeconomic overview

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.

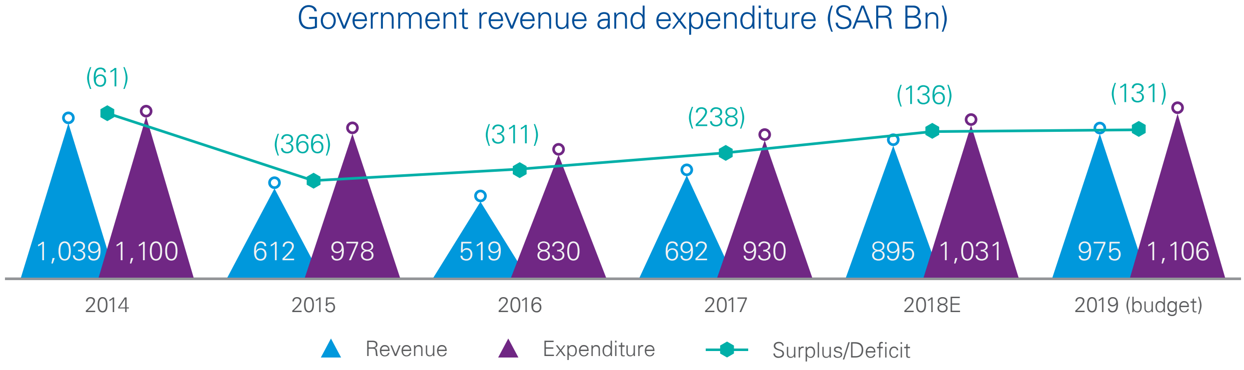
Being an important contributor to the country GDP, the real estate sector has also been impacted by the economic slowdown.

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

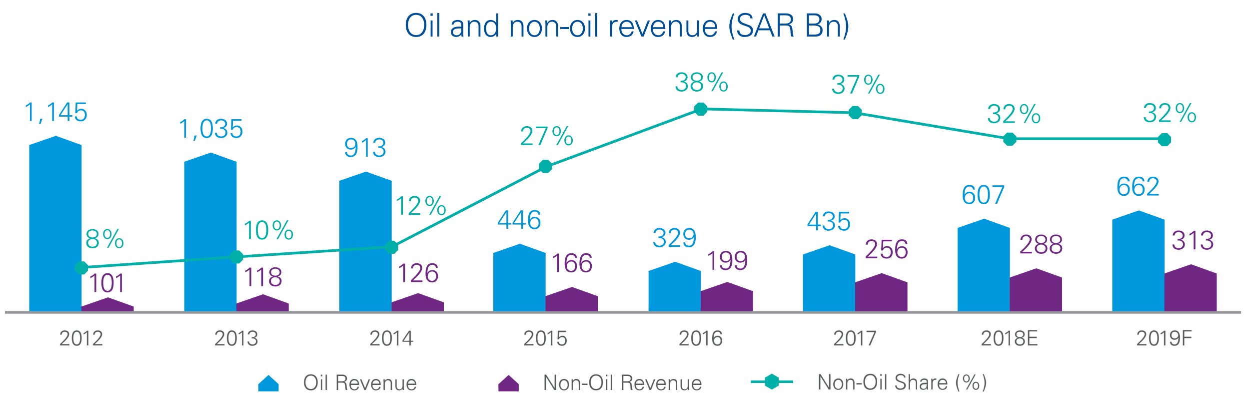


Source: Ministry of Finance

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

With a population of more than four million, Jeddah is the largest city in Makkah Province and the second largest city in Saudi Arabia after Riyadh and is also the most cosmopolitan city of the Kingdom. Jeddah, being the biggest seaport in the Red Sea, serves as the commercial capital of the country.

Jeddah has experienced a high geographical expansion toward its northern side. The accessibility to the northern side will improve upon the completion of the long-awaited Obhur Bridge, which will make the northern suburbs a more desirable destination to live.

The market is characterized with low home ownership rate that is hampered by affordability constraints, and shortage in supply of residential units targeting lower and middle-income segment coupled with a large expatriate population base that tends to stay in rented homes due to home ownership restriction, and shorter duration of stay in the Kingdom. This issue is predicted to prevail through the upcoming years.

However, improvement in the home ownership rate among Saudis remained a keystone of government initiatives in recent years. Various measures have been taken, which are expected to resolve this imbalance in the market. Sakani program is one of those initiatives taken by the Ministry of Housing to provide residential products of varied types including ready residential units, cost-free developed residential land plots, and subsidized housing loans, to the nationals.

Supply

With a current supply of about 0.81 million residential units in the city, Jeddah is expected to receive an additional supply of around 20,000 residential units in 2019–20, an addition of 2.5 percent to the current stock.

The prominent projects that dotted skyline of the city in 2018 include Abraj Al Hilal 2, Bayat Plaza, Diyar Al Salam Residence, and J One. In addition to these notable projects, the market has witnessed a significant amount of supply that is being delivered in the form of small to medium-sized projects.

Al Ra'ida Development, owned by the 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.

The market is witnessing a shift in the trend as a proportion of the middle-income housing units is significantly increasing in the forthcoming supply. Majority of these developments are located toward the northern side of the city.

Performance

Villas

Similar to the previous years, the sale prices and rental rates of villas continued to decline in 2018, mainly due to cautious behavior from investors and end-users, resulting in a considerable drop in activities in the segment.

During 2018, the market witnessed a decline of 6–8 percent in sale prices, while the rental rates plunged with a relatively higher ratio. We expect this current market condition prevailing in the short to medium terms.

Based on KPMG research, the western side of the city commands the highest sale prices and rental rates, followed by the northern and eastern sides.

The sale prices of villas located on the western side range from SAR 5,000 to SAR 8,000 per square meter, while medium-sized villas can be rented between SAR 120,000 and SAR 140,000 per annum, depending on their size, location, accessibility, quality of construction, age of building and proximity to commercial areas, among others.

Source: KPMG Research and Analysis

Apartments

Jeddah apartment segment has softened further and both rental rates and sale prices witnessed a decline of 8–10 percent in 2018.

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 sale price of a standard apartment located in the eastern side observed a price range of SAR 2,500 to SAR 4,000 per square meter. Apartments in the south command a capital value between SAR 2,000 and SAR 2,800 per square meter, whereas sale prices in the western side range between SAR 5,000 and SAR 6,500 per square meter. Limited presence of apartments has been observed in the northern part of the city, particularly toward north of Obhur Creek.

Source: KPMG Research and Analysis

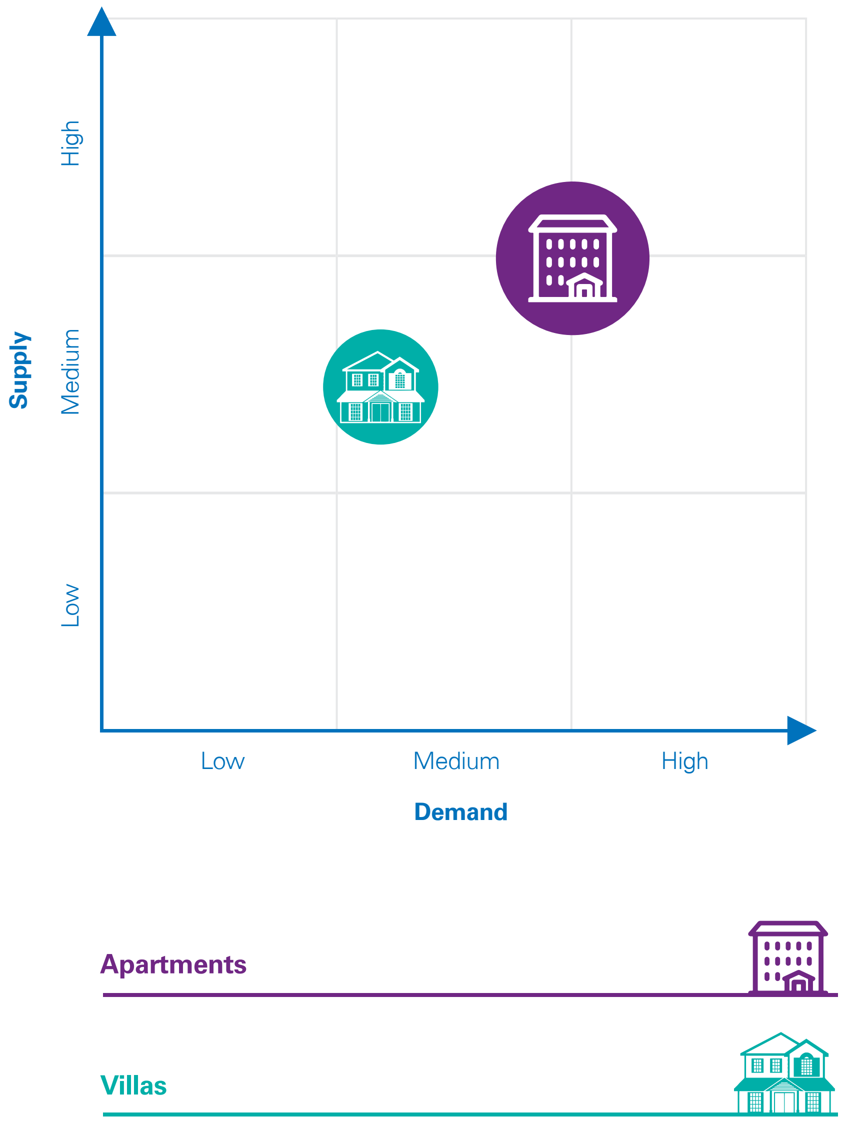
Note: Please refer to page 23 for details of Jeddah zones.

Investment opportunities

Despite the current slowdown in the market and subdued performance during the last couple of years, it is worth mentioning that the market drivers seem to be positive for the long term, backed by the favorable demographic, and government's focus on the real estate sector as part of the diversification process.

The demand for apartments and small-sized villas/duplexes is expected to remain high as compared to large-sized 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.

Moreover, the residential community concept (semi-gated complexes) is getting market acceptance and recently completed fully-integrated communities such as J One and Diyar Al Salam Residence are enjoying healthy occupancy rates. We further expect the delivery of such developments in the short to medium term.



Source: KPMG Research and Analysis

Retail sector overview

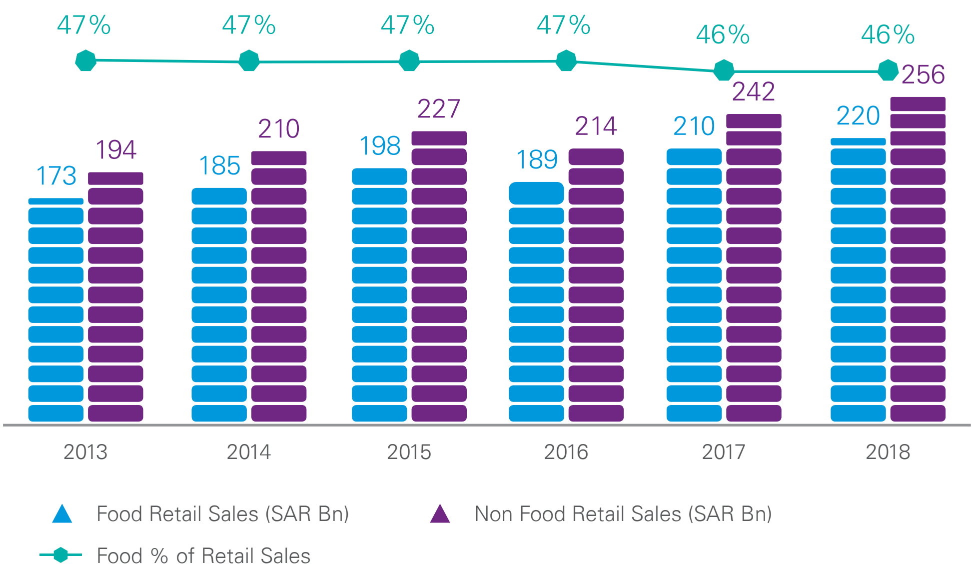
Introduction

Increasing urbanization trend, favorable demographics, and westernized consumption patterns are playing key roles in transforming the retail market of Saudi Arabia. The market has witnessed a shift from independent high street retail units toward new destination shopping centers. Whereas, cinemas, F&B, and entertainment facilities are the hot topics of shopping centers and will play a greater role in malls' performances going forward.

Despite witnessing a decline in 2016, retail sales grew at a CAGR of 5.3 percent between 2013 and 2018. As depicted in the below chart, it is almost equally divided between food and non-food sales and this trend is anticipated to prevail during the foreseeable future.

Jeddah's retail market is benefiting from a high population base, elevated disposable income, and changing lifestyle. We expect the demand for quality retail space in Jeddah to continue rising. However, retail operators need to implement new methods that combine shopping with entertainment to attract more footfall to their space and to distinguish their retail space from other offerings in the market.

KSA retail sales (SAR Bn)



Source: EIU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Mall of Arabia

Supply

Jeddah's current retail supply is estimated at 1.41 million square meters of organized retail space, which includes recent completions such as Al Marwa Plaza, second expansion of Red Sea Mall, and Marina Avenue. Whereas, the organized retail supply in the city is dominated by super regional malls.

The market is anticipated to witness the delivery of much higher retail space in the coming 2–3 years given the delay in under construction projects, which were scheduled to be delivered in 2018 coupled with other forthcoming projects.

Approximately 400,000 square meters of organized retail space is expected to be delivered during this time. The Jeddah Park and King Avenue Mall are the most prominent forthcoming projects.

Other under construction projects including Obhur Mall, Atelier Lavie, and Sunset Avenue will also be adding to the quality retail space, once completed.

Performance

The Saudization drive in the retail sector, in line with the Saudi Vision 2030, will bring benefits to Saudis and the national economy by creating more business and job opportunities for the nationals. However, it is pertinent to mention that the market will take some time to absorb this change as we have observed the closure of many street-facing strip retail shops, which were being run by the expatriates.

After witnessing a subdued performance during last couple of years, Jeddah's organized retail market showed signs of stability in 2018 where retail rents and occupancies remained generally unchanged. However, rentals for regional malls have experienced a modest decline of 4–5 percent owing to the decreasing demand for this asset class.

This relatively stable performance by the organized retail segment can be attributed to the limited supply delivered last year. However, new upcoming supply (if delivered as announced) is likely to put pressure on the rental rates.

Regional and super regional malls have higher rental rates than community malls because of higher footfall. The rental rates of community malls range between SAR 1,800 per square meter and SAR 2,400 per square meter, while the rental rates for super regional malls range between SAR 2,700 per square meter and SAR 3,500 per square meter.

Source: KPMG Research and Analysis

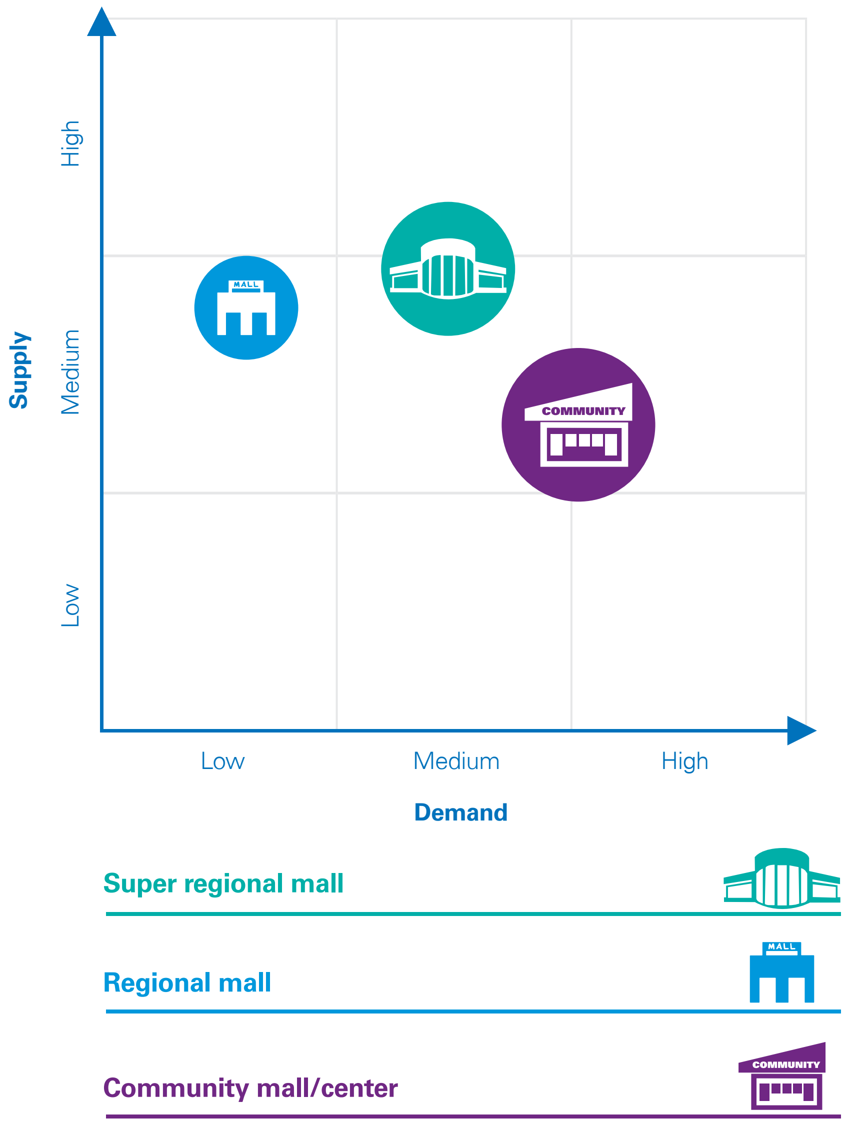
Investment opportunities

Mixing up retail with other real estate components such as hotel, office or residential could be a commendable idea to generate certain footfall. Following the success stories of Red Sea Mall and Andalus Mall, upcoming Jeddah Park and King Avenue Mall will be mixing retail with a hospitality component.

Due to the expansion of the city toward the northern and north-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. Even though the population density in these areas is relatively low, it is anticipated to be temporal given the growth of the city.

We still see an opportunity in developing super regional malls that can serve as destination malls, equipped with advanced entertainment facilities, and vast range of F&B offerings. However, the size of the opportunity is small because of the forthcoming supply in the pipeline.

Additionally, there is a potential for the development of medium-sized community malls that cater to the demand generated by surrounding neighborhoods, and duly occupied by brands needed in that particular area.



Source: KPMG Research and Analysis

Office sector overview

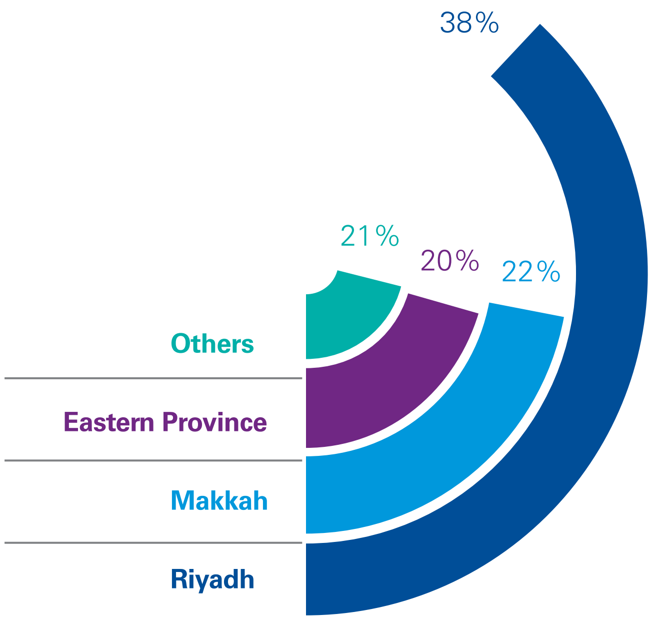
Introduction

The government's success in diversifying the economy and encouraging investment programs in non-oil sectors to enhance sustainable and strong economic growth is expected to strengthen the economic base, increase the country's labor force, empower the private sector, and subsequently result in increased long-term corporate demand for office space.

Jeddah, being the second most populous urban city, remains the major business hub of the western region, where it has experienced a sustained growth in the business sector over the past decades.

The implementation of various urban regeneration initiatives, including mixed-use communities such as Jeddah Downtown and large-scale infrastructure projects such as new King Abdulaziz International Airport, are expected to upsurge the demand for office space in the city by generating the additional jobs.

Labor force distribution by province in 2018



Source: General Authority for Statistics

Supply

Jeddah's office market can be characterized as having a polycentric typology with office buildings scattered with no defined primary CBD. Office buildings are mostly located on arterial roads like Tahlia Street, Sari Street, Prince Sultan Street, Madinah Road, King Abdullah Street, King Abdul Aziz Road, and others.

A large proportion of Jeddah's office stock is of Grade B quality, which leaves unmet demand for reasonably priced Grade A office spaces in the city. However, considering the forthcoming supply, we anticipate a measured shift of the supply composition toward Grade A office spaces.

The current stock of Grade A and Grade B office spaces is estimated at 1.1 million square meters that includes recent completions such as Ibrahim Center, Randa Tower, Lilian Towers, and Rovan Plaza.

Furthermore, it is expected that more than 100,000 square meters of quality office space is due to enter the market in the short term and is expected to be delivered in the form of small to medium-sized projects.

Nevertheless, in the medium to long term, the market is set to witness a delivery of relatively bigger projects including King Avenue, Al-Rawdah Complex, and Jeddah Gate that will deliver high-quality office spaces. However, it is noteworthy that the market might observe some delay in the forthcoming projects owing to the current market conditions.

Performance

The Jeddah office market continued to soften in 2018 and observed a diminishing trend in both occupancy and rental rates mainly because of subdued economic conditions coupled with the oversupplied situation of the market.

The landlords are showing flexibility and offering more incentives to attract and retain tenants owing to the tenant-friendly market dynamics.

The rental rates of Grade A offices observed a moderate decline of 4–5 percent, while Grade B rents have witnessed a higher drop of more than 10 percent. This relatively stable performance of Grade A offices is mainly because of lack of high quality stock.

As supply is continuously increasing and the same trend is expected to be followed in the short to medium term, we anticipate that rentals will remain under pressure. Grade B office buildings that are located on secondary roads are expected to witness a significant drop in rental and occupancy rates.

It is worth mentioning that the government's initiatives to bring foreign investment to the country, encouraging nationals to work in the private structure as well as forthcoming infrastructure and other mega developments are likely to support the demand for office spaces.

Source: KPMG Research and Analysis

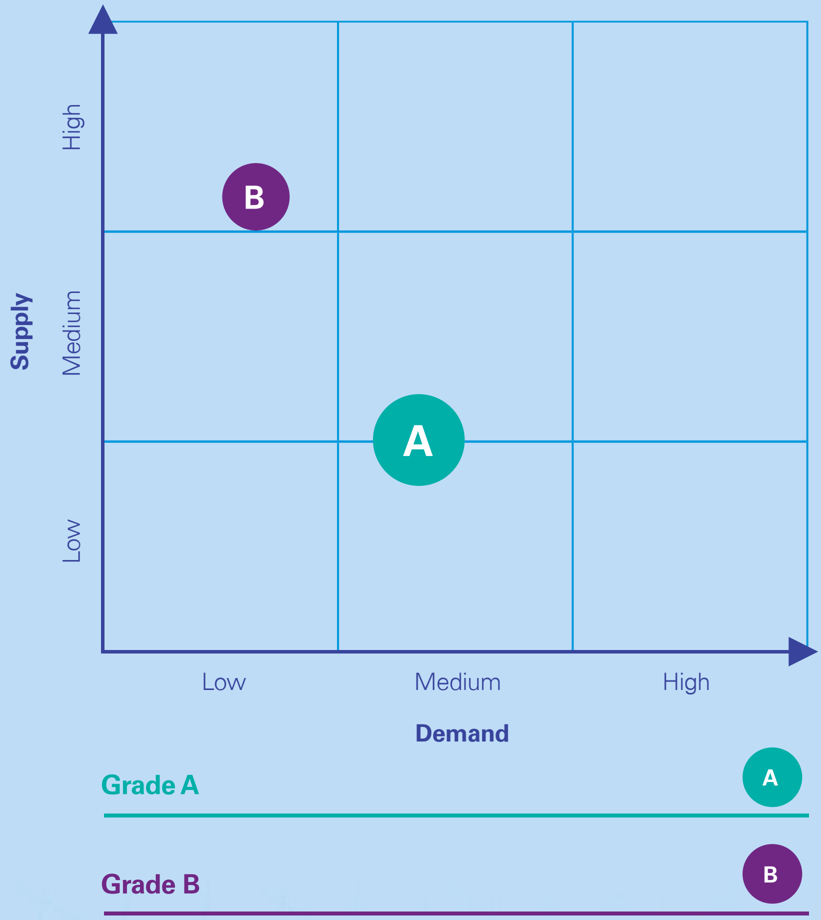
Investment opportunities

Supply has surpassed the demand and led the market to be oversupplied. However, new transport infrastructure developments in Jeddah are paving the way for a more connected city, which along with other mega developments could positively impact future office demand.

As mentioned earlier, the supply is dominated by Grade B office developments with limited supporting amenities. Any additional supply might result in further reduction of rents and occupancies as Grade B office developments do not command the same demand levels as of Grade A.

An opportunity exists in introducing Grade A office space and business parks with small office units, featuring enhanced amenities and services such as onsite retail and F&B. Moreover, development of Grade A office spaces 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.

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



Source: KPMG Research and Analysis

Hospitality sector overview

Introduction

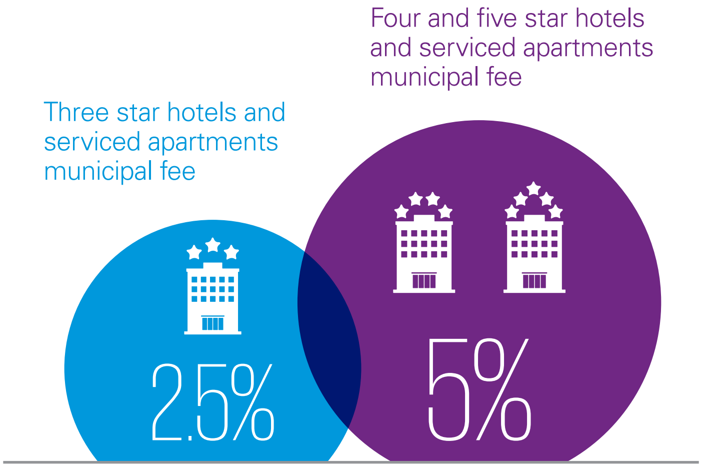
Despite a challenging environment during the last couple of years, the direct contribution of travel and tourism to GDP surged at a CAGR of 5.1 percent between 2012 and 2018, reflecting the strong demand fundamentals of the sector.

The Ministry of Municipal and Rural Affairs has levied a municipal tax on occupied rooms ranging between 2.5 and 5 percent, depending on the property class. This will mainly impact domestic tourists with comparatively weak spending power.

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 number of tourist trips are increasing at a healthy pace and are expected to continue rising over the coming years, given the initiatives being taken by the government including airport expansion, Haramain Railway, and investment in upgrading the leisure offerings.

Jeddah features a number of local festivals arranged by the Saudi Commission for Tourism & National Heritage, which generates significant interest from domestic tourists.



Supply

The Jeddah hospitality market is hosting more than 11,300 keys of three, four and five star hotels, where the wider portion of existing supply, particularly four and five star properties, is clustered in the central and western sides of the city. It is pertinent to mention that the majority of upcoming developments promised to be delivered in 2018 have been delayed and are expected to be delivered during 2019–20.

Some of the noticeable hotels that started operations in 2018 include Centro Salamah on Madinah Road, Salsabil by Warwick Hotel located on King Abdullah Road, and Radisson Blu Hotel & Residence on Corniche Road.

Going forward, the city's market is likely to witness the delivery of more than 4,000 hotel keys in the coming 2–3 years, which will increase the current hotel stock by 35 percent. The prominent forthcoming hotel developments include Raffles Jeddah, Swissotel Jeddah, and Fairmont Jeddah Hotel & Resort, among others.

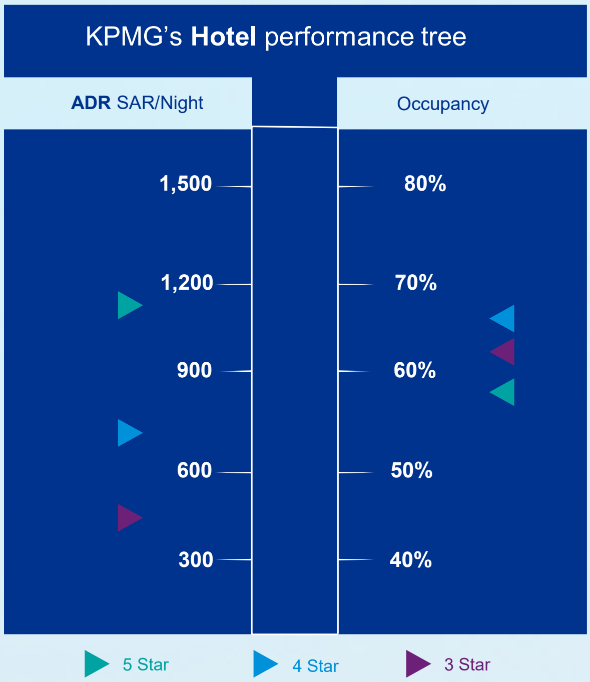
Performance

The hospitality market of Jeddah showed an upward trend in KPIs in 2018, after witnessing a dwindling performance during 2016–17. This is mainly driven by an increase in tourist trips coupled with limited supply during this time period.

During 2018, ADRs got unpurged by a healthy growth rate of 8–10 percent, however, occupancy rates remain stable with minimal variance.

The highest ADRs are commanded by five star hotels due to the brand positioning and service offering, which include state-of-the-art facilities, swimming pools, and business centers. At the same time, four star hotels have the highest occupancy rates.

The market is expected to remain subdued in the short term owing to the bulk of supply due to deliver in 2019. However, in the long term, the market is expected to witness a steady performance backed by the government's initiatives to support the development of culture, leisure and entertainment projects in Jeddah. Furthermore, the growing number of pilgrims will have a positive impact on the hospitality market of Jeddah.



Source: KPMG Research and Analysis

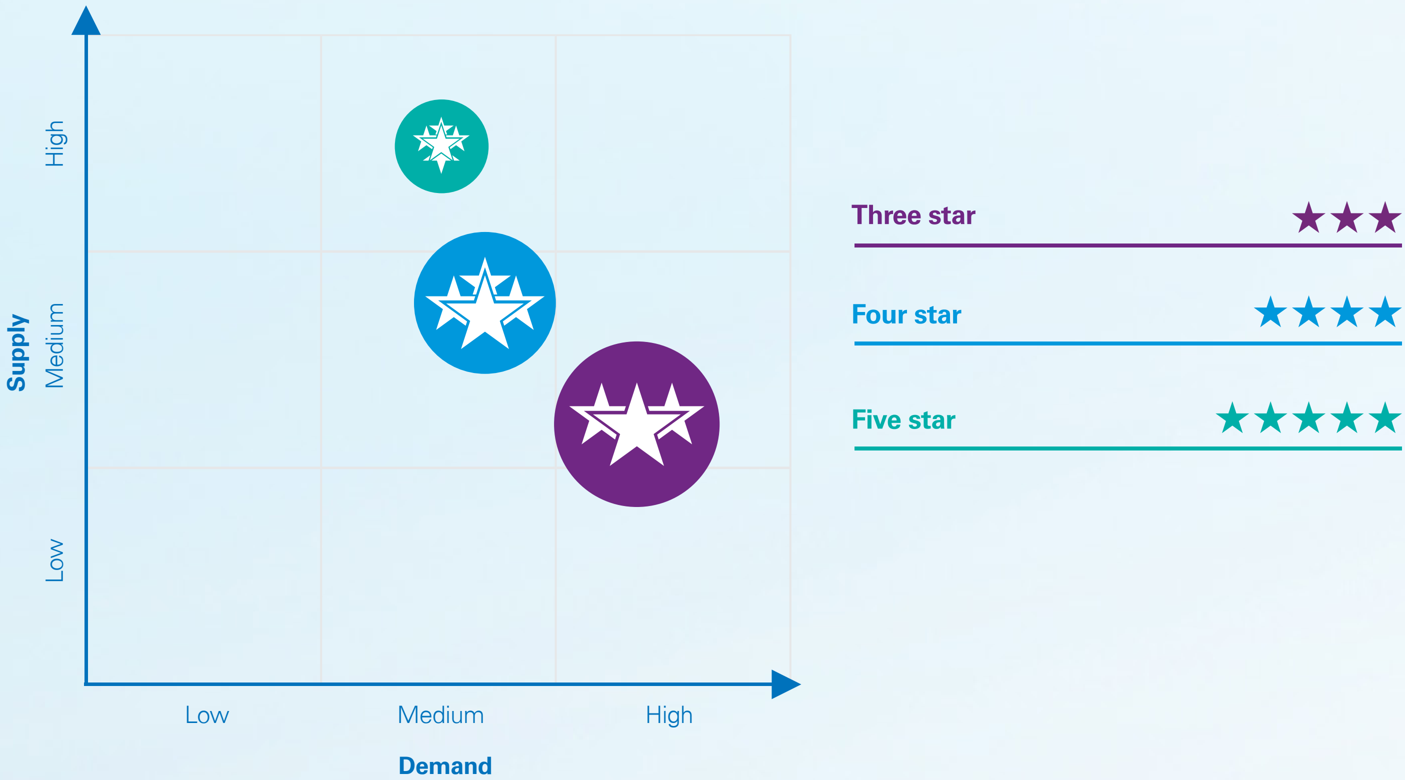
Investment opportunities

Despite the forthcoming supply that will put a downward pressure on the performance in the short term, we believe that the demand for hospitality units in Jeddah is likely to remain robust due to which the market is expected to recover in the medium to long term.

Mixing up a hospitality development with other real estate components such as retail, office or residential could be a commendable idea to secure certain occupancy.

Although five star hotels enjoy higher ADRs, we are expecting a diminishing trend in occupancy rates and ADRs mainly due to increased competition in the upscale segment.

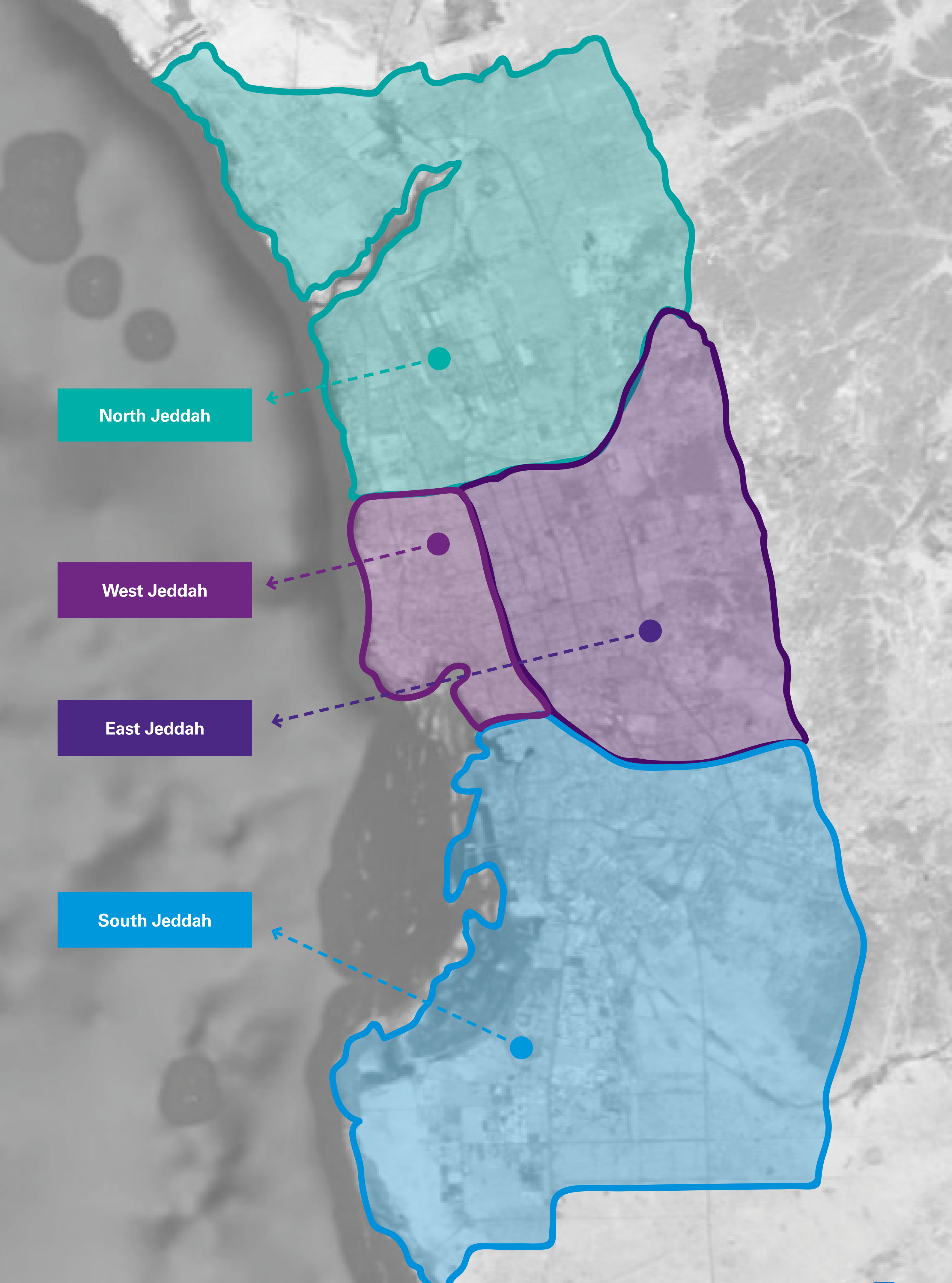
With increasing number of leisure and business tourists, and stopover travelers, four star and branded three star budget hotels present an excellent investment opportunity, which can be explored further.



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


North Jeddah
West Jeddah
East Jeddah
South Jeddah

KPMG Real Estate Services

KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We have more than 207,050 outstanding professionals working together to deliver value in 154 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 1,142 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 pried.

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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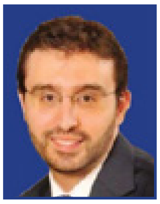

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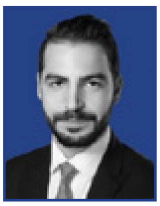

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