

RIYADH & JEDDAH

HOSPITALITY MARKET REVIEW, WINTER 2017

Key findings

The hospitality sector is likely to see an increase in Saudi-national participation.

Leisure related initiatives such as 'Entertainment City' will help diversify demand.

Given the opacity of the market, financial forecasting is often challenging, particularly in Jeddah in which project delays are systemic.



ALI MANZOOR
Associate Partner

"Given the scale of the various initiatives aimed to stimulate visitation, it is clear that the government has long-term ambitions for the hospitality sector."

Stemming from a sharp fall in crude oil prices, austerity measures in Saudi Arabia were implemented in September 2016 in an effort to curb government spending and rebalance the deficit. While some of these measures were ultimately reversed, others, such as increased Iqama (residency) fees and the introduction of dependent fees have forced employers to reconsider the composition of their workforce in favour of Saudi-national participation.

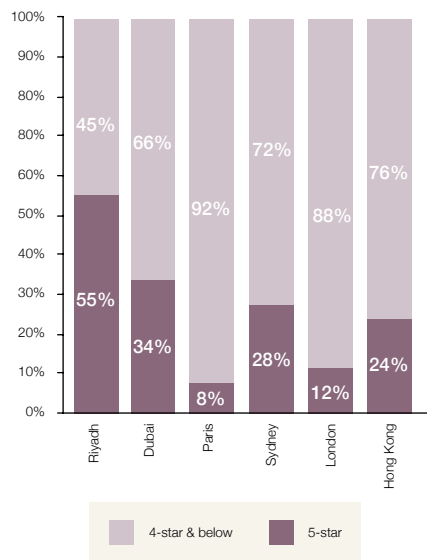
As a result of these new regulations, in the short to medium term, a number of outcomes are likely to happen:

- Hotel employees that are foreign nationals may leave the Kingdom in response to increases in the cost of living. Echoing this sentiment, a recent report by Banque Saudi Fransi indicated that this number would stand at approximately at 670,000 by 2020 across the wider workforce.
- Companies may reduce the number of expatriates occupying entry level positions, instead choosing to train and hire Saudi and other GCC nationals. While this will help keep operating costs down (in terms of various fees), the question remains whether or not such individuals would be willing to take on such roles.
- Companies may take it upon themselves to accommodate their

employees and either partially or fully cover the costs associated with dependant fees. However this would be done at the expense of potential returns – and in many KSA markets in which profitability levels are on the decline, this is not always a viable option from the perspective of either the operator or the owner.

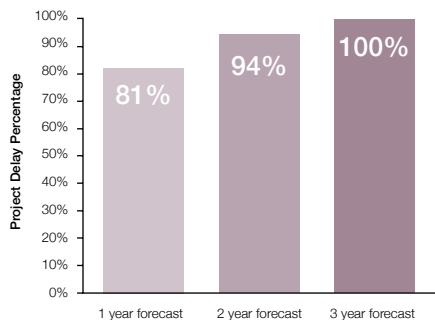
What remains to be seen is the long-term systemic impact that these policy changes will have on the hospitality sector, particularly against the backdrop of an increasingly challenging economic environment. This report examines the performance of the hospitality market in Jeddah and Riyadh as these policies have started to come into effect.

FIGURE 1
Supply breakdown: Riyadh versus key cities



Source: Knight Frank Research

FIGURE 2
Historic project delays



Source: Knight Frank Research

Riyadh Hospitality Market Overview

Supply

H1 2017 saw the entry of several new properties to Riyadh’s hotel market including Hyatt Regency Olaya, the Ascott Rafal Olaya and Best Western plus Fursan Hotel.

When analysing the composition of quality hotel supply in Riyadh, it is noticeable that it is heavily skewed towards the five star sector, which accounts for 55 percent of the city’s key count. This is significant, particularly when compared to other key global cities in which five star supply is far more limited. As such, development opportunities from a supply perspective in Riyadh over the coming years lie in the midscale and upscale sectors more so than the upper upscale and luxury sectors.

Project Delays

Based on announcements and materialisation rates, Figure 2 depicts the number of hotel projects that are delayed one, two and three years from the forecast date.

Our data shows approximately 81 percent of supply forecast to come online within 12 months is delayed, 94 percent of supply forecast to come online between 13 and 24 months is delayed, and 100 percent of supply forecast to come online between 25 and 36 months is delayed.

When applying these figures to the anticipated supply over the coming years,

the magnitude of these delays become apparent as shown in Figure 3.

Developers are often cautious when reports indicate large amounts of future supply, however based on historic precedent, the future market situation is often quite different to initial forecasts. Therefore, it is important to account for such observed delays when forecasting demand and supply when considering hotel development in order to arrive at more accurate performance projections.

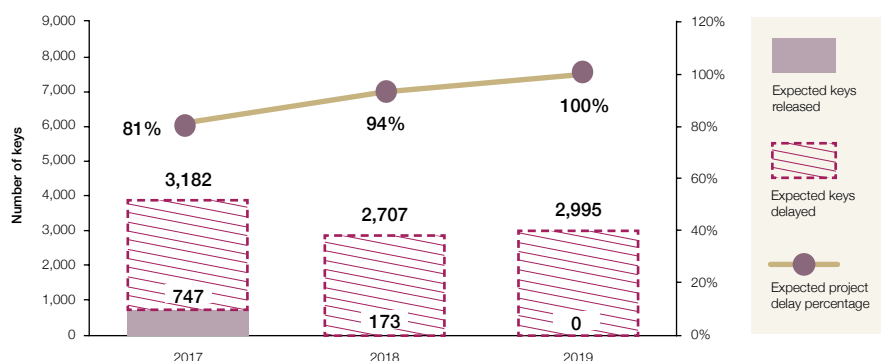
Demand

Historically corporate markets and business tourism remain the largest sources of demand for hotels in Riyadh. While internationally branded hotels remain the preference of corporate guests, there have been increasing instances of major corporate entities renting units within residential compounds for their employees to use on an ad-hoc basis due to the security, affordability, space, and facilities on offer in relation to traditional hotel accommodation.

Performance

After years of relative stability, hotel market performance in Riyadh began to decline sharply in 2015 when crude oil prices first began to fall and corporate visitation declined. This trend has continued throughout the first half of 2017.

FIGURE 3
Expected upcoming supply with delay factor, 2017 - 2019



Source: STR, Knight Frank Research

Note: The above figures do not account for supply anticipated in 2017 that came online in 2018 or 2019, nor do they account for anticipated supply in 2018 that came online in 2019.



a Six Flags theme park) will help boost leisure demand – particularly from the domestic sector.

Outlook

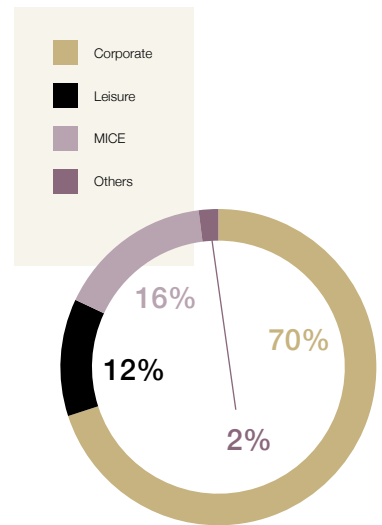
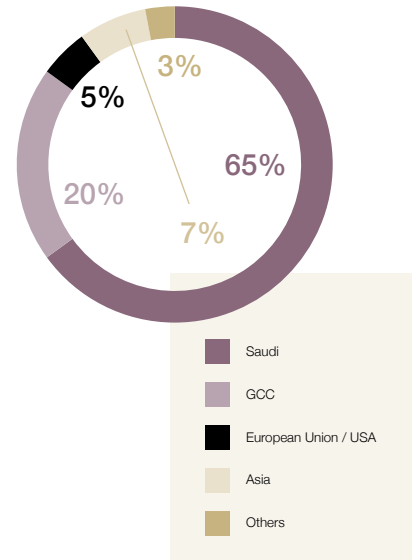
The Vision 2030 plan and the National Transformation Program have shown that the government is making coordinated efforts to not only diversify from oil dependence, but make meaningful changes to the traditional ways of doing business. More leisure related initiatives such as cultural events and ‘Entertainment City’ indicate that steps are being taken to present the Kingdom as a more leisure friendly destination.

From the standpoint of the authorities, the tourism industry is seen to be one which can be a major source of employment for young Saudis, with an additional 375,000 hospitality related jobs anticipated by 2020. By diversifying the demand profile of potential guests to the capital, sustained demand growth can be stimulated in the medium term, which will in turn create additional employment for the domestic market.

Primary interviews indicate that hotel managers remain pessimistic regarding performance for the remainder of 2017 but are more positive on the medium to long term due to the various development initiatives in the capital. Aside from the two planned mega-malls, the recently announced ‘Entertainment City’ spearheaded by the Public Investment Fund (which will include sports facilities, cultural attractions, safari elements and

FIGURE 4

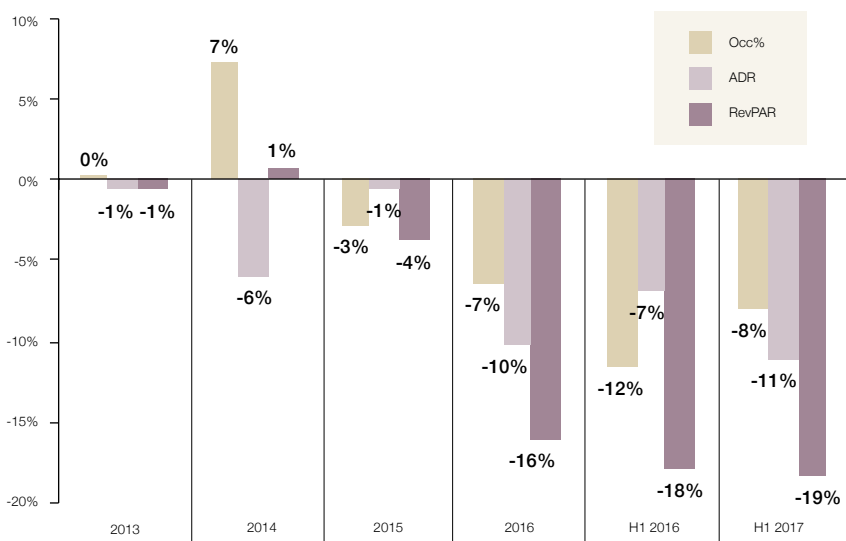
Top source markets and business mix



Source: Knight Frank Research

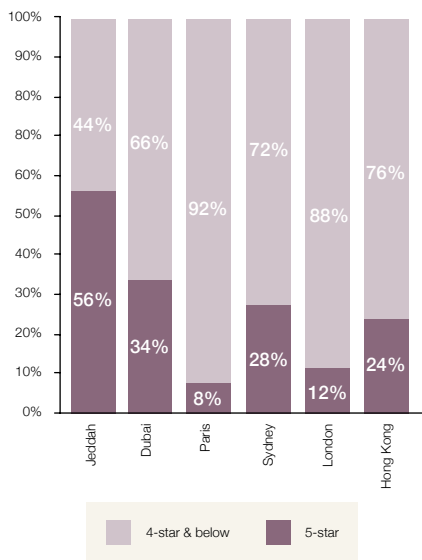
FIGURE 5

Key performance indicators: Year on Year performance



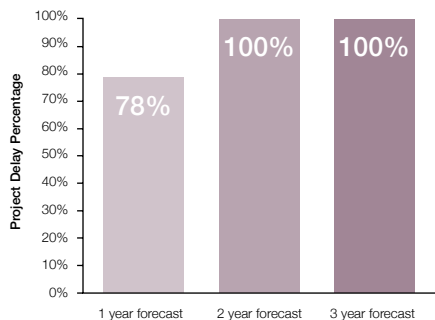
Source: STR, Knight Frank Research

FIGURE 6
Supply breakdown: Jeddah versus key cities



Source: Knight Frank Research

FIGURE 7
Historic project delays



Source: Knight Frank Research

Jeddah Hospitality Market Overview

Supply

Jeddah has witnessed a number of new hotel openings in 2017 amidst a backdrop of challenging market conditions. One of note was the Ritz Carlton Jeddah, which opened in May 2017 and features 224 keys within which are 30 royal suites that are 500 sq m in size. This property is expected to capture the majority of demand generated by HRH King Salman bin Abdul-Aziz and his entourage during their annual summer visits to Jeddah, which will have a knock-on effect to the wider market.

Other hotel openings include the Rocco Forte's Assila Hotel (304 keys), Centro Shaheen (250 keys), Mövenpick Hotel City Star (228), Ramada Jeddah Corniche (165 Keys), and Sofitel Jeddah Corniche (191 keys).

In response to market conditions, the Marriott Jeddah hotel (210 keys) which opened in 1983 has temporarily suspended operations in order to undergo refurbishment. The timing of the works was well considered, particularly in the context of declining market performance, and the influx of new-build supply. If refurbishment and maintenance is not regularly undertaken, operators and hotel owners can face challenges both in terms of the guest experience and their relationship with the management company. An example of this was the Sofitel Al Hamra which was downgraded to the Pullman Al Hamra, before eventually being de-flagged altogether due to the condition of the structure.

Similarly to Riyadh, Jeddah's quality hospitality market is primarily represented by five star hotel developments, accounting for 56% of total quality supply as depicted in Figure 6.

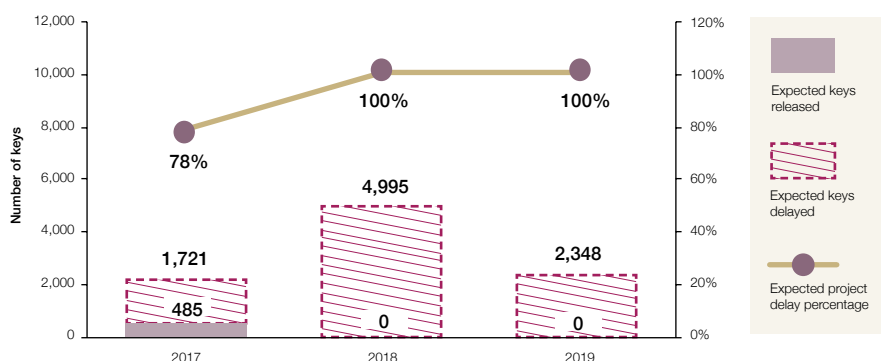
Project Delays

Current projections indicate that approximately 2,206 keys are expected to enter the market during 2017, 63% of which will be rated 5 star. However, much like Riyadh, many of these projects are likely to be delayed as shown in Figure 8.

Hotel developments in Jeddah have traditionally been prone to delays to a far greater extent than other cities within the Kingdom, which makes financial forecasting particularly challenging. When looking at historic forecasts versus what materialised between 2014 and 2016, the extent of the challenge becomes apparent. From historic data, it is clear that accuracy of forecasts are only reliable within a 12 month timeframe in Jeddah. Over the last three years, in Jeddah, all hotel openings projected to come online 13 months or more from the forecast date have faced delays.

While these delays in additional supply have helped to sustain strong KPI's in recent years, 2016 saw a significant amount of supply come to market, which has had an immediate impact on citywide performance. With the opening of Assila Hotel, the Ritz-Carlton Jeddah, Centro Shaheen, Citadines Al Salamah Jeddah, Mövenpick City Star Jeddah, and

FIGURE 8
Expected upcoming supply with delay factor, 2017 - 2019



Source: STR, Knight Frank Research

Note: The above figures do not account for supply anticipated in 2017 that came online in 2018 or 2019, nor do they account for anticipated supply in 2018 that came online in 2019.

Casablanca Grand Hotel, the market has absorbed a significant supply expansion over a condensed period, resulting in subdued performance extending into 2017.

When these delays are taken into account within the context of supply forecasts as they stand today, the potential magnitude of disparity between anticipated and materialised supply becomes apparent. As with Riyadh's hotel market, it is important to take account of such delays when conducting demand-supply projections in order to avoid overstating supply-side risk factors for hotel development projects.

Demand

The corporate and leisure segments, which primarily stem from the domestic market, represent the majority of demand in Jeddah, accounting for 41 and 34 percent of total demand respectively. Primary interviews with hotel managers indicate that in recent months guests have been looking to 'downgrade' their choices of hospitality accommodation, with many guests who traditionally stay at beachfront properties choosing instead to stay in the city and guests who stay in the city opting for more affordable options.

From a supply perspective, the vast majority of midscale hotels are old and poorly maintained, and given

that the market demand is moving towards affordability, the lack of quality internationally branded midscale hotels in the city presents opportunities for potential hotel developers.

Performance

After years of strong performance, Jeddah's hospitality market faced headwinds in 2015 and 2016. Driven by severe occupancy declines, the market experienced a fall in RevPAR of 9 percent in 2016, and further 16 percent in H1 2017. The severe decline in performance was not only attributable to wider economic conditions but also due the influx of supply.

Outlook

Jeddah's hospitality market has been facing challenging conditions, both from a demand and supply perspective. In terms of demand, a more price sensitive guest profile has resulted in a flight to affordability. While looking at supply, the recent influx of keys as a result of the materialisation of delayed projects has resulted in rate compression. Given the fact that much of the supply in Jeddah is aging and of poor quality, development opportunities lie in the establishment of quality internationally branded midscale offerings.

FIGURE 9
Top source markets and business mix

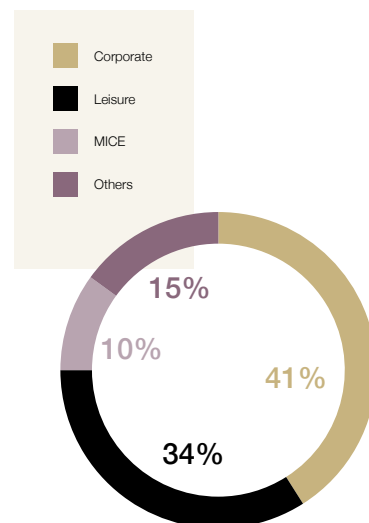
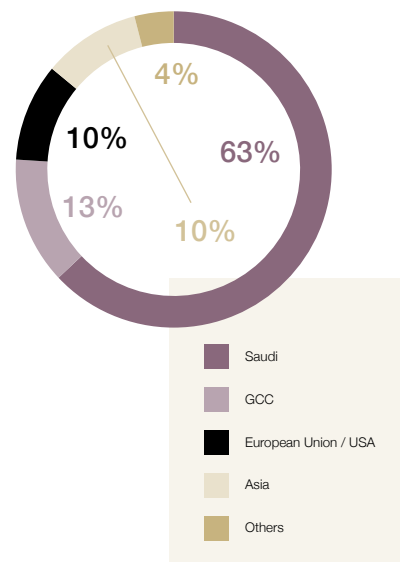
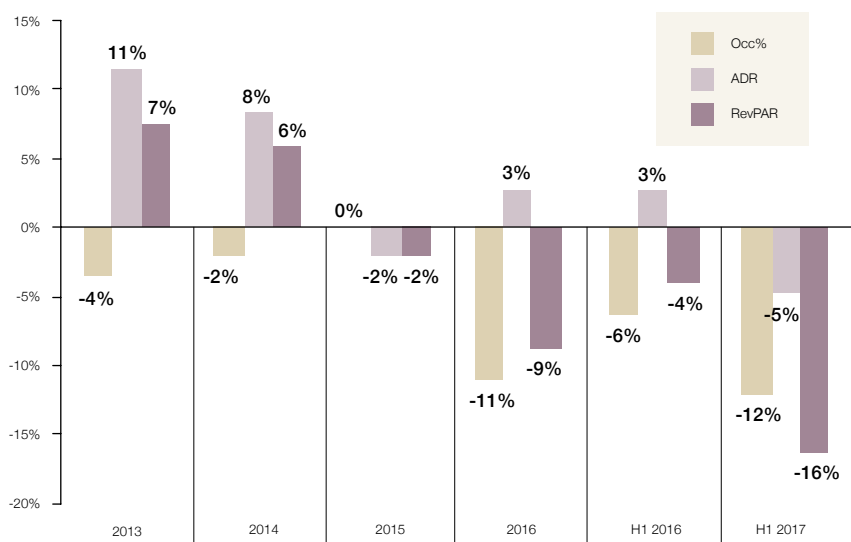


FIGURE 10
Key performance indicators: Year on Year performance



Source: Knight Frank Research

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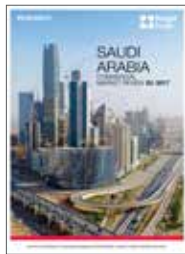
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