



A Comprehensive View on the Saudi Real Estate Market

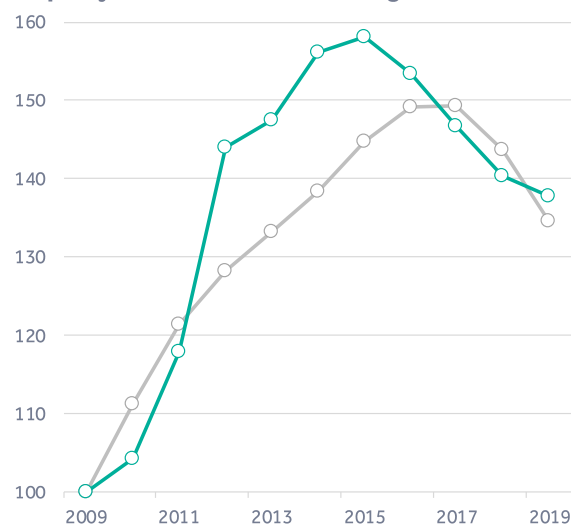
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Prospects for the Saudi Real Estate Market Brightening Up

- The real estate sector is expected to be a major growth factor for the overall economy under SaudiVision2030. Its contribution to GDP is aimed at expanding from 5.2% (2018) to 10% which is close to the average amongst OECD countries.
- A proprietary house price index shows that over the last 10 years the Saudi real estate market was characterized by a period of expansion until 2015 and a subsequent decline until mid-2019. Housing rents tended to lag house prices during this period (see graphic below).
- Furthermore, we provide evidence that a number of key variables of the Saudi economy can largely explain the cycle of local property prices over this time frame.
- Based on our forecasts, these macro driving factors should positively impact the Saudi real estate market in 2020. Hence, we believe that after the protracted decline since 2015, the prospects for the Saudi real estate markets are brightening up.
- This view is underpinned by growing signs of a market stabilization in the first half 2019. In particular, GASTAT real estate price indices have bottomed and overall real estate transaction activity has notably picked up.
- Mortgage loans in Saudi Arabia currently constitute 14% of GDP. This compares to an average of 57% across developed economies. Therefore, capital markets will play a key role in refinancing the projected long-term growth of the Saudi real estate market.

Property Price Index and Housing Rents



Over the past 10 years, the Saudi real estate market went through a period of expansion until 2015, followed by a protracted decline until H1 2019. Housing rents tended to lag this trend.

- RC Property Price Index, 2009 = 100
- GASTAT Housing Rents Index, 2009 = 100

source: GASTAT, RC

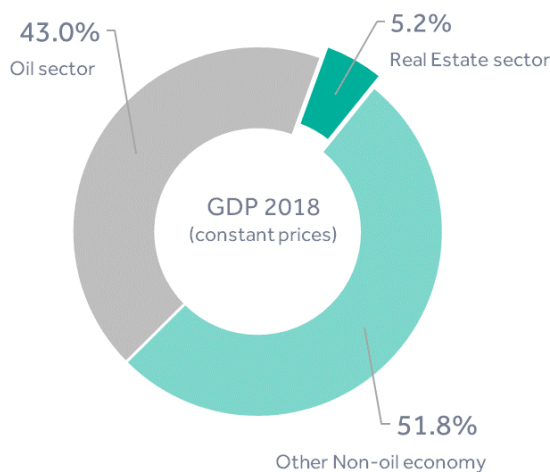
Introduction

The Saudi real estate market traditionally plays an important role for investors as well as for the overall economy. For investors the property market constitutes historically the most important asset class in Saudi Arabia, for the economy the real estate sector represents a major contributor to Saudi GDP growth.

In this report we want to shed light on the Saudi real estate market from different angles.

First, we show the importance of the real estate sector to the overall Saudi economy. Next, we try to create more transparency about the historical development of the Saudi property market, focusing on the cycle of the last 10 years. In addition, we also make a comparison to selected international property markets. We, further, emphasize which are the most important macro driving factors for the local real estate market and illustrate this for the development of the last 10 years. This analysis will also allow an outlook for the short- and medium-term prospects of the Saudi property market. We, finally, also discuss the importance of real estate financing as a key factor to support growth from a longer-term perspective.

Figure 1:
GDP Contribution from Real Estate Sector



source: GASTAT

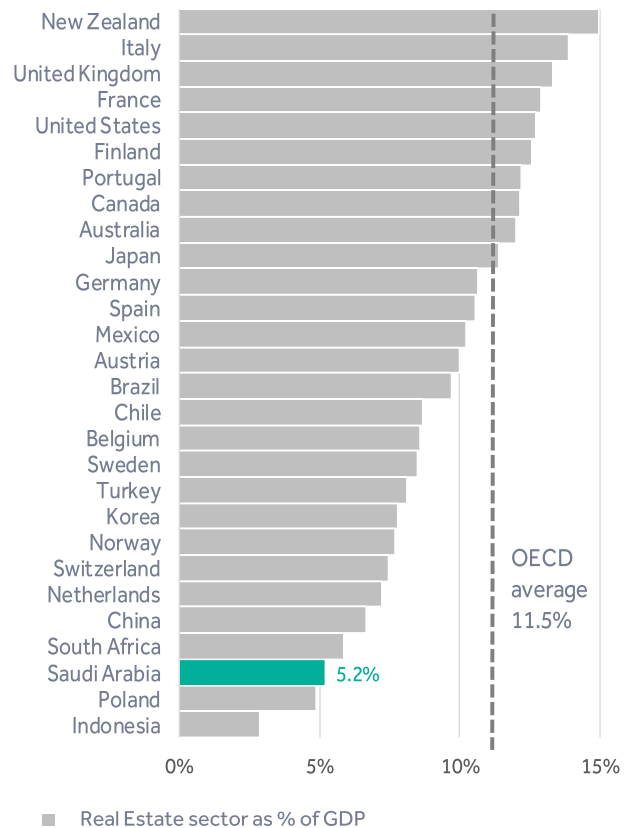
The Macroeconomic Importance of the Saudi Real Estate Sector

In the GDP context, the contribution of the real estate sector is defined as the value added from the ownership of dwellings. In fact, this stands for the collective net rental income (after deduction of service charge costs) generated by the entire residential and com-

«In the GDP context, the contribution of the real estate sector is defined as the value added from the ownership of dwellings»

mercial real estate infrastructure. This figure also includes the imputed value from ownership use which means an estimated market rent in cases where property is owned by the user himself.

Figure 2:
Real Estate GDP Contribution International Comparison



source: OECD

For 2018, the contribution of the real estate sector to the overall economy (GDP) amounted to 5.2% (see figure 1). An international comparison reveals that the current real estate sector contribution in Saudi Arabia is still relatively low (see figure 2). For the majority of the countries analysed, the real estate contribution is in a range between 7% and 13%. The average across all OECD countries, i.e. amongst developed economies, is 11.5%.

«The real estate sector constitutes a core sector in SaudiVision2030 and is expected to sustainably expand in the medium to long term.»

The real estate sector constitutes a core sector in SaudiVision2030 and is expected to sustainably expand in the medium to long term. In the National Transformation Plan (NTP), one of the Vision Realization Programs, the target for the real estate GDP contribution has been fixed at 10%, i.e. twice the current level and in the neighbourhood of the OECD average. (In the original NTP this target for the Ministry of Housing was expected to be achieved by 2020).

In a broader sense, the contribution of the real estate sector also includes the development of new real estate structures, i.e. the construction of residential and non-residential buildings. In national GDP accounting, this real estate development activity is included in the construction sector. According to our estimates, the development of residential and non-residential buildings amounted to about 2.3% of total GDP in 2018. Hence, in this broader definition the real estate sector contributed 7.5% to the overall GDP last year.

«In a broader sense, the contribution of the real estate sector also includes the development of new real estate structures, i.e. the construction of residential and non-residential buildings.»

The targeted massive increase in GDP contribution by the ownership of dwellings requires a strong expansion in real estate construction activity. As a consequence, the real estate sector in this broader definition is expected to be a major growth contributor for the entire economy in the years to come.

The Real Estate GDP Deflator - a Proxy Indicator for the Saudi Property Market

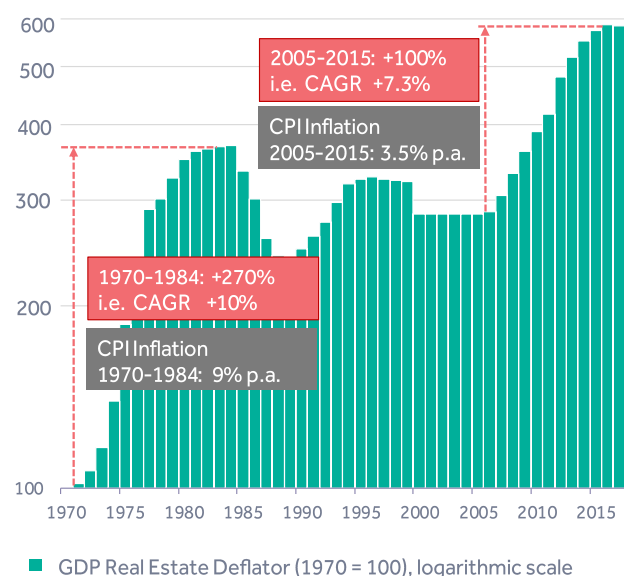
As the GDP of the real estate sector in the narrow sense constitutes the net rental income of residential and non-residential property, the difference between these numbers at constant and at current prices represents the overall inflation of housing rents. Hence, the GDP deflator of the real estate sector can be considered as an index of housing rent prices. Traditionally, the trend in housing rents broadly corresponds to the overall trend in property prices, although differences may occur in the short term. Therefore, the real estate GDP deflator can be interpreted as a broad proxy indicator for the development of the property market overall.

«The Saudi real estate sector was subject to strong price fluctuations over the last 50 years and these cycles generally coincide with the business cycles of the overall Saudi economy.»

We use this GDP deflator of the real estate sector to depict the longer-term historical trend of the Saudi real estate market.

Figure 3 reveals that according to this indicator the Saudi real estate market was subject to strong price

**Figure 3:
Real Estate GDP Deflator – an Indicator for the
Property Market**



source: GASTAT

Special Topic:

A Residential Property Price Index for Saudi Arabia

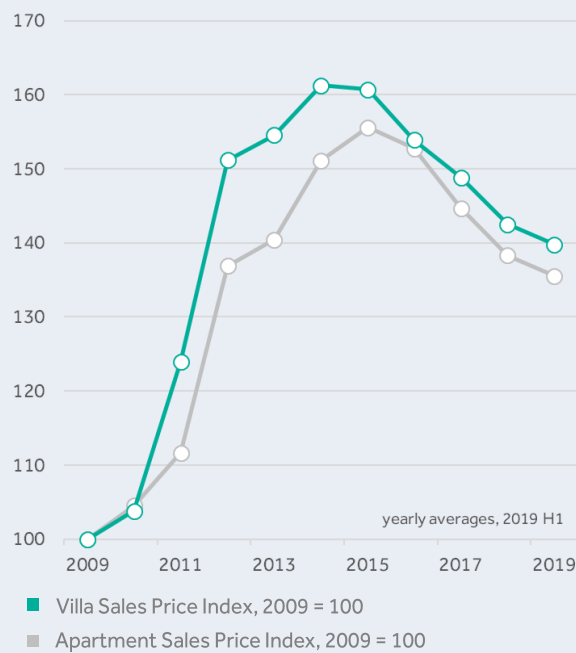
In order to create more transparency in the local real estate market over the entire cycle of the last 10 years, we have constructed a residential property price index for Saudi Arabia. (The real estate indices published by GASTAT only start in 2014 and, therefore, cover just the downturn of the current real estate cycle).

This index is based on sales prices for villas and apartments in the urban areas of Riyadh, Jeddah and

estimated stock of properties in each region as the weighting factor (and not the transaction volume). The respective indices for villas and apartments are depicted in figure 4. Finally, the weighted average of these two indices results in the overall residential property index for Saudi Arabia (figure 5).

We have used various sources to construct this index. Primarily, we relied on sales price data published by the Ministry of Justice. Besides, we also referred to

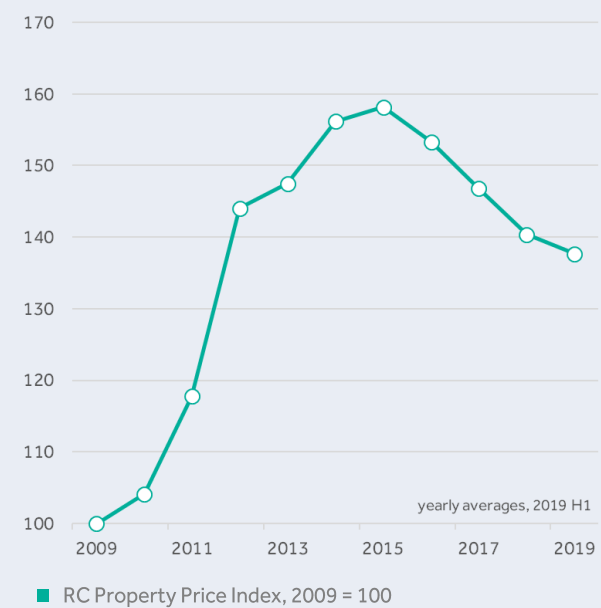
Figure 4:
Villas and Apartments Sales Price Indices



Dammam. The underlying assumption is that these three areas are broadly representative for the country-wide trend of the residential property market. The base year for this index is 2009.

For each of the three areas a sub-index for villas and for apartments has been constructed. In a next step, an overall average across all three areas has been composed for both villas and apartments, using the

Figure 5:
Overall Property Price Index



the research reports on the Saudi real estate market by Jones Lang LaSalle (JLL). As we are primarily interested in the medium-term trend of the real estate market, we used yearly average sales prices to smoothen the trend and eliminate occasional erratic short-term price movements. For the year 2019, the index value reflects the average over the first 6 months.

fluctuations over the last 50 years. The important finding, however, is that these cycles generally coincide with the business cycles of the overall Saudi economy.

This is specifically true in the case of the two major boom phases of the Saudi economy from 1970-1984 and from 2005-2015 during which the real estate market witnessed its strongest appreciation. As during the economic boom phase of the 70ies, consumer price inflation soared at the same time (average 9% p.a.), real estate as an asset class demonstrated its strong inflation protection characteristics.

Mapping the Saudi Real Estate Market over the last 10 Years

In this section, we examine the real estate market more in detail over the period of the last 10 years.

To this end, we have developed a proprietary sales price index for the residential real estate area back to the year 2009. The details on the construction of this index can be found in the special topic box on page 4. According to this index, residential property prices advanced by 58% from 2009 to 2015 and corrected by 14% in the subsequent period until mid-2019 (see figure 5).

«According to our proprietary index, residential property prices advanced by 58% from 2009 to 2015 and corrected by 14% in the subsequent period until mid-2019.»

We compare this property sales price index with the housing rental price index provided by GASTAT over this period (see figure 6). The comparison generally confirms our assumption above that property sales prices and rental prices largely follow the same cycle. In the short-term, however, there have been some differences.

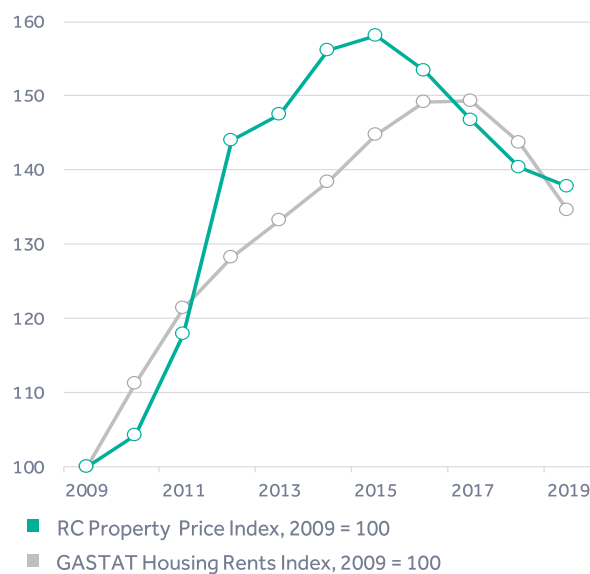
Rental prices lagged sales prices in the period of strong price appreciation in 2011-2013 and peaked somewhat later. The considerable drop in housing rents from 2017 to mid-2019 can specifically be explained by demographics in our view. During this period, 1.9mln expat workers left the country as a result

of the weakening economy and the labor market policy of the Saudi government. This demographical shift certainly had an impact on the Saudi real estate market which was most probably more pronounced in the case of rental prices as expat workers and their families are predominantly tenants.

«The considerable drop in housing rents from 2017 to mid-2019 can specifically be explained by demographics, as during this period, 1.9 mln expat workers left the country.»

Next to the price development, we also analyse the transaction activity in the real estate market over this period. Figure 7 depicts the total value of residential and commercial real estate transactions on an annual basis, as reported by the Ministry of Justice.

Figure 6:
Property Price Index and Housing Rents

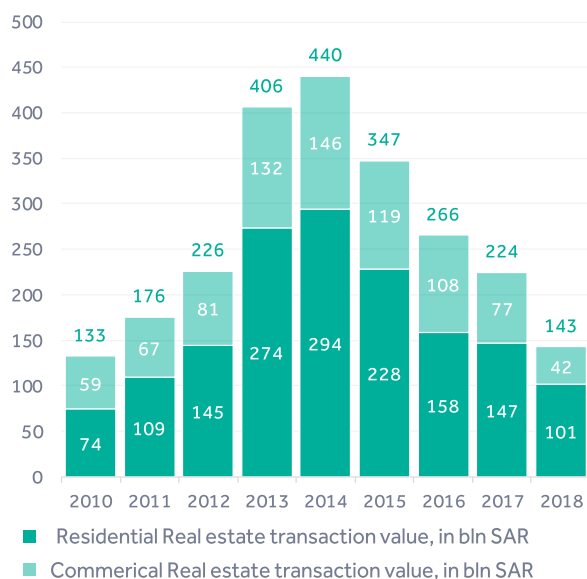


source: GASTAT, RC

The transaction value shows a similar pattern as the residential sales price index, strongly increasing in the first half of the decade with a distinct decline thereafter. At their peak in 2014, total transactions amounted to 440 bln SAR, while in 2018 this figure declined to 143 bln SAR. Throughout the entire period, residential real estate transactions were dominating with about 2/3 of the total transaction value, while the remainder was attributable to commercial deals.

In this context, it is worthwhile to have a closer look at the type of transactions in the Saudi real estate market. Figure 8 shows that in the year 2018 white land transactions (residential and commercial combined) constituted not less than 86% of the entire transaction value, while transactions in (residential and commercial) real estate structures only accounted for 10% of the total.

Figure 7:
Total Annual Transaction Value (in bln SAR)



source: MoJ

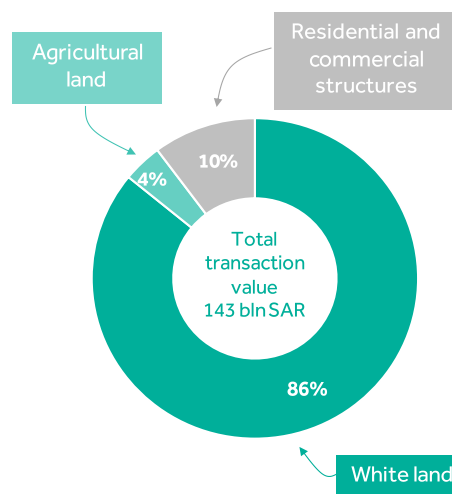
This illustrates that the Saudi real estate market is still in an emerging phase of its longer-term evolution. As the market eventually matures in the years to come, the share of transactions in real estate structures will further expand at the expense of white land transactions.

«In the year 2018, white land transactions (residential and commercial) constituted not less than 86% of the entire transaction value.»

In order to put these transaction volumes on the Saudi real estate market in a broader context, we compare them with the turnover on the Saudi stock exchange Tadawul, since equities constitute another major asset class next to real estate from a Saudi investor's perspective.

Figure 9 illustrates that the overall pattern of the Saudi equity market turnover largely resembles the one of

Figure 8:
Transaction Value Break-down 2018



source: MoJ

the real estate market since 2010. However, the total traded value on Tadawul exceeds the real estate transaction volume by a factor of 4 to 5 times throughout the entire period.

These figures, however, contrast with the overall market value of these two asset classes. The total

«While the overall size of the Saudi real estate market surpasses the market capitalization of Tadawul by 2.5 times, its yearly transaction volume merely corresponds to 20%-25% of the local stock market turnover.»

market capitalization of the Saudi stock market amounts to approximately 2 trillion SAR, while the Saudi real estate market exhibits a total market value of about 5 trillion SAR according to estimates of TAQEEEM, the Saudi authority of accredited valuers.

Hence, while the overall size of the Saudi real estate market surpasses the market capitalization of Tadawul by 2.5 times, its yearly transaction volume merely corresponds to 20%-25% of the local stock market turnover.

As a conclusion, these figures demonstrate that real estate as an asset class is generally characterized by comparably low market liquidity from an investor's perspective.

Figure 9:
Real Estate vs. Stock Market Transaction Value

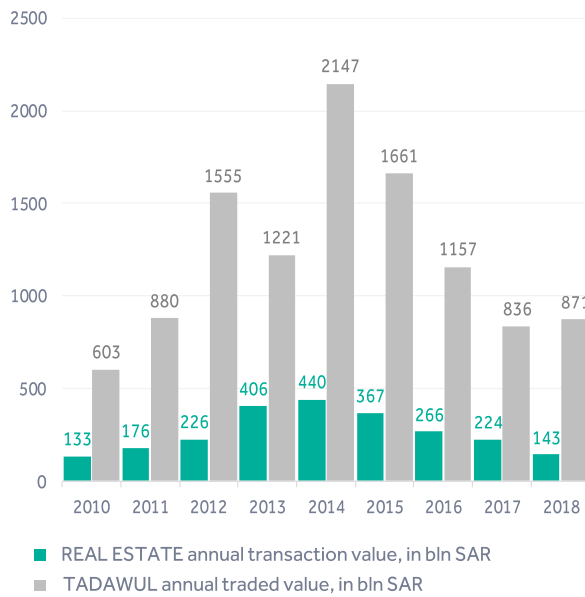
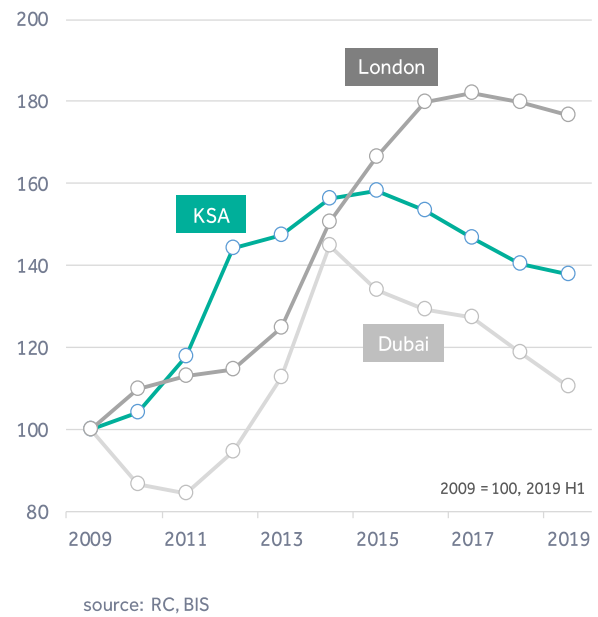


Figure 10:
Property Price Indices: KSA vs. Dubai and London



The Saudi Property Market in a Global Perspective

Our proprietary property price index also allows a comparison to international real estate markets over the period under consideration. Amongst global property markets we have first selected Dubai and London since they are traditionally two prime destinations for Saudi real estate investors. Besides, we also conduct a comparison to the US and the Eurozone markets. These comparisons can be seen in the figures 10 and 11.

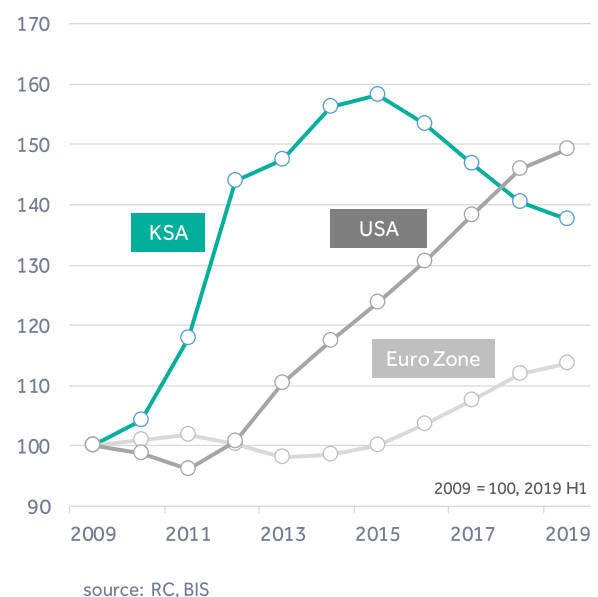
«The Saudi residential property market performed reasonably well in an international comparison, despite its downturn in the second half of the decade.»

The graphs illustrate that the Saudi residential property market performed reasonably well in this international comparison, despite its downturn in the second half of the decade. This is all the more true if currency movements are taken into consideration. Since 2009, the Pound Sterling as well as the Euro declined by about 20% vs. the US dollar and, hence, the Saudi Ri-

yal. In the case of the London property market, this currency devaluation wipes out almost the entire overperformance versus the Saudi real estate market.

At the same time, the graphs also illustrate that local real estate cycles generally differ as they are primarily

Figure 11:
Property Price Indices: KSA vs. USA and EMU



driven by local factors. From an investor's viewpoint this offers substantial diversification benefits through a carefully structured combination of local and international property investments.

The Macro Drivers of the Saudi Real Estate Market

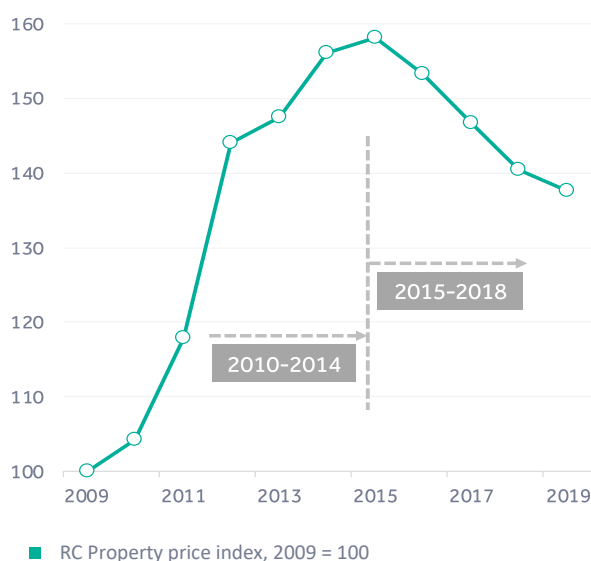
In this section, we analyse more in detail which macro-economic factors typically drive a local real estate market and how this played out in the case of the Saudi property market. In general, the macro variables listed below are commonly considered as the major driving factors for a local real estate market.

Common Macro Drivers of the Real Estate Market:

- Real economic growth
- Market liquidity/money supply
- Funding costs, i.e. interest rates
- Inflation
- Demographics, employment

In order to illustrate this in the case of the Saudi market, we split the entire market cycle over the last nine years into the period of expansion (2010-2014) and the subsequent period of contraction (2015-2018)

Figure 12:
Boom and Correction Phase of the Cycle



source: RC

(see figure 12). Table 1 shows the average annual growth rates of the above-mentioned macro variables of the Saudi economy for these two sub-periods.

Table 1:
KSA Real Estate and the Economic Backdrop

Average Annual Growth Rates	2010 - 2014	2015 - 2018	2020F
RC Property Price Index	+9.3%	-3.1%	
GDP Real Non-oil Economy	+7.3%	+1.7%	+3.2%
Money Supply M3	+10.9%	+1.6%	+4.3%
3M SAIBOR (yearly average)	0.8%	1.8%	2.2%
Inflation (Non-oil GDP)	+4.3%	+1.3%	+1.4%
Employment	+6.4%	+0.3%	+1.3%

The first sub-period was characterized by substantial economic growth, ample liquidity, low funding costs, inflationary pressure and strong employment growth. Hence, the macro backdrop was overall extremely supportive for the local real estate market. In the following sub-period, however, the same macro variables clearly deteriorated from a real estate perspective, causing the slowdown witnessed over the last four years on the Saudi property market.

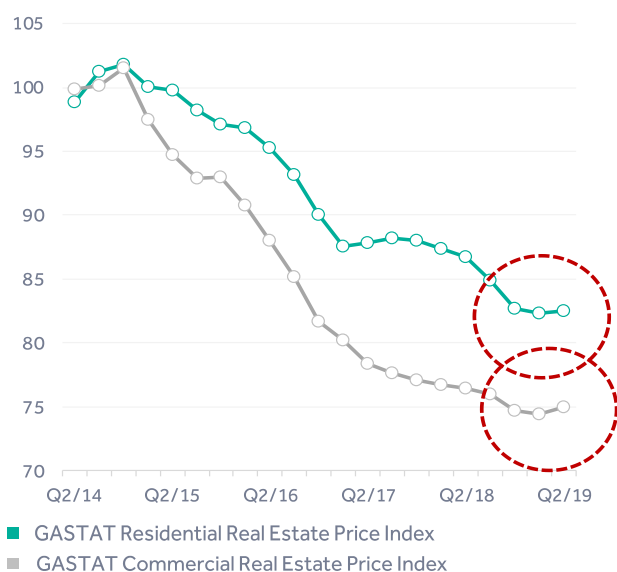
«The most recent Saudi real estate cycle can be largely explained by the different phases of the Saudi business cycle and its key macro drivers during this decade».

This example provides clear evidence that the most recent Saudi real estate cycle can, in fact, be largely explained by the different phases of the Saudi business cycle and its key macro drivers during this decade.

Growing Signs of a Market Stabilization

As table 1 also shows, we generally forecast these macro drivers to clearly improve in 2020 on the back of a sustained growth acceleration of the Saudi non-oil economy. As a consequence, the macroeconomic

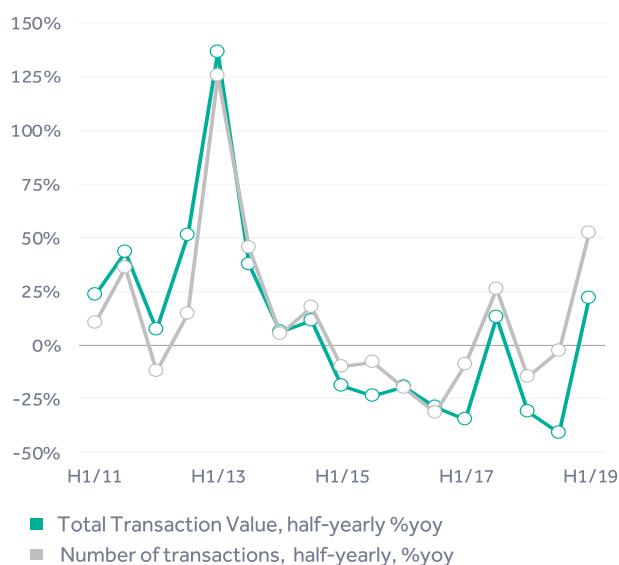
Figure 13:
GASTAT Real Estate Price Indices



source: GASTAT

environment is expected to notably brighten up which will positively impact the Saudi real estate market in the near future.

Figure 14:
Total Real Estate Transaction Activity



source: MoJ

In fact, we already observe encouraging signals of a market stabilization in the first half 2019. The residential and commercial real estate indices, published quarterly by GASTAT (with a base year in 2014), have started to consolidate in the first half of 2019 after having declined by 19% resp. 26% since 2014 (see figure 13).

«The macroeconomic environment is expected to notably brighten up which will positively impact the Saudi real estate market in the near future.»

Contrary to our property price index, the GASTAT indices include all types of transactions and as white land deals still dominate overall market activities, they are in the first place a reflection of residential and commercial land prices. Stabilizing land prices may be considered as a first indication that the real estate market has entered a bottoming-out period.

This is further supported by a pick-up in real estate transaction activity in H1 2019 (see figure 14). The number of (residential and commercial) transactions has rebounded by not less than 50%, the total transaction value by 25% since H1 2018.

«From an investor's view, a more constructive stance towards Saudi real estate as an asset class may be warranted at this juncture.»

As a conclusion, we, therefore, believe that the Saudi real estate market is about to bottom out and to stabilize after its protracted decline since 2015 and that it will be supported by the positive macro outlook in 2020. Hence, from an investor's view, a more constructive stance towards Saudi real estate as an asset class may be warranted at this juncture.

Government Policy Supporting the Market

Next to the macro environment, policy action by the government can also influence the development of the local property market. Since real estate has been identified by the Saudi government as a key sector for future growth, a number of initiatives have been taken in the last years.

In 2016, the regulatory framework was approved for the launch of local Real Estate Investment Trusts (REITs) to offer liquid access to professionally managed property assets. In 2017, a white land tax was introduced in order to incentivize land owners to develop their land plots and, at the same time, to put some pressure on elevated land prices back then. In order to spur homeownership for Saudis and, hence, demand for residential real estate, SAMA increased the maximum loan-to-value ratio for mortgage loans on first home ownership from 70% to 85% in January 2017 and later on, in January 2018, finally to 90%.

«Since real estate has been identified by the Saudi government as a key sector for future growth, a number of initiatives have been taken in the last years.»

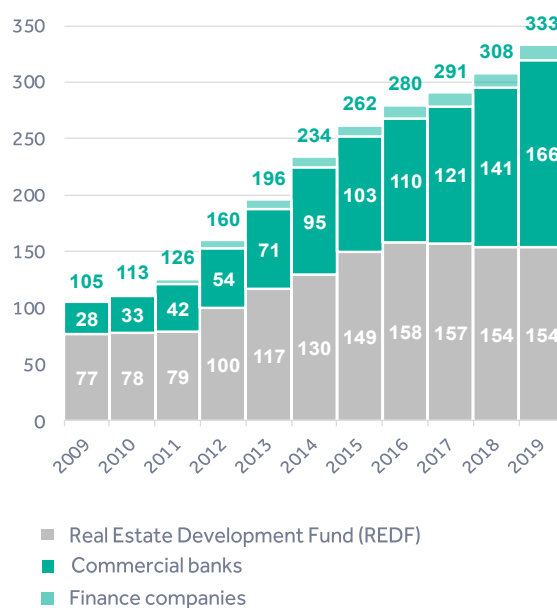
As a core initiative, the Ministry of Housing through its Sakani program targets to offer affordable housing in order to boost Saudi home ownership since a couple of years. This is supported by the Real Estate Development Fund (REDF) offering favourable financing solutions.

Finally, increased fiscal spending for infrastructure projects by the government also supports the Saudi real estate market. This specifically applies to various infrastructure projects in urban areas to increase the standard of living and, in particular, connectivity through public transportation (e.g. Riyadh metro) which typically has a positive impact on the value of neighbourhood property.

Funding the Growth of the Saudi Real Estate Market

In recent years, real estate loans have recorded strong growth. The strategy adopted by REDF since 2017 to offer subsidized mortgage loans via the broad network of the commercial banking sector, has played a key role in this context. As of mid-2019, outstanding residential real estate loans totalled 333 billion SAR, with 50% (166 bln SAR) falling on commercial banks (see figure 15). If one also adds the commercial mortgage loans, the portfolio of outstanding real estate loans amounts to 433 bln SAR by mid-2019, which

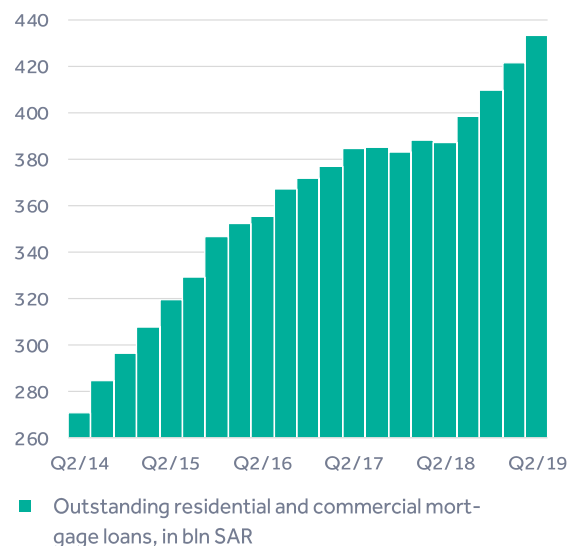
Figure 15:
Residential Mortgage Loans by Source



source: SAMA

corresponds to a growth rate of 12% within one year (see figure 16).

Figure 16:
Total Outstanding Mortgage Loans



source: OECD

The recent positive development of mortgage loans, however, cannot hide the fact that Saudi Arabia still has a relatively low real estate financing ratio compared to developed economies. Total outstanding real

estate loans of 433bn SAR equal 14% of Saudi GDP. Figure 17 puts this figure into a global perspective. In fact, the average mortgage-loan-to-GDP-ratio amongst developed countries amounts to 57%.

«The recent positive development of mortgage loans cannot hide the fact the Saudi Arabia still has a relatively low real estate financing ratio compared to developed economies.»

In the first chapter of this report, we showed that developed economies exhibit on average a GDP contribution by the real estate sector of more than 10%. Figure 17 provides evidence that such a contribution typically also requires a correspondingly high level of real estate financing.

It can, therefore, be concluded that Saudi Arabia needs to seek a substantial increase in mortgage financing, in order to achieve its objective of a real estate contribution of 10% to GDP. As a first interim target, the Ministry of Housing has set an amount of 502bn SAR in outstanding residential real estate loans

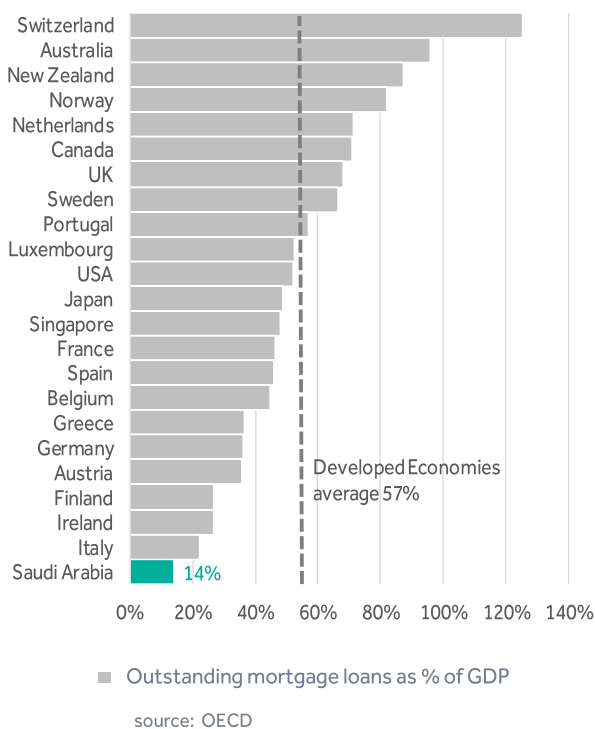
for the end of 2020. Given the recent growth momentum of mortgage loans, we may come close to this ambitious goal.

From a longer-term perspective, however, the substantial mortgage loan growth needed to achieve the real estate GDP contribution target will require considerable refinancing facilities for commercial banks. To this purpose the Saudi Real Estate Refinance Company (SRC) has been founded two years ago.

This company essentially constitutes the financial intermediary between the mortgage loan portfolios of commercial banks (and finance companies) on the one hand and the capital markets on the other. It is fair to say that SRC has been modelled after the US mortgage finance firm Fannie Mae.

«From a longer-term perspective, the substantial mortgage loan growth needed to achieve the real estate GDP contribution target will require considerable refinancing facilities for commercial banks.»

Figure 17:
Mortgage Loans as % GDP International Comparison



In fact, SRC is expected to purchase a growing number of home loan portfolios from commercial banks in the coming years. This will require SRC to issue not only debt securities on the local market, but increasingly also on the international debt capital markets. Eventually, SRC is supposed to securitize these home loan portfolios as mortgage-backed securities in order to further widen the range of debt instruments linked to the local real estate market and, hence, considerably broaden its global investor base.

This underpins the pivotal role capital markets will play in achieving the ambitious long-term targets for the Saudi real estate sector.

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