

RESEARCH



# SAUDI ARABIA

RESIDENTIAL MARKET REVIEW  
JANUARY 2018



## Key findings

The residential market across the main cities of Saudi Arabia started decelerating in 2016 as transaction volumes and sales prices came under pressure following a period of relative resilience. In 2017, the slowdown in performance continued and we saw a shift in demand from villas to apartments due to affordability constraints.

The trend towards a weaker residential market is mainly due to eroding market liquidity and is exacerbated by a combination of more inherent factors namely the lack of affordability and limited access to financing, supply shortage in the mid-to-lower end of the market and the lack of suitability of existing stock.

While we see current dynamics prevailing in the short term, we remain broadly positive as a result of government initiatives aimed at addressing key challenges restraining the residential sector.

Drivers for the market appear to be positive for the long term, which include favourable demographic dynamics, room for improvement in economic growth from current levels and economic reform programs placing a focus on real estate as part of the diversification process.



**RAYA MAJDALANI**  
Research Manager

“The slowdown in the residential market continued in 2017 as tightening market liquidity weighed on transaction volumes and prices. More recently, we started seeing signs that the market has bottomed out and may be close to stabilising following two years of decline.”

## Viewpoint

The residential market has for some time been softening as highlighted by lower levels of transactions and a correction in sales prices across major cities in Saudi Arabia. This trend is mainly due to a deceleration in economic growth triggered by the fall in oil prices and is exacerbated by a combination of more inherent factors namely the lack of affordability and limited access to financing, a supply shortage in the mid-to-lower end of the market as well as the lack of suitability of the existing stock.

While we see this current situation prevailing in the short term, we remain broadly positive as a result of government initiatives looking to address key challenges restraining the residential sector in Saudi Arabia including high land prices, supply/demand imbalances and affordability among others. Regulatory efforts such as the white land tax, the large housing schemes and the mortgage law, display clear intent from the government to engage with the issues facing the residential market in the kingdom. While efforts are slowly filtering through, we see these initiatives as a step in the right direction for a more active real estate market over the coming years.

Longer term, demographic factors will continue acting as demand generators for the residential market in Saudi Arabia. This includes a large population which has seen a sustained growth rate over the past decades and a long term trend towards smaller size households. On a macroeconomic level, the economy is expected to gradually adapt to the new norm in oil prices as it diversifies away from its dependence on the hydrocarbon sector in line with economic reform programs. Therefore GDP growth should regain some momentum in the medium term mainly driven by non-oil GDP, which should provide support to the recovery in the residential market.

Recently introduced strategic reforms aimed at creating a favourable environment for investment and strengthening the non-oil sector have placed a focus on real estate which is forecast to double its contribution to economic output throughout the period to 2030. Moreover, the implementation of various urban regeneration initiatives

including mixed use communities and investment in infrastructures are expected to act as catalysts for sustainable development and a more active residential market.

The drivers for the Saudi Arabian residential market appear to be generally positive for the long term despite some key risks to market performance including: heightened geopolitical risks weighing on consumer sentiment, further volatility in oil prices and increased challenges entailed by the implementation of economic reforms.

## Macroeconomic Overview

Despite maintaining healthy GDP growth levels in 2015 (4.1% as per the IMF), the impact of the challenging macroeconomic backdrop, triggered by lower oil prices, started to trickle into 2016, with Saudi Arabia's GDP growth rate moderating to 1.7% and expected to further decline to near zero in 2017 according to the IMF estimates (*Figure 1*).

Given the extent to which Saudi Arabia's economy is reliant on the hydrocarbon sector, the sharp fall in oil revenues, has squeezed the kingdom's budget surplus which has slipped into a deficit mode (*Figure 4*). The government has taken several fiscal consolidation measures to curb spending and diversify revenues in an effort to rebalance the budget and adjust to the realities of lower oil prices.

Fiscal consolidation continued into 2017 with the introduction of the excise tax and the tax on dependants for expatriates. Coupled with an upward correction in oil prices, these measures

should help alleviate pressures on the country's fiscal position with the deficit anticipated to shrink to 9.3% of GDP in 2017 according to the IMF estimates. The introduction of the VAT regime at the beginning of 2018 at an initial rate of 5% will contribute in balancing the budget over the coming years.

In an effort to adapt the economy to the new norm in oil prices, the government has embarked on an economic reform plan under Saudi Vision 2030 and the National Transformation Plan (NTP) that were launched in 2016 by targeting a diversification of the economy away from oil dependence and encouraging the private sector participation in this process.

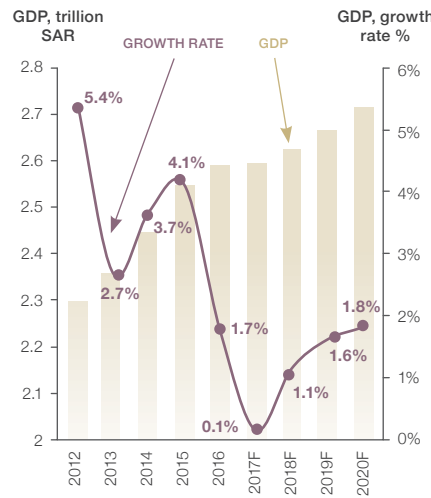
The real estate sector is a particular area of focus of the economic reform plans, where both the public and the private sectors are encouraged to take a role in ensuring the growth of the property market. We note that housing is the biggest area of government expenditure under the NTP with an allocated budget of SAR 59 billion of the total SAR 268 billion over 5 years, an encouraging step for the sector. (Figure 5)

As structural reforms are implemented and Saudi Arabia begins to see the benefits of its on-going diversification away from crude oil revenues, overall GDP growth is expected to stabilize at 1.1% in 2018 and should gain further momentum to reach 1.6% in 2019 as forecasted by the IMF. Non-oil sectors are expected to provide support to the overall economy with non-oil GDP growth expected to ramp up to 3% in the medium term ahead of overall GDP growth.

## Residential Sector Overview

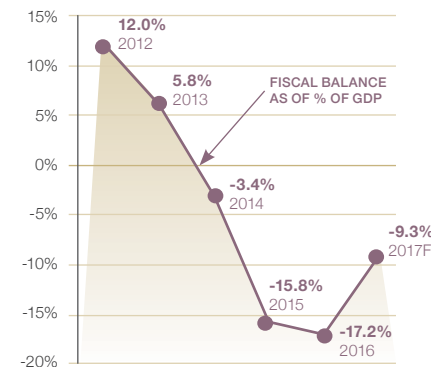
The real estate sector has been the keystone of government initiatives in recent years. Various measures aimed at stimulating the property market across the kingdom have come underway. Recent initiatives include the release of regulations for the introduction of a 2.5% 'white land' tax on undeveloped land plots, the approval of regulations for the use and listing of Real Estate Investment Trusts (REITs), the introduction of a new

FIGURE 1  
Saudi Arabia GDP, constant prices



Source: IMF economic outlook database, October 2017

FIGURE 4  
Saudi Arabia fiscal balance as % of GDP



Source: IMF Country Report on Saudi Arabia, October 2017

mortgage law to boost Saudi Arabia's home ownership rate, the development of a home-building programme named Sakani by the Ministry of Housing (Figure 7), the launch of the Wafi online program and the creation of a real estate refinance company by the Public Investment Fund. (Figure 6)

On the back of decelerating economic growth, triggered by the slump in oil prices which began in the second half of 2014, the residential sector saw a slow down in performance which has continued throughout 2017 in a context of tightening liquidity.

On the supply side of the residential market, the reduction in government

FIGURE 2  
Government spending



Source: IMF economic outlook database, October 2017

FIGURE 3  
Government revenues



Source: IMF economic outlook database, October 2017

FIGURE 5  
Selected targets of the Saudi Vision 2030 and the NTP in relation with the real estate sector

Broad sector targets
Increase the real estate sector's growth to 7% per year up from 4% currently
Increase the private sector contribution from 40% to 65% of GDP with particular focus on energy, healthcare, housing and municipal services
Double the real estate contribution to GDP from 5% to reach 10% by 2020
Specific housing targets
Establish PPPs to develop government land for housing projects
Increase the percentage of available housing units to total number of citizens
Increase Saudi families homes ownership to 52% by 2020 from 47% currently
Other targets
Decrease the average time required to approve new residential projects to 60 days
Establish fast-track licenses and special finance packages to encourage private sector investment in housing projects.

Source: Knight Frank Research, Saudi Vision 2030, NTP

FIGURE 6

Recent government initiatives in support of the real estate sector

June 2016	Release of regulations governing the introduction of a white land tax
November 2016	Approval of regulations for the use and the listing of REITs
January 2017	Increase of the LTV ratio for first home ownership
February 2017	Launch of the Sakani Program by the Ministry of Housing
May 2017	Launch of the Wafi online program
October 2017	Creation of the Saudi Real Estate Refinance Company

Source: Knight Frank Research

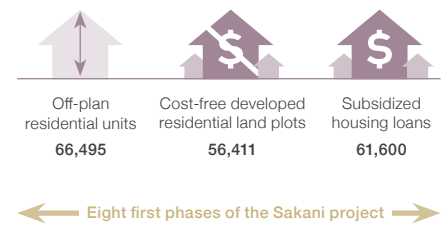
spending is impacting the financing of real estate projects resulting in delays and scaling back of many real estate and infrastructure projects.

On the demand side, households' real disposable income has been dampened by weaker economic conditions. Tightening liquidity and fiscal consolidation measures have altered consumer confidence and eroded spending which has, in turn, undermined real estate transaction volumes and values (Figure 8 and 9). As a result, the residential sector experienced a decline in sales prices due to the lower level of activity. In recent quarters we have seen that residential real estate prices have flattened, which could be an indication that the market has bottomed out and may be close to stabilising following a year of rapid decline (Figure 10).

Data from the Saudi Arabian Monetary Authority (SAMA) reveals that while real estate residential loans granted by banks trended up sharply from 2011 to 2014, the rate of growth decelerated in 2015 down to 8%. The growth in housing loans remained stable in 2016 at 8% despite measures aimed at addressing the affordability of housing, including the rise in the loan to value ratio. Nonetheless, the growth of residential loans outpaced the growth rate of overall banks' lending which stood at a mere 2% for 2016, as consumer confidence remains generally low. (Figure 11)

FIGURE 7

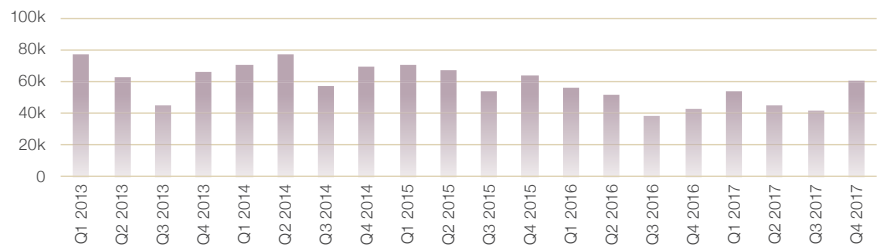
SAKANI housing schemes, milestones from February to September 2017



Source: Knight Frank Research, Ministry of Housing

FIGURE 8

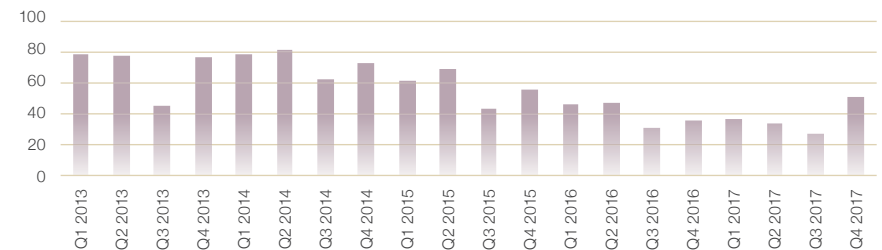
Total number of residential transactions



Source: Ministry of Justice

FIGURE 9

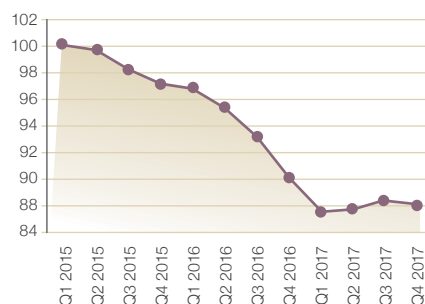
Total value of residential transactions, in SAR billions



Source: Ministry of Justice

FIGURE 10

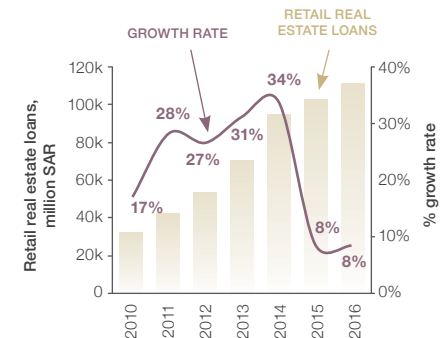
KSA residential price index (2014=100)



Source: General Authority of Statistics

FIGURE 11

Residential real estate loans



Source: Saudi Arabian Monetary Authority (SAMA)

## Riyadh Demand

Demand for residential property is expected to be underpinned by a growing population, the lack of existing good quality stock and a long term trend towards smaller average household size. Going forward, these factors should inevitably fuel the demand for residential units in Riyadh.

Currently, the level of demand for housing units continues to outstrip supply as developers have found it increasingly difficult to bridge the gap between supply and demand due to construction delays and the lack of available land. Supply/demand imbalances are more pronounced in the mid-to-lower end of the market which has traditionally been overlooked by developers due to lower development margins.

## Supply

Generally, Riyadh has seen rapid growth in its urban limits over the past five decades with the majority of developments currently taking place beyond King Salman Road as the city continues to expand in a northerly direction due to the availability of land in locations further away from the city centre.

While we remain concerned about prevailing economic conditions which would result in additional delays in handovers and restructuring in the pipeline, we view the large housing schemes launched by the Ministry of Housing as a positive step in addressing the shortage of housing in Riyadh particularly in the mid-to-lower end of the market.

In the first eight months of the Sakani program which was launched in early 2017, the Ministry of Housing distributed c.38,000 affordable residential products in Riyadh Province, including residential units (17,151 units), cost-free developed residential land plots (3,949 plots) and subsidized housing loans (17,028 loans). While these measures are aimed at addressing affordability, housing supply shortages, and relatively low level of home ownership among Saudi nationals, concerns remain on whether the system

would have sufficient capacity to deliver the required number of units to meet current levels of pent up demand and on the type of product that is being delivered to the market.

## Performance

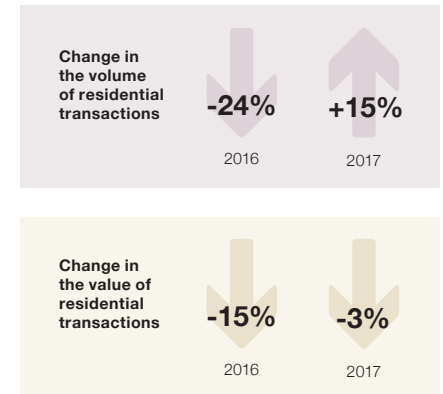
Transaction volumes have increased by 15% in 2017 compared to previous year while the total value of transactions over this period continued to fall, albeit at a slower rate registering a 3% decline compared to a year earlier. (Figure 12)

The average sales price per square metre for apartments across Riyadh gained 36% in 2017, while decreasing by 5% for villas according to data from the Ministry of Justice. This trend in prices, which is clearly in favour of apartments, reflects a shift in residential demand from villas to apartments as limited affordability is driving buyers to purchase smaller size units. (Figure 14)

Although apartment sale prices differ significantly even within major areas of the city, the northern side of the city consistently achieves the highest rates per square metre, particularly in proximity to the Northern Ring Road. In contrast, residential areas in the south such as Al Aziziya and Al Shifa areas achieve the lowest average sales prices.

FIGURE 12

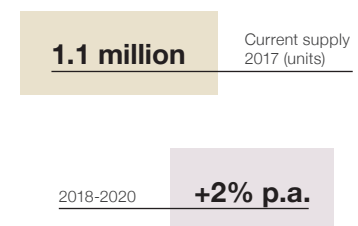
Change in the volume and value of residential transactions, Riyadh



Source: Ministry of Justice

FIGURE 13

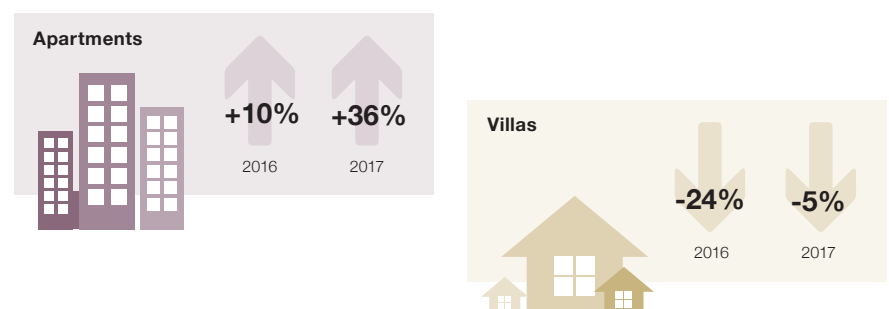
Existing and future supply, Riyadh



Source: Knight Frank Research

FIGURE 14

Sales price growth, Riyadh



Source: Knight Frank Research, Ministry of Justice

## Jeddah Demand

In Jeddah, demand for residential units will continue to be supported by a dynamic momentum in population growth. Jeddah's population is estimated to grow at an average of 2.5% over the next five years (2018-2022) which will be met with pent up demand for housing.

Similarly to Riyadh, demand for residential units continues to outstrip supply in Jeddah which has been exacerbated by significant construction delays especially in large scale developments.

## Supply

In Jeddah we are seeing oncoming supply being mostly geared towards middle-income housing, with the north of Jeddah increasingly seeing the majority of development activity. This will prompt further lifestyle focused developments and urban growth to the North of the city over the next couple of years as land availability remains restricted.

In the short term we remain cautious of the delivery of many projects within the announced timelines including large-scale community developments. Nevertheless, as a large proportion of residential homes are built outside of such master plans, forthcoming residential units are likely to be understated.

While supply/demand imbalances should remain a concern over the next few years,



**STEFAN BURCH**  
Partner, Saudi Arabia

“Despite lacklustre performance throughout 2017, we remain broadly positive when it comes to the medium term outlook, mainly as a result of government initiatives aimed at addressing key challenges restraining the residential market’.”

we see the affordable housing schemes which are being implemented by the Ministry of Housing as a step in the right direction for alleviating supply shortages in the residential market. In the first eight months of the Sakani program which was launched in the beginning of 2017, the Ministry of Housing distributed c. 32,000 affordable residential products in the Makkah Province, consisting of residential units (11,796 units), cost-free developed residential land plots (10,046 plots) and subsidized housing loans (9,963 loans).

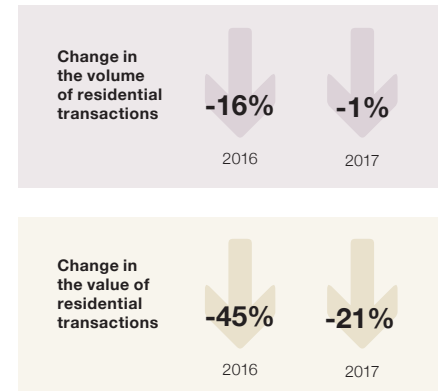
## Performance

Transaction volumes remained relatively unchanged in 2017 compared to previous year while the total value of transactions over this period have witnessed a 21% year-on-year decline. (Figure 15)

The average sale prices per square metre across Jeddah have stabilized for apartments in 2017 while decreasing by 24% for vilas according to data from the Ministry of Justice. (Figure 17)

Similar to Riyadh, sales prices for apartments have been supported by a shift in demand from villas to apartments as buyers' appetite for more affordable housing options is increasing given reduced spending power.

FIGURE 15  
Change in the volume and value of residential transactions, Jeddah



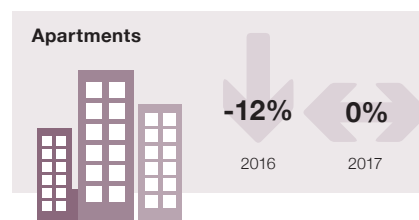
Source: Ministry of Justice

FIGURE 16  
Existing and future supply, Jeddah

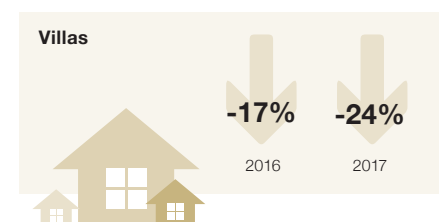


Source: Knight Frank Research

FIGURE 17  
Sales price growth, Jeddah



Source: Knight Frank Research, Ministry of Justice





## Eastern Province

### Demand

In recent years, the fall in oil prices has resulted in cutbacks in the labour market as the Eastern Province economy has been historically heavily reliant on the hydrocarbon sector. This has, in turn, exerted downward pressure on demand for residential real estate which we see prevailing in the short to medium term. Despite current headwinds to the residential market, our view remains positive for the longer term as we expect demand for residential properties in Dammam and Khobar to remain supported by population growth and a potential for significant pickup in economic growth from current levels.

### Supply

In the Eastern Province, the introduction of the white land tax and the recent fall in the cost of building materials is driving development activity. This is despite the fact that demand for residential property has been cooling over the past two years in light of the sharp fall in oil prices which has hit the local economy.

New residential developments in Al Khobar are largely taking place in the Al Hamra and Al Aziziyah districts, which are close to the King Fahd Causeway, as the central areas have a limited stock of residential land available following many years of strong development activity.

The affordable housing schemes which are being implemented by the Ministry of Housing are playing a key role in triggering more activity in the residential real estate market. In the first eight months of the Sakani program which was launched in the beginning of 2017, the

Ministry of Housing distributed c. 25,000 affordable residential products in Eastern Province, consisting of residential units (15,294 units), cost-free developed residential land plots (1,894 plots) and subsidized housing loans (8,015 loans).

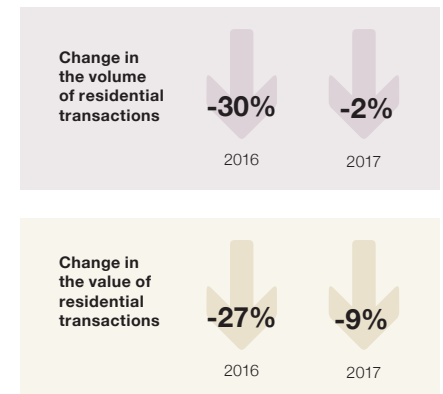
### Performance

Transaction volumes fell by 2% in 2017 compared to the previous year while the total value of transactions over this period have witnessed a 9% decline year-on-year. (Figure 18)

The average sale prices per square metre for villas across Dammam and Khobar have declined by 28% in 2017, while the average sale prices per square metre for apartments have decreased by a softer 7% according to data from the Ministry of Justice. (Figure 20)

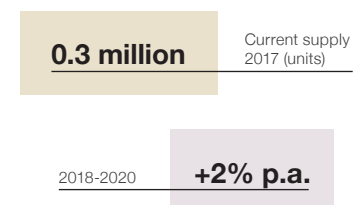
Similar to Riyadh and Jeddah, sales prices in the Eastern province have been more resilient to the downside for apartments as compared to villas on the back of a focused demand towards apartments rather than villas. This is attributed to the fact that buyers are targeting more affordable housing options including smaller size units in light of current market conditions, weighing on consumer spending power.

FIGURE 18  
Change in the volume and value of residential transactions, Dammam and Khobar



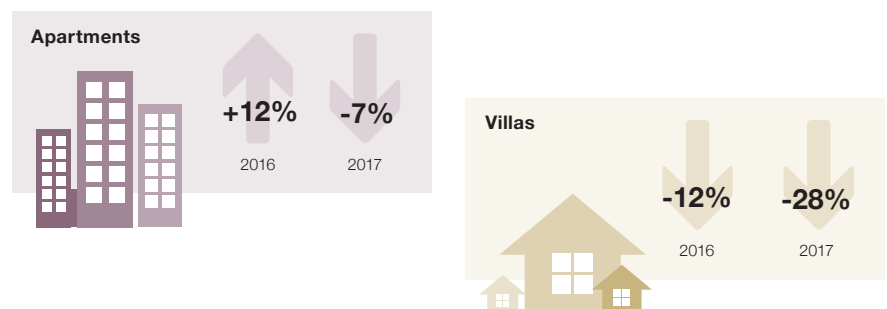
Source: Ministry of Justice

FIGURE 19  
Existing and future supply, Dammam and Khobar



Source: Knight Frank Research

FIGURE 20  
Sales price growth, Dammam and Khobar



Source: Knight Frank Research, Ministry of Justice

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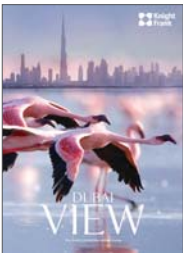
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