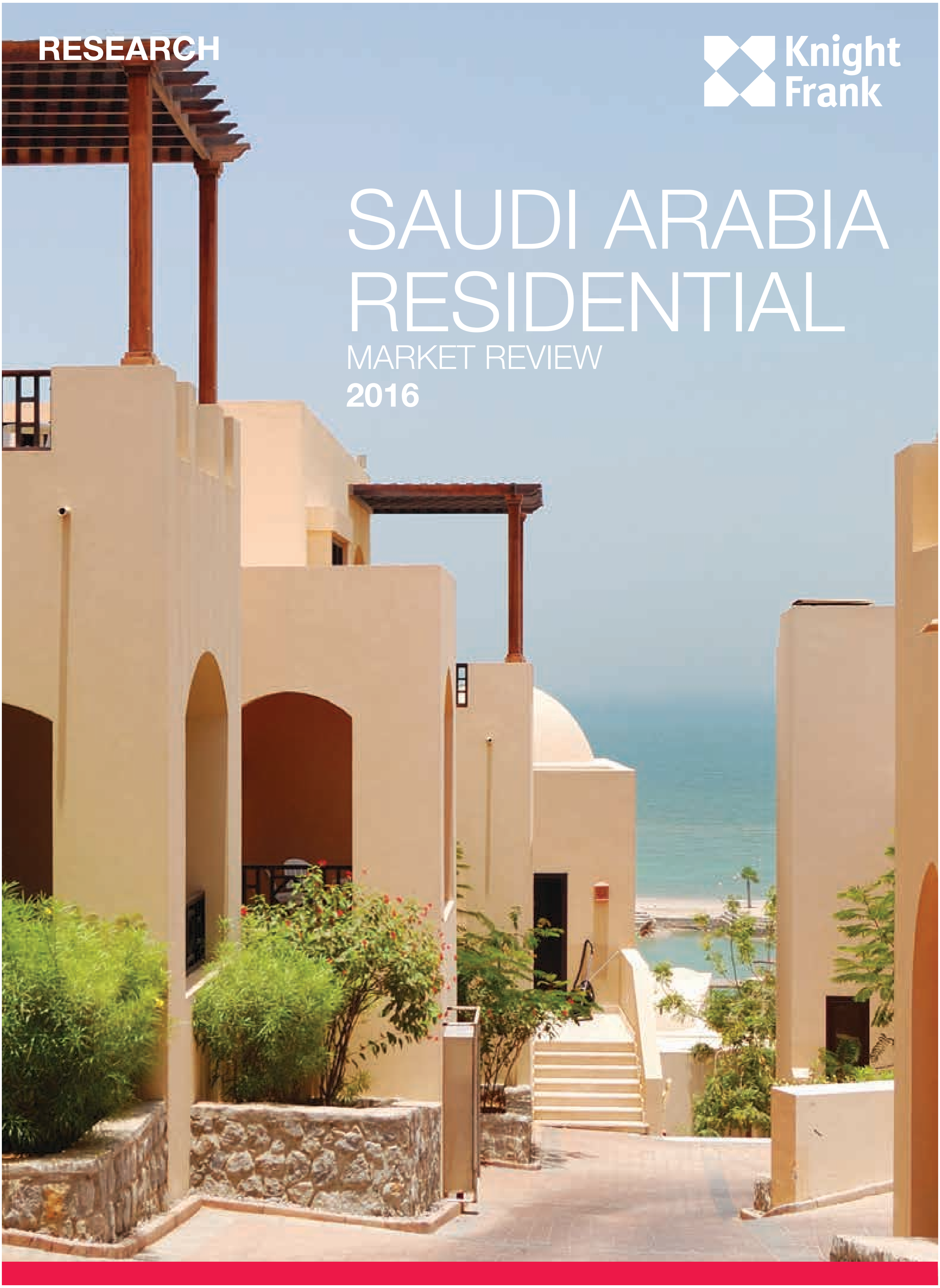
RESEARCH

Knight Frank

# SAUDI ARABIA RESIDENTIAL

## MARKET REVIEW

**2016**



## KEY FINDINGS

The residential market across the main cities of Saudi Arabia (Riyadh, Jeddah and the Eastern Province) has seen a shift in demand for property from sales to rentals.

Given limited affordability and the low penetration of home financing, demand for rental property increased in 2015 thus strengthening rental rates across the Kingdom. Rents are expected to maintain their growth levels in 2016, albeit at a slower rate. The decision to impose a 2.5% white land tax on undeveloped property, in addition to revisions in the mortgage law (increasing the loan-to-value ratio to 85%) are expected to revive demand for the sales market across the Kingdom in 2016.

2016 is expected to see a more selective approach to the development of residential real estate projects. Lower oil prices, reduced market liquidity and a tightening budget are likely to see the re-prioritisation of projects, with direct emphasis on the delivery of affordable housing and other critical infrastructure. Currently, the Ministry of Housing has a total of 187 affordable projects in its pipeline, providing 233,651 units.

Please refer to the important notice at the end of this report.

# MACRO ECONOMIC OVERVIEW

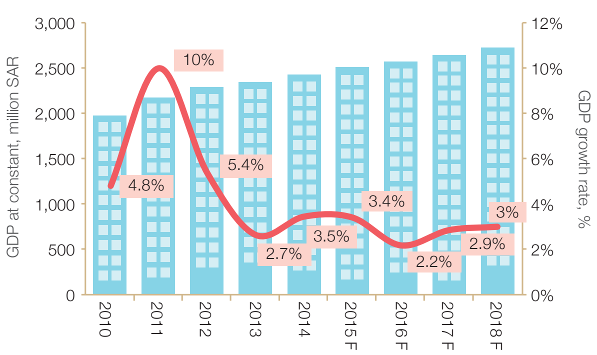
Despite maintaining healthy GDP growth levels in 2015 (3.4% as forecasted by the IMF), the impact of lower oil prices is expected to trickle into 2016 as Saudi Arabia's annual growth rates are forecast to slow down to 2.2%.

On the back of challenges witnessed in 2015, namely the drop in oil prices, the residential sector in Saudi Arabia continued its slowdown in 2016, with transaction volumes and sale prices declining at a slower rate.

Coupled with mounting geopolitical tensions, the Saudi government announced a 14% decline in its spending throughout 2016. In tandem, energy subsidies were cut and plans to introduce a Gulf-wide sales tax have been discussed.

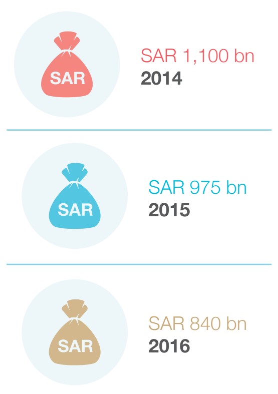
Although we see subsidy reform as essential to turn the economy into a more efficient and productive state, we are wary of the impact this will have on the cost of living. Saudi inflation rates increased from 2.3% in December 2015 to 4.2% in February 2016. As households' real disposable income is expected to erode, this is likely to weigh in on consumer spending.

FIGURE 1
**Saudi Arabia GDP - constant prices** (2010 = 100)




**Sources:** Saudi Arabia Monetary Agency / IMF — GDP — GDP % growth

FIGURE 2
**Government spending**

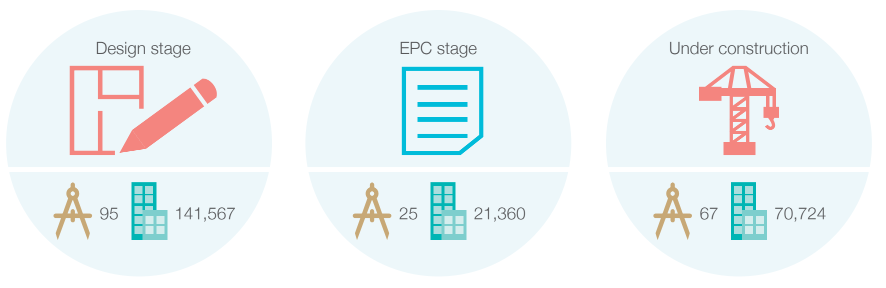



**Source:** KSA Ministry of Finance

While the backdrop appears negative in the short-term, the situation is expected to see authorities push ahead with diversification efforts in order to increase revenues from the non-oil sector. Already in 2015 the Saudi stock market (Tadawul) published regulations allowing for direct foreign investments in listed shares. The Saudi Arabian General Investment Authority (SAGIA) also announced it will allow 100% ownership of retail and wholesale businesses.

More recently, Saudi Arabia approved a strategy to restructure its economy in a bid to reduce the Kingdom's dependence on oil. The National Transformation Plan called on efforts to promote diversification and the privatisation of state assets (namely Saudi Aramco). The 15-year blueprint included the creation of a USD 2 trillion Saudi sovereign wealth fund, developing the tourism market as a key revenue generator, and focusing on social aspects such as job creation, as key drivers for the new policy.

FIGURE 3
**Affordable housing projects from ESKAN**




**Sources:** Ministry of Housing, ESKAN — No. of projects — No. of units

# SECTOR OVERVIEW

Emphasis on the housing sector in the Kingdom has been the keystone of the government's initiatives following the Arab Spring in 2011. Since then, various regulatory efforts at improving accessibility to real estate have come underway.

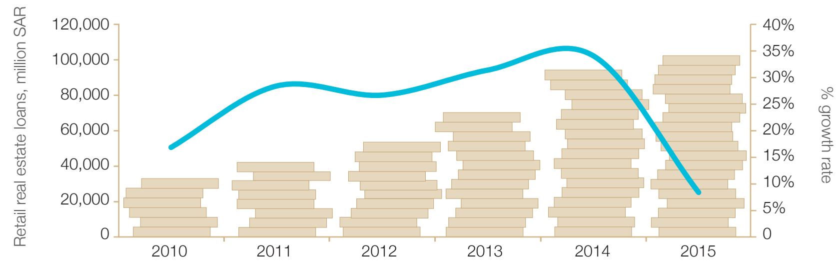
- Announced plan to construct 500,000 affordable housing units
- Ministry of Housing launches a housing scheme 'ESKAN'
- Formation of a real estate financing company to improve access to finance
- Restructuring & recapitalisation of the Real Estate Development Fund (REDF) to target low income households
- Introduction of a mortgage law to boost Saudi Arabia's home ownership rate

While these efforts are a step in the right direction, the policies are only slowly filtering through. Data from the REDF reveals that while real estate loans trended up sharply from 2012 - 2014, the rate of growth slowed throughout 2015. The decision to set the loan-to-value ratio at 70% (in December 2014) priced out middle-income households who were unable to afford the 30% down payment, and thus the retail real estate loans grew by a mere 8% in 2015 versus 34% in 2014.

More recently, Saudi Arabia's Central Bank raised the maximum loan-to-value ratio to 85%, a measure expected to increase demand for housing loans in 2016. These measures aimed at addressing accessibility to housing, however, are faced with an ongoing shortage in housing supply. While the approval to levy a 2.5% white land tax on undeveloped land plots within urban boundaries is expected to encourage the development of more projects, the impact of this is yet to be seen.

Meanwhile, the reduction in government spending is likely to impact the financing of real estate projects. Delays and scaling back of many real estate and infrastructure projects will further exacerbate the shortage of housing across the Kingdom

FIGURE 4
**Residential real estate loans**




**Sources:** Saudi Arabia Monetary Agency / Real Estate Development Fund — Retail real estate loans — % growth

"While the approval to levy a 2.5% white land tax on undeveloped residential and commercial plots within urban boundaries is expected to encourage the development of more projects, the impact of this is yet to be seen."

DANA SALBAK
**Associate Partner, Research**

# RIYADH

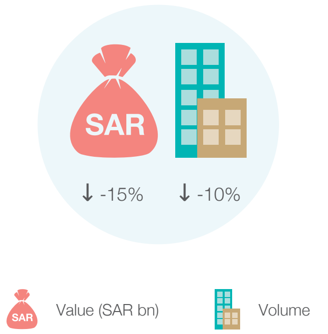
In terms of supply, Riyadh has seen rapid growth in its urban limits over the past five decades.

Demand in Riyadh continues to be concentrated at the mid-to-lower end of the market which has traditionally been overlooked by developers due to lower development margins. Assuming consistent household income levels, this trend is expected to continue into the future as Riyadh's population is estimated to grow at 2% per annum over the next couple of years (2016 - 2018). While measures are being considered to address this dynamic, concerns remain over the capacity of the development pipeline and the type of product that is being delivered to the market.

In terms of supply, Riyadh has seen rapid growth in its urban limits over the past five decades. Due to the affordability of land in locations further away from the city centre, the majority of development continues to take place beyond King Salman Road and towards the north of the city.

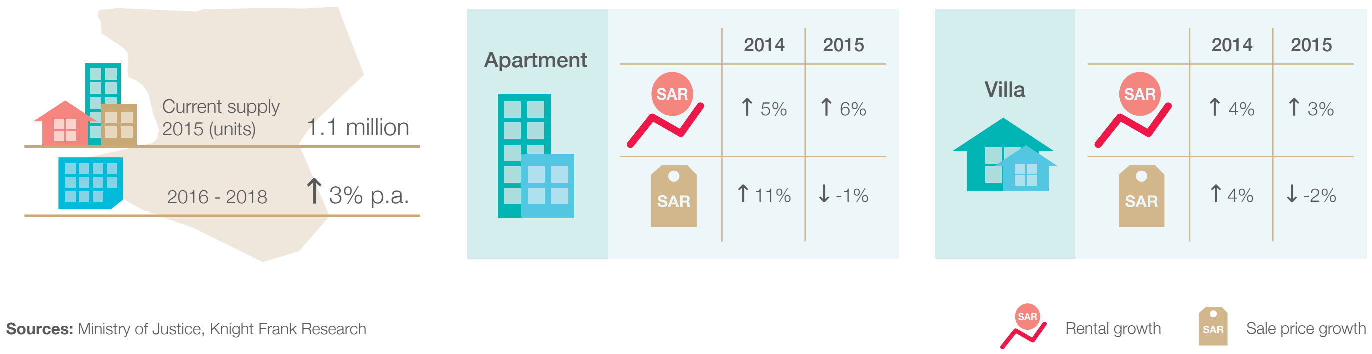
Strong demand for rental property in Riyadh saw rental rates increase across the city. Meanwhile, average sale prices remain subdued as annual growth rates slowed. This is further illustrated by transactional data from the Ministry of Justice (MoJ) which shows an annual 10% decline in the number of residential transactions in Riyadh (Q1 2016 versus Q1 2015).

FIGURE 5
**Riyadh's % change in the volume and value of residential transactions**
(Q1 2016 vs. Q1 2015)




**Source:** Ministry of Justice

FIGURE 6
**Riyadh supply growth rate**




**Sources:** Ministry of Justice, Knight Frank Research

# JEDDAH

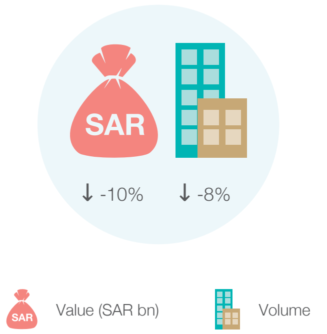
Similar to Riyadh, rental rates in Jeddah increased on the back of a shift in demand from sales to rental property.

In Jeddah, demand for residential property has been concentrated in the city centre, in the areas of Al Rawdah, Al Salamah, Al Shatie and Al Naeem. Given population growth estimates and absorption rate patterns, coupled with the shortage of land available for further development, demand is shifting to the North of the city towards Obhur.

Areas surrounding the Kingdom Tower and Jeddah Economic City in North Obhur are expected to see growth in residential developments over the next couple of years. Similarly, plots in South Obhur and close to the airport are witnessing substantial activity, led by the Public Pension Agency (PPA) project. However we remain cautious of the delivery of many projects within the timeline, and expect delays and restructuring given current market conditions.

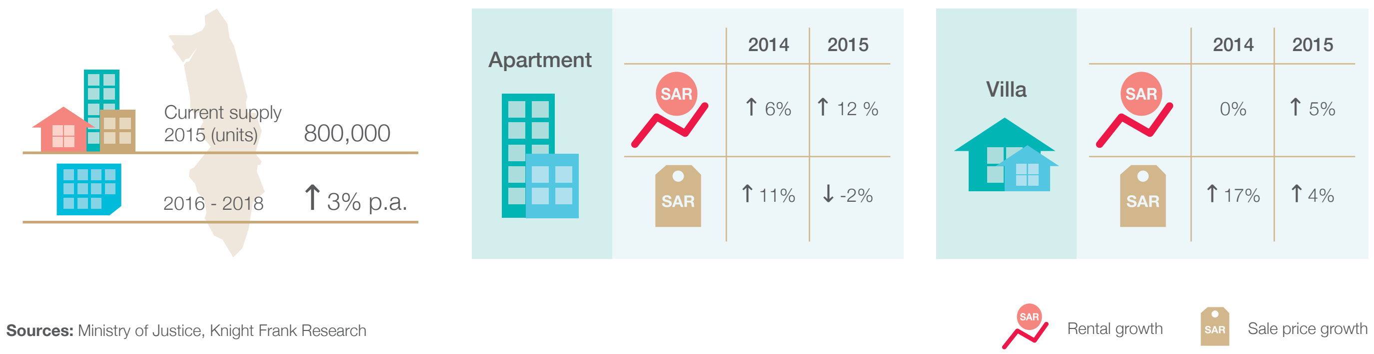
Similar to Riyadh, rental rates in Jeddah increased on the back of a shift in demand from sales to rental property. Consequently, average sale prices remained flat as the volume of residential transactions in Jeddah decreased by 8% (Q1 2016 versus Q1 2015).

FIGURE 7
**Jeddah's % change in the volume and value of residential transactions**
(Q1 2016 vs. Q1 2015)




**Source:** Ministry of Justice

FIGURE 8
**Jeddah supply growth rate**




**Sources:** Ministry of Justice, Knight Frank Research

# EASTERN PROVINCE

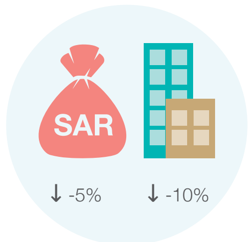
In terms of performance, rental rates maintained their stability over the second half of 2015 and into 2016.

Dammam and Khobar have seen significant population growth over the past couple of years, which has been met with limited residential supply. This lack of supply is more pronounced in the middle-income segment of the market, which is forecasted to see strong demand over the next couple of years. However, demand is expected to cool off as the fall in oil prices impacts the labour market, which is heavily dominated by expats.

The central areas of Dammam and Khobar are beginning to witness a shortage of residential land following many years of low and medium density developments. As a result, the majority of upcoming developments will be located in previously undeveloped areas outside the current city limits. These upcoming areas however (e.g. Al Hamra, Aziziya in Khobar) lack developed infrastructure and amenities, which has impacted the absorption rate.

In terms of performance, rental rates maintained their stability over the second half of 2015 and into 2016. The slowdown in the economy and resulting cutbacks in the main economic industries (e.g. Construction & Infrastructure and Oil & Gas) is expected to slow demand in the medium-to-long term, exerting downward pressure on rents. The sales market is expected to remain buoyant, particularly for residential property in the south of Khobar, closer to the Saudi Arabia-Bahrain Causeway.

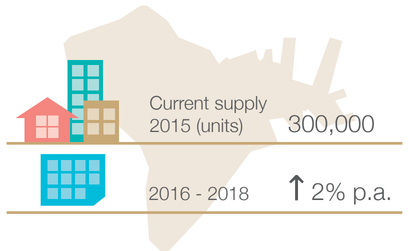
FIGURE 9
**Eastern province's % change in the volume and value of residential transactions** (Q1 2016 vs. Q1 2015)




Value (SAR bn) Volume

**Source:** Ministry of Justice

FIGURE 10
**Dammam Metropolitan Area (DMA) & Khobar supply growth rate**




**Apartment**

| | 2014 | 2015 |
|---|---|---|
| Rental growth | ↑ 10% | ↑ 12% |
| Sale price growth | ↑ 8% | ↑ 5% |

**Villa**

| | 2014 | 2015 |
|---|---|---|
| Rental growth | ↑ 6% | ↑ 8% |
| Sale price growth | ↑ 10% | ↑ 7% |

Rental growth Sale price growth

**Sources:** Ministry of Justice, Knight Frank Research

# RESIDENTIAL SUMMARY

The residential market has for some time been dominated by a shortage of suitable units and a constrained development pipeline. In turn the sales market has shown weaker performance as a lack of affordability and limited access to finance has focussed demand towards the rental market. We see this current dynamic prevailing in the short term while stimulus packages and sector reform work through the system.

While the much debated White Land Tax displays clear intent from the government to engage with the issues facing the built environment, we believe that the prevalence of high land prices are just one factor that has contributed to the current market situation.

We set out below a diagram highlighting some of the factors that currently restrain the residential market.

FIGURE 11
**Factors restraining the residential market**


**Source:** Knight Frank Research

As the main urban areas of Saudi Arabia continue to develop, suitable and sustainable zoning will increasingly become a key factor in responding to the needs of the market. Land availability and access to infrastructure should drive urban regeneration in the short term as the development of mixed use communities become more important to the local population. With the implementation of various public transport systems over the coming years, we see these projects acting as catalysts for sustainable development.

"In Saudi Arabia, the subject of creating suitable and sustainable zoning is increasingly being debated in order to ensure that future development meets the requirements of the fast-growing population. In addition the scarcity of land in some major cities, combined with key infrastructure projects underway (such as the Riyadh metro), is providing the impetus for urban regeneration initiatives. Over the medium to long-term these development strategies are expected transform cities for the better, improving the quality of life, affordability, safety and health of local communities – a central objective of the kingdom's leadership."

STEFAN BURCH
**Partner, Knight Frank KSA**



**RESEARCH**

**Dana Salbak**
Associate Partner
+971 56 4206 735
Dana.salbak@me.knightfrank.com

**ADVISORY SERVICES**

**Stefan Burch**
Partner, Kingdom of Saudi Arabia
+966 53 0893 297
StefanBurch@me.knightfrank.com

**CAPITAL MARKETS**

**Joseph Morris**
Partner
+971 50 5036 351
Joseph.Morris@me.knightfrank.com

**INTERNATIONAL RESIDENTIAL**

**Victoria Garrett**
Associate Partner
+971 56 7835 523
Victoria.Garrett@me.knightfrank.com

**MEDIA ENQUIRIES**

**Nicola Milton**
Head of Middle East Marketing
+971 56 6116 368
Nicola.Milton@me.knightfrank.com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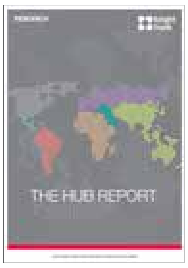


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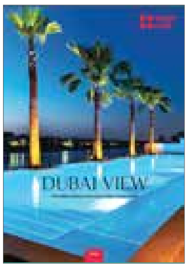


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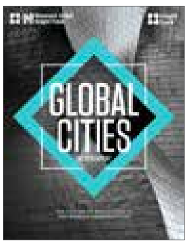


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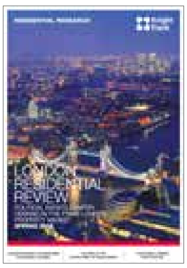


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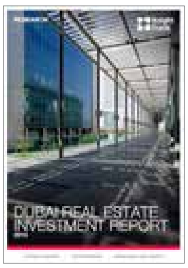


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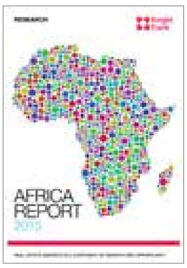


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