RESEARCH

Knight Frank

H1 2014 SAUDI ARABIA OFFICES

Market update

HIGHLIGHTS

- The non-oil private sector looks set to drive growth in 2014, aided by large public sector infrastructure spending and strengthening domestic demand.
- Completion of construction projects will remain a challenge in light of tightening labour laws which has resulted in large numbers of workers being deported.
- Demand for office space has historically been driven by the public sector. However with growth of 4.9% the non-oil private sector looks set to underpin demand in the short term.
- Grade A rents remain stable in Jeddah, Riyadh and Eastern Province while Grade B rents across the Kingdom soften slightly.
- With large amounts of supply due to be released to the market in each major centre, citywide vacancy rates look set to increase.

KHAWAR KHAN
Research Manager

"The performance of the Jeddah market is explained by its relatively low vacancy rate – driven down by a combination of strong demand from the public and private sectors, as well as weak supply of new, prime office space."

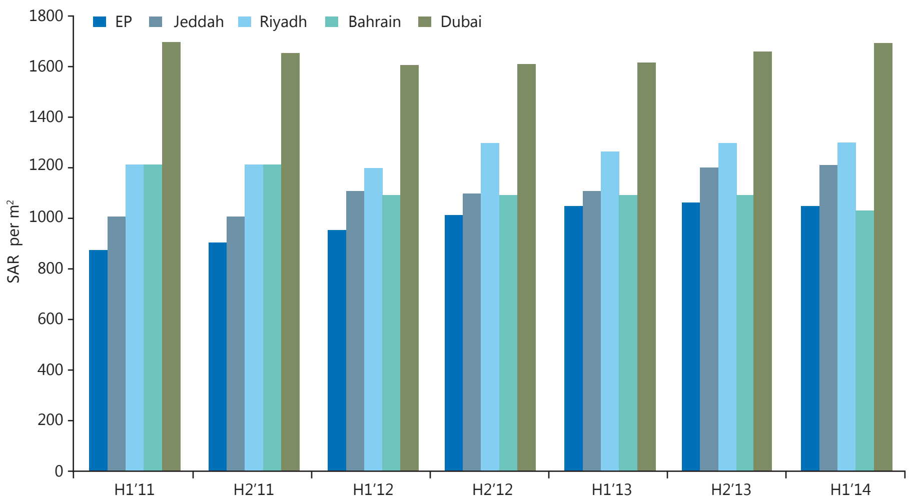
SAUDI ARABIAN ECONOMY WEATHERS LOCAL UPHEAVAL

Last year, the Saudi Arabian economy weathered the upheaval in nearby Egypt, as well as the on-going civil war in Syria, fairly well. Admittedly, with estimated real GDP growth of 3.8%, the pace of expansion in the Kingdom was a little lower than in recent years, but this was largely down to the 0.7% decline in the oil sector as production fell in light of weaker global demand. By comparison, at 4.9%, non-oil growth was relatively robust in 2013, with the construction, transport, storage and communication sectors performing especially strongly.

Finance, real estate & business services, and the public administration sector – together accounting for a third of total GDP in Saudi Arabia – also saw decent growth last year, of 4.9% and 3%, respectively. Broadly, expansion in these sectors helped to drive office occupier demand across Jeddah, Riyadh and the Eastern Province, especially for prime office space, which remains in short supply across the Kingdom as a whole. With demand for Grade A stock outstripping supply, rents on average rose by 6% year-on-year in Saudi Arabia in the first half of this year.

A breakdown of this shows that, in annual terms, in H1 2014, prime office rents in Jeddah rose by 9%, while rents in the Eastern Province and Riyadh rose by about 5%. The performance of the Jeddah market is explained by its relatively low vacancy rate – driven down by a combination of strong demand from the public and private sectors, as well as weak supply of new, prime office space. By comparison, over the past year, while rental values in Dubai have risen by 5%, those in Bahrain have fallen by the same magnitude. However, while the market is currently performing well relative to others in the region, it's worth noting that a significant amount of new supply will be delivered in the medium term, especially in Riyadh, which in turn should apply downwards pressure on citywide rents.

Figure 1
Grade A rents

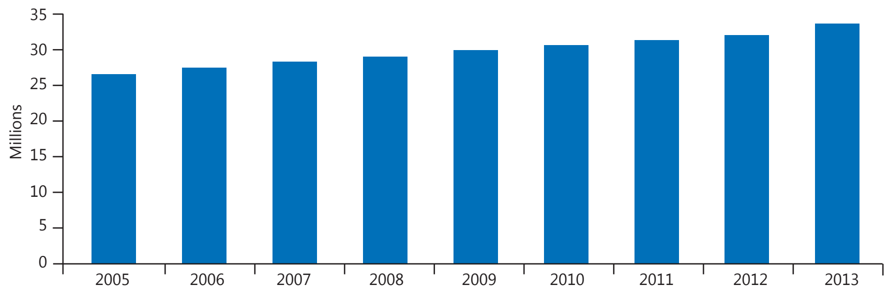


Source : Knight Frank

MACRO OVERVIEW

- Following growth of 5.8% in 2012, real GDP in Saudi Arabia is estimated to have expanded by 3.8% last year. The slowdown was primarily down to weakness in the oil sector, which contracted by 0.7% as global demand faltered and supply levels rose.
- In its latest plans, the authorities forecast another expansionary budget in order to further diversify the Kingdom's economy. What's more, despite a potential decline in oil revenue, significant levels of expenditure are planned to be directed towards the education, infrastructure and health sectors.
- The non-oil private sector looks set to drive growth in 2014, aided by large public sector infrastructure spending and strengthening domestic demand.
- Saudi Arabia is forecast to see strong population growth over the next few years. Indeed, according to the IMF, the Kingdom's population could rise from around 29 million currently to 32.7 million by 2018.

Figure 2
Population growth

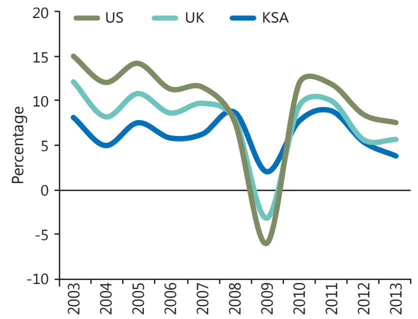


Source : Central Dep of Statistics and Information, Trading Economics

Market comment

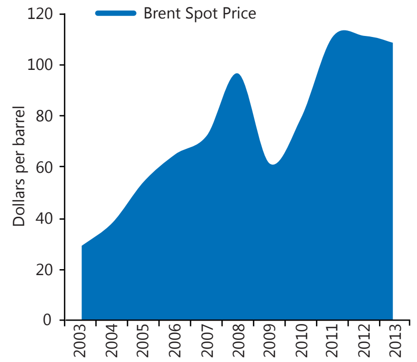
- With 60% of the population under 30 years of age, providing rewarding, sustainable jobs in the private sector will remain a key challenge for the Kingdom over the coming decade.
- The rising population will mean that the delivery of affordable housing will remain an important theme. As things stand, developers are struggling to deliver the requisite number of units. This helps to explain the government's decision to allocate a further SAR 5bn to the Real Estate Development Fund (REDF) to finance circa. 12,000 units.
- Despite rising demand for residential stock, and expansion in the non-oil private economy, the completion of construction projects will remain a key challenge for the Kingdom. This is especially true in light of the recent tightening of labour market laws, which has reportedly led to a 25% decrease in foreign labour recruitment and the deportation of 1 million illegal expatriates.

Figure 3
Annual GDP growth



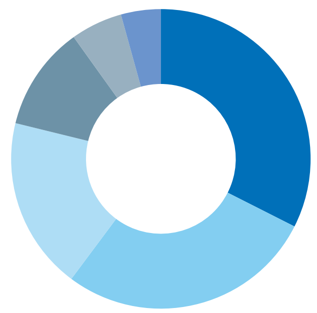
Source : Macrobond

Figure 4
Oil prices (2003-2013)



Source : EIA

Figure 5
Population segmentation (Age)



0-14	32%
15-29	28%
30-39	19%
40-49	11%
50-59	6%
60 over	4%

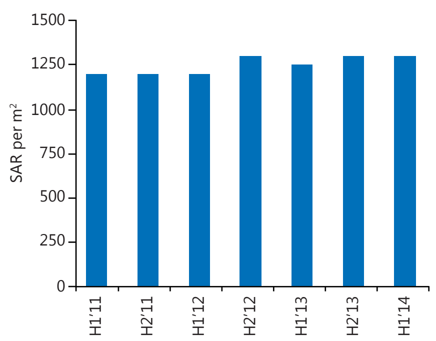
Source : Central Dep of Statistics and Information

H1 2014
RIYADH

HIGHLIGHTS

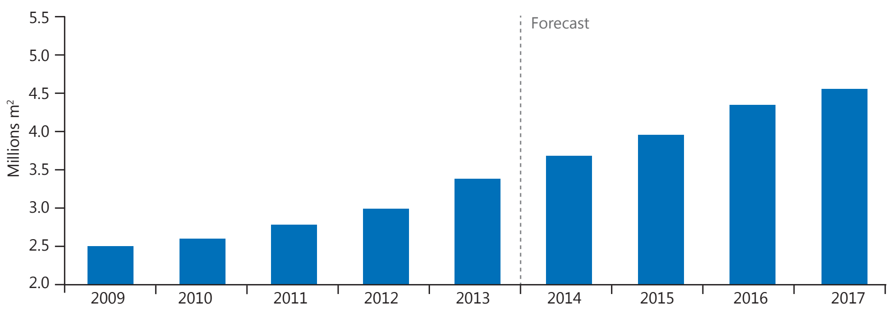
- Riyadh continues to develop as the foremost commercial centre of Saudi Arabia, being home to the majority of financial and banking institutions.
- Historically, commercial developments have been concentrated on King Fahd Road and Olaya Street. However, as traffic congestion has increased new development activity is being witnessed in the north of the city, in master planned schemes such as KAFD and ITCC.
- The current supply of Grade A and Grade B stock stands at circa 3 million square metres. However, if most of the new supply is delivered, total stock should increase by 50% in the short to medium term.
- Future supply is set to raise the standard of commercial offerings as flexible floor plates, parking and ease of access become more important to occupiers.

Figure 7
Riyadh Grade A rents



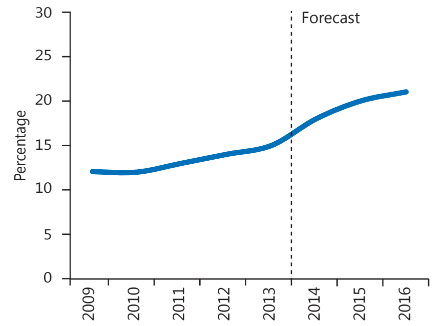
Source : Knight Frank

Figure 6
Riyadh stock (2009 - 2017)



Source : Knight Frank

Figure 8
City wide vacancy rates



Source : Knight Frank

Figure 9
Key market indicators

H1 2014	Value	Trend
Grade A	SAR 1,300	◀▶
Grade B	SAR 900	▼
Vacancy	18%	▲

Source : Knight Frank

MARKET VIEW

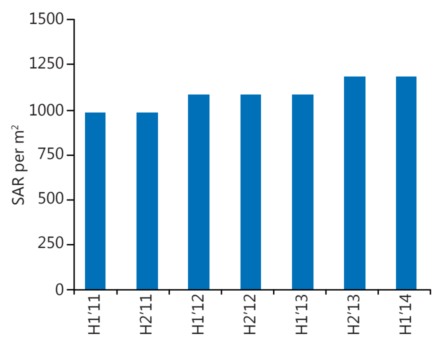
- While take-up in recent times has been robust (Granada Business Park and Riyadh Business Gate, for example, are nearing maximum occupancy), the city is expected to witness a large increase in supply as the first stages of KAFD and ITCC reach completion.
- Grade A commercial rents have remained stable over the past 12 months and currently stand at SAR 1,300 per square metre per annum. Meanwhile, Grade B space is currently leasing for SAR 900 per square metre per annum.
- While vacancy rates have remained fairly low at 18%, we suspect these will rise as new stock is released to the market. As a result, only those buildings with flexible floor plates and good parking ratios will be able to command premium rental rates.

H1 2014
JEDDAH

HIGHLIGHTS

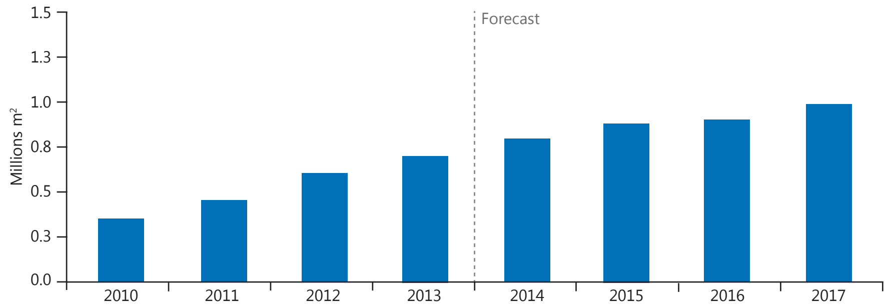
- Like Riyadh and the Eastern Province, Jeddah does not benefit from a CBD. Instead, many companies have built owner-occupied premises on land that they have owned for a number of years.
- Modern commercial development is currently focussed along a number of main roads, including Tahlia Street, Prince Sultan Street, Madinah Road and King Abdul Aziz Road.
- Jeddah does not have any international Grade A space, with Jameel Square remaining the best quality building to date. That said, parking ratios and access here remain below par.
- The supply of regional Grade A and B stock currently stands at a little under 800,000 square metres. However, this is set to increase dramatically in the short term as new schemes are completed.

Figure 11
Jeddah Grade A rents



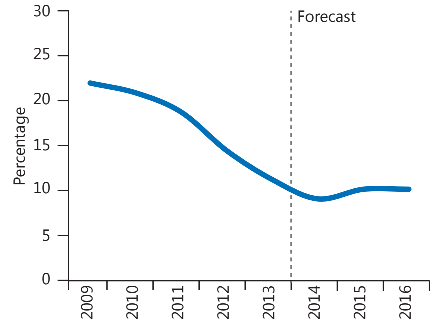
Source : Knight Frank

Figure 10
Jeddah stock (2010 - 2017)



Source : Knight Frank

Figure 12
City wide vacancy rates



Source : Knight Frank

Figure 13
Key market indicators

H1 2014	Value	Trend
Grade A	SAR 1,200	◀▶
Grade B	SAR 700	▼
Vacancy	10%	◀▶

Source : Knight Frank

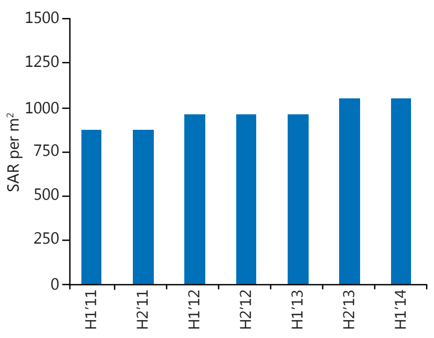
MARKET VIEW

- Rental rates across Grade A and B stock have been stable over the past six months, standing at SAR 1,200 per square metre per annum and SAR 700 per square metre per annum respectively.
- Demand driven by both the public & private sectors has helped to keep vacancy rates low, at least relative to the rest of the region.
- We estimate that there will be an additional 100,000 square metres of stock released to the market in 2014, the majority of which will be in the Head Quarter Building situated on the Corniche.
- Grade A rents look set to remain stable as supply for good quality space remains tight. Meanwhile, Grade B rents are likely to fall as the market becomes two-tiered, with older stock becoming difficult to lease.

HIGHLIGHTS

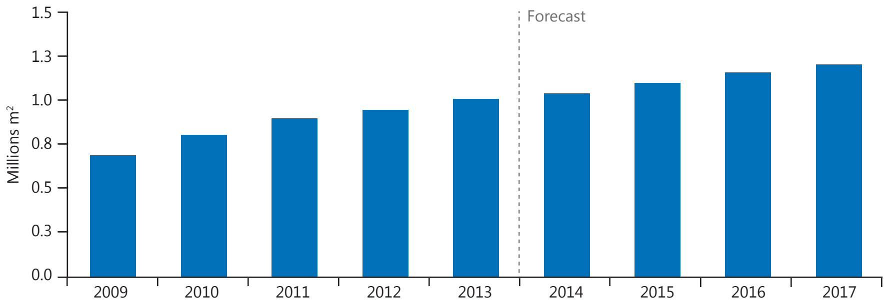
- The Eastern Province conurbations of Dammam, Al Khobar and Dhahran do not currently benefit from a well-defined CBD. As a result, the majority of commercial development has been focussed along main roads, often with retail space on the ground floor.
- The market has not placed importance on Grade A stock, large amounts of which is owner occupied. As a result, the majority of stock is classed as Grade B by international standards.
- Al Khobar benefits from better quality stock in comparison to Dammam, with the Corniche emerging as a focus for a number of multi storey commercial and mixed-use developments.

Figure 14
Eastern province Grade A rents



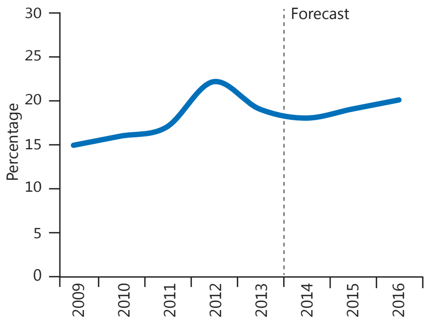
Source : Knight Frank

Figure 14
Eastern province stock (2009 - 2017)



Source : Knight Frank

Figure 16
City wide vacancy rates



Source : Knight Frank

Figure 17
Key market indicators

H1 2014	Value	Trend
Grade A	SAR 1,050	◀▶
Grade B	SAR 700	◀▶
Vacancy	18%	▼

Source : Knight Frank

MARKET VIEW

- Stock levels currently stand at around 900,000 square metres, although this figure looks set to rise over the short to medium term as new projects are delivered to the market. That in turn will exert upward pressure on vacancy rates.
- Tenants remain price sensitive and continue to place higher importance on parking and ease of access, with quality of premises coming second.
- Demand for commercial stock has primarily been driven by the oil sector, with ARAMCO the largest employer both directly and indirectly.
- The expectation is that as the market develops, demand will shift from a reliance on the oil and gas sectors to the expanding service economy.

STEFAN BURCH
Director of Professional Services

"As the market continues to develop and availability of land becomes increasingly important, we see good demand for high quality mixed use schemes situated in key locations".

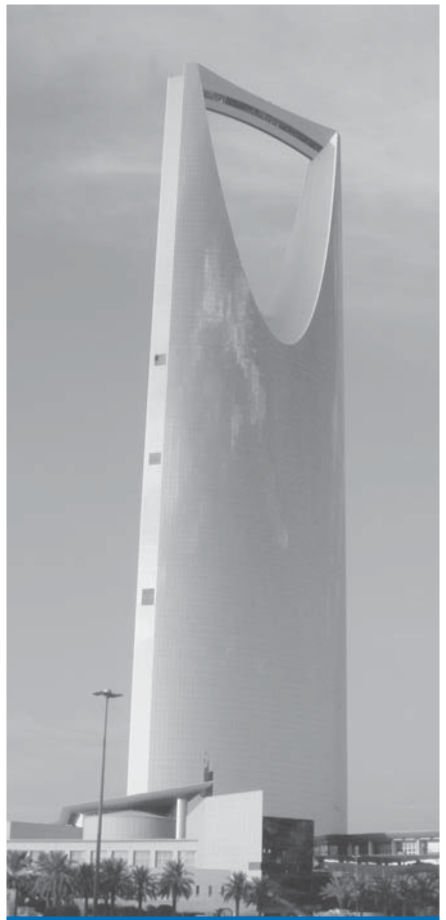
H2 2014 forecast

As the government seeks to continue the diversification of the economy away from a reliance on hydrocarbons and related sectors, what does the future hold for the commercial office market in Saudi Arabia?

An analysis of the current market shows that in general the quality of commercial offerings has historically been poor with the few prime buildings benefitting from almost 100% occupancy (see below). While there are large levels of supply due to be released to the market in each of the major cities across Saudi Arabia, phasing of developments such as KAFD and ITCC will smooth any major effect on rental values and vacancy rates.

Going forward we see strong demand for prime commercial space which offers flexible floor plates, good parking ratios and easy access in the short to medium term. In addition, as the market continues to develop and availability of land becomes increasingly important, we see an opportunity to develop good quality mixed use schemes which more accurately respond to the needs of occupiers whether they be office tenants, retailers or residents.

Grade A stock with high occupancy



Kingdom Centre, Riyadh

Turki Business Park, Eastern Province

Jameel Square, Jeddah

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