

RESEARCH



RIYADH RESIDENTIAL RESEARCH REPORT

H2 2014

DESPITE THE DELIVERY OF A NUMBER OF MAJOR RESIDENTIAL SCHEMES IN THE CAPITAL,
DEMAND FOR HOUSING CONTINUES TO OUTSTRIP SUPPLY

RESIDENTIAL PRICES CONTINUE TO RISE AS DEMAND OUTPACES SUPPLY

Urban re-generation expected to play an important role in delivering suitable housing for Riyadh's rising population

POPULATION AND LABOUR FORCE

Saudi Arabia has witnessed rapid population growth over the past decade, outpacing the region's average. According to the Saudi Arabian Monetary Agency (SAMA), the population of Saudi Arabia reached 30 million in 2013 – up 2.7%

on the preceding year and 36% higher compared to 2003. Moreover, estimates suggest that, in 2013, Saudi Arabia's population was around 52% larger than the rest of the GCC combined, and – in contrast to its neighbours such as the UAE, Qatar and Kuwait – the kingdom's expatriates were in the minority. Indeed, non-nationals account for less than a third of the total population.

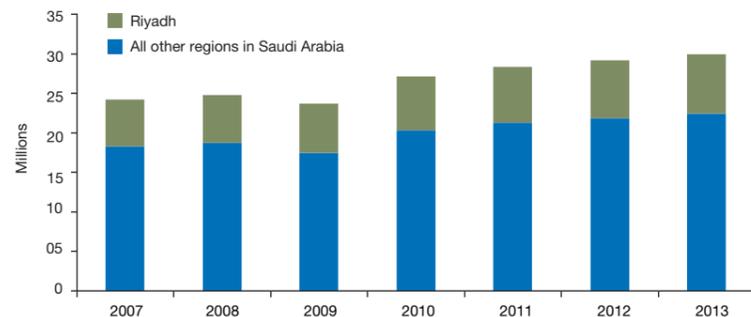
Nevertheless, employment growth across Saudi Arabia has been strong. Indeed, in 2013, it rose by 13.9% year-on-year to 10.9 million. That said, the unemployment rate edged up from 5.5% in 2012 to 5.6% last year, with a breakdown showing that higher joblessness among non-nationals was responsible for the uptick. Indeed, the unemployment rate in this segment rose from less than 0.1% in 2012 to 0.2% in 2013. By contrast, the unemployment rate for Saudi nationals declined by 0.4% points to 11.7% last year.

In light of population growth, labour market reforms and an increasing need for suitable housing, what does the future hold for Riyadh's residential market?

The number of inhabitants in the administrative region of Riyadh – which accounts for one-quarter of the kingdom's population – rose by 2.8% to 7.5 million last year. In addition, data from SAMA showed that, alongside the Eastern region, Riyadh's population was the fastest growing in Saudi Arabia between 2008 and 2013.

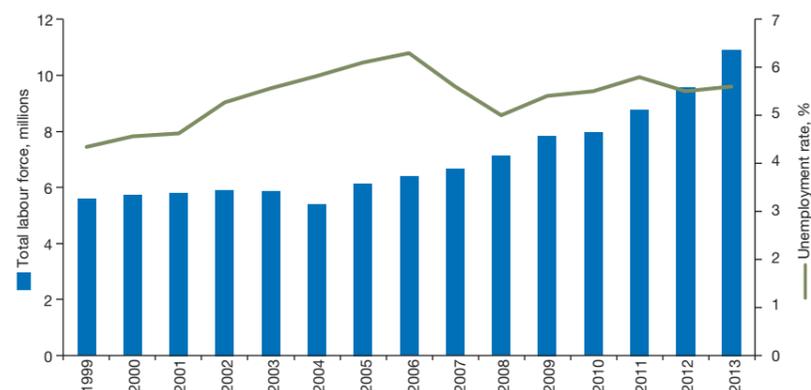
This growth can largely be attributed to increasing urbanisation, high birth rates and rising numbers of expatriates joining the local workforce. The latest available data, for example, shows that the number of non-nationals in Riyadh's labour force increased at an average rate of 5.2% per year between 2006 and 2013. On the

FIGURE 1
Population, Saudi Arabia



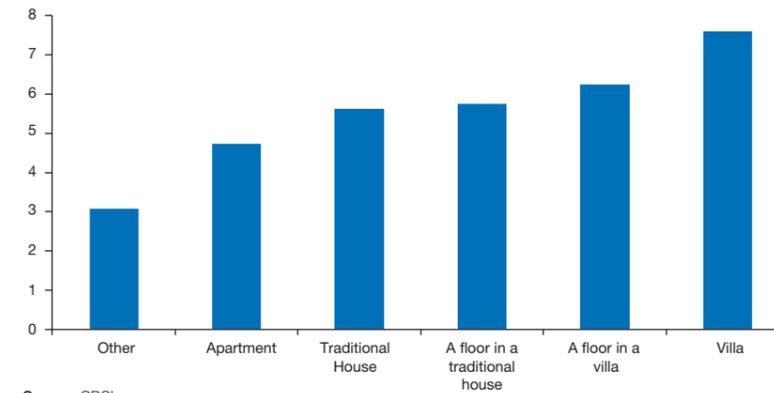
Source: SAMA

FIGURE 2
Labour force and unemployment rate (%), Saudi Arabia



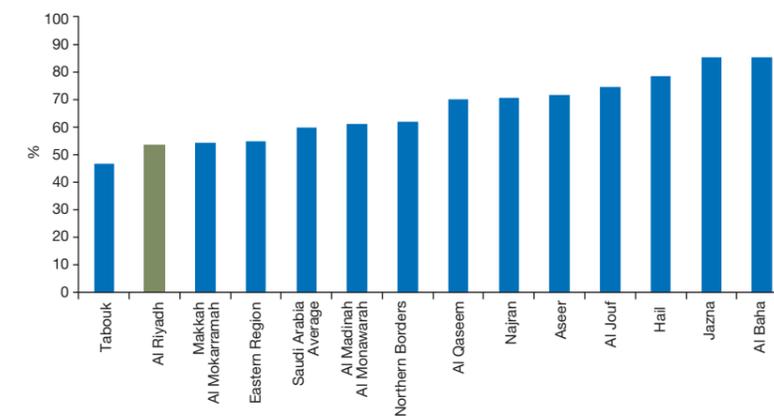
Source: SAMA

FIGURE 3
Average number of people living in a housing unit, Riyadh



Source: CDSI

FIGURE 4
Home ownership rates among Saudi citizens, by administrative area



Source: CDSI

same basis, employment among Saudi nationals rose by 3.2%.

In order to alleviate demographic pressures, the authorities have begun to implement labour market reforms in recent years. These include raising private sector employment among Saudis, strengthening education & training, enhancing the mobility & recruitment of foreign labour, and the removal of illegal workers.

But even if Saudi Arabia's illegal workforce declines over the next few years, the population of Riyadh overall is likely to continue rising. This is of concern given that the city is already facing an acute shortage of housing – as a result of which inhabitants are living in relatively cramped conditions. Indeed, figures from the Central Department of Statistics and Information (CDSI) show that the average household



STEFAN BURCH
Partner Advisory Services

As Riyadh continues to develop, we see an opportunity to respond to the current housing shortage by redeveloping local communities as the interaction between the urban and social fabric of the city becomes increasingly important

size for the administrative region of Riyadh is 5.6. By comparison, broad estimates for India (5.3), Mexico (4.3), US (2.6) and UK (2.3), for example, are notably lower.

Moreover, according to the CDSI's 2010 General Census of Population and Housing, 60% of housing units in Saudi Arabia are owner-occupied (the figure for Riyadh stood at just 53%). By comparison, Ernst and Young's 2013 Housing the Growing Population report shows that the neighbouring countries of the UAE (75%), Qatar (80%), Bahrain (82%) and Oman (83%) have much higher levels of owner occupation.



GOVERNMENT INITIATIVES

Over the past few years, a combination of rapid population growth and a shortfall in the number of units built has been exacerbating the housing undersupply issue in the kingdom. In 2011 then, King Abdullah announced a plan to construct 500,000 homes; unfortunately however, the programme was slow to gain traction due to problems relating to land availability, the complexity of allocating aid and slow-moving bureaucratic processes.

In order to bypass these obstacles, in March 2014, the Ministry of Housing launched a scheme called ESKAN. Through this programme, Saudi families seeking assistance programme were given two months to register online for a state-subsidised home loan or a subsidised sale of land or housing. But in order to be eligible for the scheme, a number of conditions were attached, including applicants not being an existing home owner or a previous recipient of aid from a state-subsidised housing programme. Also, applications would reportedly be prioritised through a points system, which consider factors such as family size, monthly income, age etc., with the neediest given precedence.

Other programmes launched, or proposed, since 2011, include the formation of a real estate refinancing company to improve access to finance, plans to launch a specialised credit union, the restructuring & recapitalisation of the Real Estate Development Fund (REDF) to target low-income households and the introduction of a mortgage law.

Among these, the most notable was the implementation of the mortgage law. Announced in March 2013, and comprising a suite of five documents, it was intended to provide low and middle-income Saudis an opportunity to get on the first rung of the property ladder. If successful, according to government estimates, the new law could boost Saudi Arabia's home ownership rate to 80% by 2024. That said, key questions remain unanswered regarding the workings of the law, with its compatibility with Sharia principles considered among the most important.

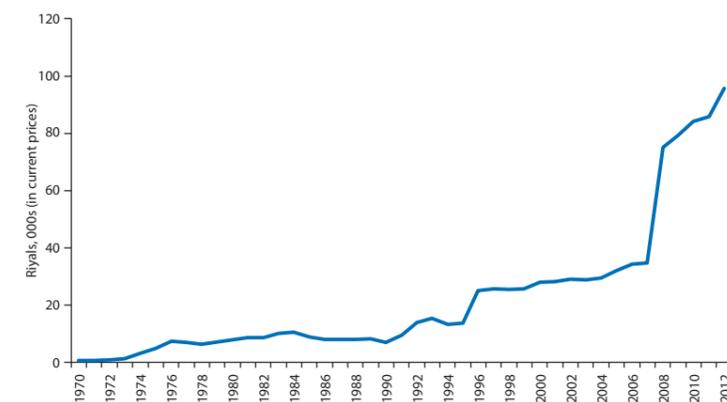
Housing supply

In recent years, Saudi Arabia's residential construction sector has been expanding rapidly. Indeed, the latest available data from SAMA shows that the value of residential building construction across the kingdom rose for the ninth consecutive year in 2012 – increasing by 11.4% year-on-year to SAR95.6 billion (in current prices).

Not surprisingly, Riyadh is an important driver of construction activity in Saudi Arabia; the capital accounted for an average of 27% of all residential and commercial permits issued across the kingdom between 2003 and 2013. Moreover, the number of permits issued in the capital rose by 319% over the 10 year period – outperforming Saudi Arabia as a whole, which experienced a 215% increase.

Despite rising development activity however, demand for residential units continues to outstrip supply in Riyadh. Indeed, the capital has a requirement for around 50,000 housing units per annum over the next five years and has an estimated housing inventory of just 1.15 million units. However, due to construction delays and the lack of available land, developers have found it increasingly difficult to bridge the gap between supply and demand. What's more, although there are a number of large housing schemes planned to be completed in the short term, there is unlikely to be enough capacity in the system to deliver the required number of units to satiate current levels of pent up demand.

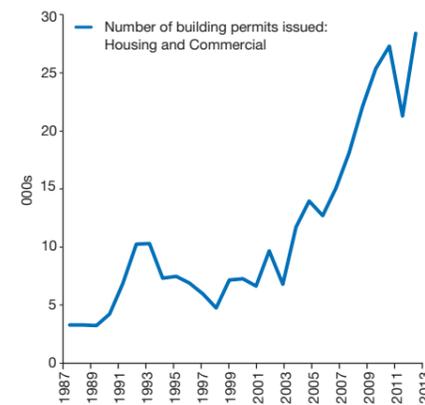
FIGURE 5
Value of residential building construction



Source: SAMA



FIGURE 6
Number of building permits issued, Riyadh



Source: Ministry of Municipal and Rural Affairs

SUMMARY

Over the past year, residential prices in Riyadh have risen by 5-7% overall.

However, we have witnessed variable performances across the capital's districts, with congestion issues in the south, for example, responsible for prices stagnating. Meanwhile, in the north – which has seen notable development activity – prices have seen a healthy uplift of around 9%.

In the short to medium-term, with new supply unlikely to be able to fully offset pent-up demand, we expect residential prices to continue to move in an upward direction.

Market recalibration

The *Ministry of Labour's Statistical Yearbook – 2013* shows that average wages for Saudi nationals in Riyadh stand at almost SAR4,900 per month (or close to SAR58,500 per annum). While household incomes are often higher than this due to multiple family members being employed, average income levels are nevertheless still low relative to average house prices.

Indeed, with an average 130-160 square metre apartment in the south of Riyadh currently priced at around the SAR370,000 mark, the average price to income ratio is 6.1 – high by international standards. Assuming a deposit of 20% and a mortgage amortised over 20 years at 4%, payments therefore account for roughly 37% of average income. Moreover, in the case of an average priced villa of SAR 1,100,000, the average mortgage payment increases to SAR 5,300 per month – higher than the average monthly income. Thus, based on average salaries, an affordable price point for a housing unit appears to be around SAR 300,000–400,000, much lower than current price levels.

Clearly then, there is a considerable mismatch between affordability (based on suitable financing mechanisms) and current residential values. Further analysis shows that high land values have contributed to an escalation in residential sales values. Indeed, with land values in Riyadh

accounting for between 45% to 50% of total development costs, developers have been targeting the middle to upper-end of the market in order to achieve their requisite development margins.

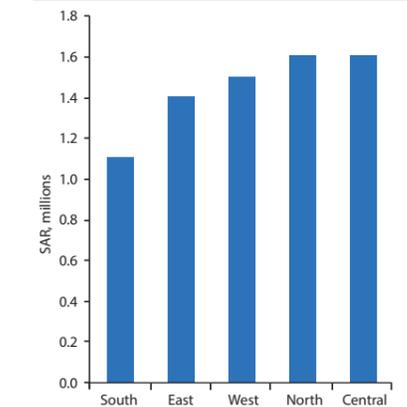
Moreover, along with difficulties in assembling suitable land parcels, another reason for the rise in land values is the manner in which land in the local market is traded – as a commodity rather than by reference to its economic or development potential. That in turn helps to explain the disparity between comparable and residual land values. As a result, we believe that current land values will need to see a correction if they are to align with residual values, in turn enabling developers to undertake schemes that target market demand while also being financially viable.

What is the future for the residential sector in Riyadh?

In the short to medium-term, we believe that urban regeneration will need to play an increasingly important role in Riyadh as existing road and power infrastructure limits the extent to which the city can expand. That said, the planned metro has the potential to regenerate existing neighborhood's in close proximity to its stations as the project opens up travel to parts of the city which currently suffer from congestion, and are seen as less desirable.

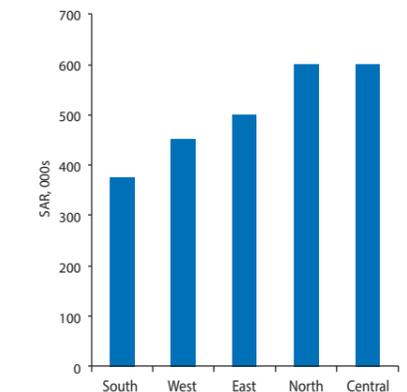


FIGURE 7
Average villa prices by area



Source: Knight Frank

FIGURE 8
Average apartment prices by area



Source: Knight Frank

Moreover, there is a need for a more varied residential product. While Riyadh is dominated by low rise development, young Saudis looking to get on the first rung of the housing ladder are faced with little choice in terms of the type of residential stock available. Going forward however, through the regeneration of existing neighborhoods, and by building a range of residential stock (including apartments, townhouses and villas), these issues may be resolved.

Over the next couple of years, we expect residential prices to continue to rise in Riyadh as the city's rising population exacerbates the already acute housing shortage. Beyond that period, improving infrastructure, as well as new international developers entering the market, should boost construction activity and thus housing completions.



COMMERCIAL BRIEFING

For the latest news, views and analysis of the commercial property market, visit knightfrankblog.com/commercial-briefing/

ADVISORY SERVICES SAUDI ARABIA

Stefan Burch

Partner

M: +973 3955 3776

M: +966 5 3089 3297

Stefan.Burch@me.knightfrank.com

VALUATION & ADVISORY SERVICES

Stephen Flanagan

Partner

O: +971 4 4512 000

M: +971 50 8133 402

Stephen.Flanagan@me.knightfrank.com

CAPITAL MARKETS

Joseph Morris

Partner

O: +971 4 4512 000

M: +971 50 5036 351

Joseph.Morris@me.knightfrank.com

DEVELOPMENT & RESEARCH CONSULTANCY

Harmen De Jong

Partner

O: +971 4 4512 000

M: +971 56 1766 588

Harmen.DeJong@me.knightfrank.com

Khawar Khan

Research Manager

O: +971 4 4512 000

M: +971 56 1108 971

Khawar.Khan@me.knightfrank.com



Technical Note

Floorspace has been sub-divided into Prime, A & B grade accommodation, reflecting high and low quality respectively. Whilst subjective, this categorisation is based on an assessment of each property's age, car parking ratio, specification, quality of finish, location, situation and overall attractiveness.

Category A works comprise services, lift safety elements and basic fittings and finishes for the operation of lettable work space, including but not limited to suspended ceilings; raised floors and skirting; cooling and heating services.

A Tenant Inducement % is the proportion of rent free period over the term certain. The U.A.E Dirham is pegged to the US Dollar at a rate of USD 1 : AED 3.673.

Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.

© Knight Frank LLP 2014

This report is published for general information only. Although high standards have been used in the preparation of the information, analysis, views and projections presented in this report, no legal responsibility can be accepted by Knight Frank Research or Knight Frank LLP for any loss or damage resultant from the contents of this document. As a general report, this material does not necessarily represent the view of Knight Frank LLP in relation to particular properties or projects. Reproduction of this report in whole or in part is allowed with proper reference to Knight Frank Global Research.

Knight Frank UAE Limited - Dubai: Prime Star International Real Estate Brokers "PSIREB" RERA ORN: 11964 trading as Knight Frank with registration number 653414. Our registered office is 5th Floor, Building 2, Emaar Business Park, PO Box 487207, Dubai, UAE.

RECENT MARKET-LEADING RESEARCH PUBLICATIONS



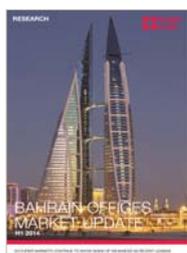
Dubai Offices Market Update Q3 2014



Abu Dhabi Office Research Report Summer 2014



Dubai Industrial Research Report H1 2014



Bahrain Offices Market Update H1 2014



Saudi Arabia Offices Report H1 2014



Riyadh Residential Research Report H2 2014



Dubai Residential Insight Autumn 2014



Dubai View 2014



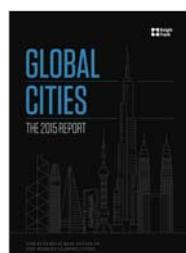
Abu Dhabi and Dubai Hospitality Report Q1 2014



The Wealth Report 2014



Private View 2014



Global Cities The 2015 Report