

# REAL ESTATE INVESTMENT TRUSTS

## INSIGHTS ON SAUDI ARABIA | Q4 2019

### Viewpoint

Since the listing of the first REIT on the Tadawul in late 2016, we have seen the number of REITs listed on the stock exchange reach 17, with a total market capitalisation of USD 3.7 billion as at early November 2019. This is a substantial increase compared to Q1 2018, Knight Frank's last REIT update, where the market consisted of 12 REITs with a USD 2.3 billion market capitalisation. However, as expected we are seeing a slowdown in listings, with the vast majority of activity taking place in 2018 and not 2019. In 2018 nine new REITs were listed compared to just one listing to date in 2019.

From a regulatory perspective, the Saudi Arabian Capital Market Authority (CMA) has proven to be generally proactive in addressing the various regulatory challenges facing the market. A key proposed regulatory change that we had identified in our last review is the increase in the minimum capital requirement for new funds from SAR 100 million to SAR 500 million. A strong and flexible regulatory framework, which has proven to be favourable for the development of REIT markets in more mature jurisdictions, will remain a key objective in the governance of the REIT market in Saudi Arabia.

Earlier this year, the inclusion of selected Saudi-based REITs in the FTSE EPRA Nareit Emerging Index was announced. The FTSE EPRA Nareit Global Real Estate Index Series is specialised in REITs and real estate companies and is designed as a performance-tracking tool for both developed and emerging markets. We expect the inclusion of Saudi REITs in this global real estate benchmark to have a favourable impact on the market by further aligning the regulatory guidelines governing their listing and operations with international best practices. Furthermore, the inclusion is seen as an important step towards increasing transparency, improving corporate governance

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and incentivising accessibility of foreign investors to Saudi capital markets while broadening the investor base. Generally, this falls in line with the recent inclusion of the Tadawul All Share Index in global benchmark indices including the MSCI Emerging Markets Index and the FTSE Russell Emerging Markets Index.

From a valuation perspective, Saudi-based REITs have seen their price to net asset value (NAV) narrow over the past two years with REITs currently trading at an average of 9% discount to NAV, a figure that is in line with more mature markets. On a positive note, the index tracking the performance of Saudi REITs showed healthy performance in the first ten months of 2019, following a significant drop in 2018. The index rose by over 5% during this period, indicating that the market performance of Saudi REITs is likely turning the corner following a correction phase that has offset initial buoyancy. Going forward we should expect spreads between higher and lower quality REITs to widen given the greater availability of financial information enabling investors to increase their focus on fundamentals such as the quality of the underlying portfolio and the stability of the cash flows.

The growing depth of the market is offering a more favourable platform for investors willing to adopt a long-term investment approach while taking advantage of the portfolio diversification benefits offered by REITs. Moreover, the increased level of competition in the market is considered to be a trigger for the adoption of best-in-class practices by REIT management teams.

Diversified REITs are consolidating their dominance on the market as opposed to thematic REITs due to a structural lack of institutional grade real estate stock. This trend

contrasts with more mature markets where there is a greater prevalence of thematic REITs, allowing investors to gain exposure to specific asset classes in line with individual risk/return profiles. Following a phase of rapid expansion, the pace of REIT listings on the Tadawul has started to lose momentum in 2019, which should be an indication of the trend that will be shaping the upcoming phase. The limited number of approvals that are currently in the pipeline indicates that the listing momentum will remain moderate, in line with what we have seen throughout 2019.



**SAUD SULEYMANI**  
Partner, Saudi Arabia

*“We have seen REITs starting to invest outside of Saudi Arabia, where Saudi REITs are able to invest up to 25% of their capital in international markets. Recent examples include Riyadh REIT’s partial acquisition of an office building in Washington D.C., USA and Bonyan and MEFIC REITs’ acquisition of residential assets in Dubai.”*

# Key findings

1

Five new REITs have been listed on the Tadawul since our Q1 2018 review, taking the total number of REITs listed on the market to 17 with a market capitalisation of **USD 3.7 billion**.

2

Diversified REITs account for around **80%** of listed REITs.

3

Saudi-based REITs have seen their price to net asset value (NAV) narrow over the past two years with REITs currently **trading at an average of 9% discount to NAV**, a figure that is in line with more mature markets.

4

The index tracking the performance of Saudi REITs showed **healthy performance** in the first ten months of 2019, with the index rising by **over 5%** during this period.

5

Saudi-based REITs offer investors an average **7.3% dividend yield**, representing an attractive return well above the levels displayed by some key global benchmarks.

6

The recent inclusion of selected **Saudi-based REITs in the FTSE EPRA Nareit Index** signals an important step in the development of the REIT market in Saudi Arabia.

Figure 1  
The evolution of the global REITs market



Sources: National Association of Real Estate Investment Trusts (NAREIT)

## The GCC REIT market

### Update

#### Saudi Arabia

In Saudi Arabia, five new REITs have been listed on the Tadawul since our Q1 2018 review, taking the total number of listed REITs on the market to 17.

The market capitalisation of listed REITs on the Tadawul reached USD 3.7 billion as at early November 2019, compared to USD 2.3 billion as at the end of Q1 2018, representing a growth of 61%.

#### Other GCC countries

During 2019, there were no major developments in the regulatory or listing activities in the GCC REIT markets outside of Saudi Arabia. The most recent development has been the implementation of a regulatory framework for the use and listing of REITs in Oman in January 2018, hence joining the UAE, Saudi Arabia and Bahrain as GCC countries with established listed REIT regulations (Fig. 2).

## The Saudi Arabian REIT market

### Recent developments

In June 2019, the inclusion of selected Saudi-based REITs in the FTSE EPRA Nareit Emerging Market Index was announced after all required criteria for the inclusion were met.

The FTSE EPRA Nareit Global Real Estate Index Series is a property index specialised in REITs and real estate companies and is designed as a performance-tracking tool for both developed and emerging markets.

As at 31 October 2019, there were 6 Saudi-based REITs in the FTSE EPRA Nareit Emerging Index with a combined market capitalisation of almost USD 1.4 billion, these REITs account for 0.7% of the index.

The reclassification of Saudi Arabia as an eligible market for the FTSE EPRA Nareit series represents an important step in the development of the REIT market in the Kingdom and in the government's drive to increase transparency and visibility around real estate markets.

**STEFAN BURCH**  
Partner, Saudi Arabia

*“Three years following the implementation of a regulatory framework governing the use and the listing of REITs in Saudi Arabia, the market has witnessed a significantly expansion. There are currently 17 listed REITs on the Tadawul with a market capitalisation of 3.7 billion.”*

Figure 2  
Key highlights about GCC REIT markets in Q4 2019\*

Key highlights	Dubai (UAE)	Abu Dhabi (UAE)	Saudi Arabia	Bahrain	Oman
Years law enacted	2006	2015	2016	2016	2018
Regulatory authority	Dubai Financial Services Authority (DFSA)	Financial Services Regulatory Authority (FSRA)	Capital Markets Authority (CMA)	Central Bank of Bahrain (CBB)	Capital Markets Authority (CMA)
Exchange/ Financial Centre	Nasdaq Dubai / DIFC	Abu Dhabi Global Market (ADGM)	Tadawul	Bahrain Bourse	Muscat Securities Market (MSM)
Number of REITs*	2	2**	17	1	0
Estimated number of assets owned	22	N.A	140	2	N.A
Market capitalisation (million USD)**	322	N.A	3,709	47	N.A

Sources: Knight Frank Research, Macrobond, Local exchanges websites, REITs financials  
Notes: \*As at November 01, 2019  
\*\*Based on ADGM website. REITs on the ADGM are incorporated as private REITs  
\*\*\* Market capitalisation calculated by multiplying the total number of shares by the share price

## Investment approach

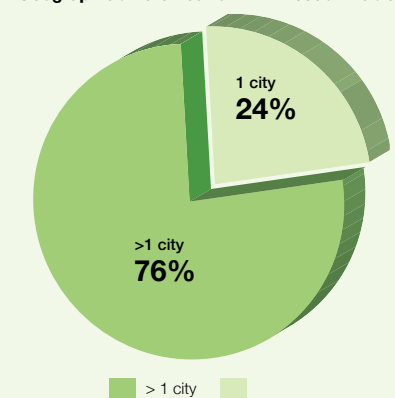
### Sector diversification

The Saudi Arabian listed REIT market is characterised by a large dominance of non-thematic REITs, accounting for around 80% of listed REITs as at Q3 2019. This compares to circa 70% in our previous Q1 2018 review given that the large majority of newly listed REITs have an exposure to more than one asset class. This is partly the result of a limited stock of institutional grade assets that can be placed within REIT structures which have the ability to provide investors with a long-term sustainable income.

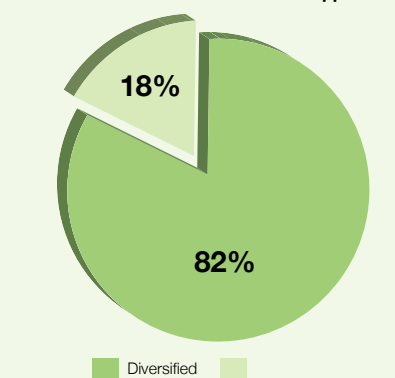
A greater prevalence of thematic REITs is common in more mature markets, enabling investors to gain exposure to specific real estate sectors. The share of thematic real estate companies and REITs in the FTSE/EPRA, NAREIT Global index and in the MSCI World

Figure 3  
Portfolio allocation of listed REITs as of Q4 2019<sup>(1)</sup>

#### Geographic diversification within Saudi Arabia



#### Thematic vs. diversified investment approach



Sources: Knight Frank Research, Tadawul  
Notes: (1) Based on the portfolio allocation of Saudi-based REITs as at November 01, 2019

REITs Index stood at 65% and 91% respectively as at 31 October 2019.

Although the blended approach provides investors with important long-term diversification benefits, the thematic approach can better match an investor's risk profile. This is particularly important for investors seeking exposure to non-cyclical, defensive sectors such as healthcare and education.

### Geographic diversification

In terms of geographic diversification, the number of listed REITs where assets are spread across more than one city in the Kingdom has been steadily increasing and now currently stands around 76%. This compares with just 50% of total REITs in our Q1 2018 review.

We have also seen REITs starting to invest outside of Saudi Arabia, where Saudi REITs are able to invest up to 25% of their capital in international markets. Recent examples include Riyadh REIT's partial acquisition of an office building in Washington D.C., USA and

Bonyan and MEFIC REITs' acquisition of residential assets in Dubai.

### Market price performance

Following initial buoyancy we have seen a significant price moderation starting late 2017. The REIT index has dropped by approximately 30% in 2018 in the context of a softening real estate backdrop despite the Tadawul gaining nearly 9% in the same period supported by the inclusion story and a regain in confidence among investors.

Most REITs have pared back early gains and are currently trading below listing price. The average performance of Saudi-based REITs from listing date until 01/11/2019 stands at -11% (Fig. 4).

On a positive note, the REIT index rose by approximately 5% so far in 2019 pointing to the fact that the market performance of Saudi REITs is likely turning the corner following a correction phase that has offset initial buoyancy (Fig. 5).

Figure 4  
Performance of Saudi REITs from listing date until 01/11/2019<sup>(1)</sup>



Sources: Knight Frank Research, Macrobond  
Note: (1) REITs are presented in this graph chronologically based on their listing

## Valuation

The initial trend for trading at a premium to NAV was mainly attributable to large amounts of capital seeking exposure to income producing real estate.

During the past two years, pricing has moved closer in line with mature markets and Saudi-based REITs are currently trading at an average of 9% discount to their NAV. (Fig. 6).

Going forward we should expect spreads between higher and lower quality REITs to increase as investors increase their focus on fundamentals.

### PRICE TO NAV BENCHMARKS

GLOBAL AVERAGE	US AVERAGE	UAE AVERAGE
5%	6%	55%
PREMIUM <sup>(1)</sup>	PREMIUM <sup>(1)</sup>	DISCOUNT <sup>(2)</sup>

Sources: Knight Frank Research, Macrobond, UBS  
Notes: (1) UBS priced at 08/11/2019  
(2) NAV as per H1 2019 financials

## Dividend yields

REITs in Saudi Arabia are required to distribute 90% of their profits to unit holders in the form of dividends, with only 10% of profits allowed to be re-invested.

With the market gaining in maturity and a rise in the number of REITs on the market, dividend yields are becoming a key performance indicator to watch and an indicator of long-term success for investors.

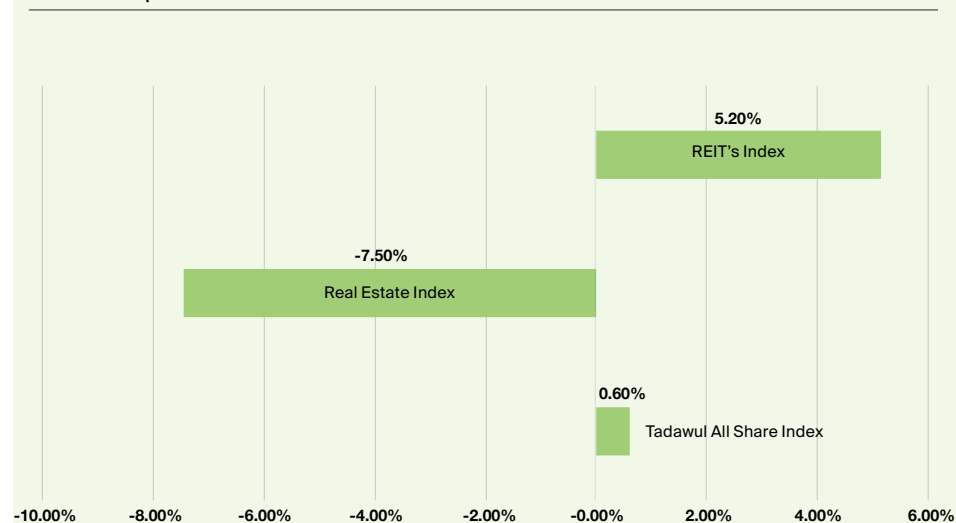
Our calculations show that REITs in Saudi Arabia offer investors an average of 7.3% dividend yield, representing an attractive return for investors. This is well above the average dividend yield offered by some of the key global REITs indices and above our previous dividend yield estimate (Fig. 7).

### DIVIDEND YIELD BENCHMARKS

FTSE EPRA NAREIT GLOBAL INDEX	3.8%	FTSE EPRA NAREIT EMERGING INDEX	4.8%
MSCI WORLD REITS INDEX	3.4%	US REITS	3.5%
<b>GLOBAL REITS</b>		<b>3.8%</b>	

Sources: Knight Frank Research, Macrobond, UBS, FTSE

Figure 5  
2019 YTD performance: REITs vs. Real Estate vs. Tadawul All Share Index<sup>(1)</sup>



Sources: Knight Frank Research, Tadawul website  
Notes: (1) YTD performance based on November

Figure 6  
Price to Net Asset Value (NAV) ratios of Saudi-based REITs

	Market capitalisation as at 01/11/2019 (in SAR mn)	Net Asset Value (in SAR mn)	Price to NAV as at 01/11/2019
Riyadh REIT	1,367	1,628	0.84
Al Jazira Mawten REIT	142	107	1.32
Jadwa REIT Alharamain	508	637	0.80
Taleem REIT	545	529	1.03
Al Almaather REIT	496	587	0.84
Musharaka REIT	726	890	0.82
Mulkia REIT	526	586	0.90
Al Ahli REIT	1,161	1,383	0.84
Mashaar REIT	431	579	0.74
Jadwa REIT Saudi	1,580	1,555	1.02
Al Rajhi REIT	1,088	1,243	0.88
Derayah REIT	1,000	1,047	0.96
SEDCO Capital REIT	504	569	0.89
Bonyan REIT	1,495	1,453	1.03
Swicorp Wabel REIT	923	1,117	0.83
Mefic REIT	572	762	0.75
Al Khabeer REIT	678	643	1.05
<b>KSA REITs Price to NAV priced at 01/11/2019</b>			<b>0.91</b>
<b>KSA REITs Price to NAV priced at 29/03/2018</b>			<b>1.01</b>
<b>KSA REITs Price to NAV priced at 28/09/2017</b>			<b>1.49</b>

Sources: Knight Frank Research, Tadawul website, Macrobond, REITs financials  
Note: - REITs are presented in this table chronologically based on their listing date on the Tadawul  
- NAV as per H1 2019 financials  
- NAV as per H1 2019 financials; market capitalisation as at 01/11/2019

Figure 7

### Dividend yields of Saudi-based REITs

	TTM Dividend Per Share (in SAR)	Market price (in SAR) as at 01/11/2019	Estimated Dividend Yield %
Riyadh REIT	0.52	7.96	6.5%
Al Jazira Mawten REIT	0.50	12.00	4.2%
Jadwa REIT Alharamain	0.54	7.69	7.0%
Taleem REIT	0.64	10.68	6.0%
Al Almaather REIT	0.64	8.08	7.9%
Musharaka REIT	0.72	8.25	8.8%
Mulkia REIT	0.68	8.76	7.8%
Al Ahli REIT	0.65	8.44	7.7%
Mashaar REIT	0.52	7.53	6.9%
Jadwa REIT Saudi	0.72	10.00	7.2%
Al Rajhi REIT	0.63	8.90	7.1%
Derayah REIT	0.75	9.30	8.0%
SEDCO Capital REIT	0.65	8.40	7.7%
Bonyan REIT	0.75	9.18	8.1%
Swicorp Wabel REIT	0.67	7.82	8.6%
Mefic REIT	0.60	7.80	7.8%
Al Khabeer REIT	0.80	10.20	7.9%
<b>KSA REITs Dividend Yield priced at 01/11/2011</b>			<b>7.3%</b>
<b>KSA REITs Dividend Yield priced at 10/04/2011</b>			<b>6.1%</b>

Sources: Knight Frank Research, Tadawul website, FTSE, MSCI

Note: - REITs are presented in this table chronologically based on their listing date on the Tadawul  
 - TTM Dividends for these REITs have been estimated by annualising most recent payouts.  
 - Index factsheets, priced at October 31, 2019

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Figure 8

### SWOT analysis

#### STRENGTHS

- Portfolio risk diversification benefits
- Attractive dividend yields
- Liquid exposure to commercial real estate
- Inclusion of the Tadawul and selected REITs in key global benchmark indices
- Market depth / increased competition/ best-in-class practices

#### WEAKNESSES

- Shortage of institutional grade assets to be placed in REIT structures
- Dominance of local and retail investors in the market

#### OPPORTUNITIES

- Continuous improvement in the investment climate
- Government focus on the real estate sector in the Kingdom
- Pro-active regulatory authority and evolving regulations
- Geographic diversification of the asset portfolio
- Thematic REITs

#### THREATS

- Lackluster macroeconomic conditions
- Soft performance of the underlying asset class
- Evolving regulations