RESIDENTIAL RESEARCH

SAUDI ARABIA RESIDENTIAL MARKET REVIEW 2019

Key findings

In the first half of 2019, prices appear to have remained under pressure while transaction volumes have picked up significantly across the key cities, indicating that the market may be heading towards the bottom of its cycle.

With a growing urban population and a mismatch in the provision of housing stock to low to middle tier buyers, housing affordability in Saudi Arabia is a rising challenge. The Sakani affordable housing scheme and the efforts to expand the mortgage market are expected to alleviate pressures in this area.

Despite challenging market conditions, we remain encouraged by the various government initiatives aimed at boosting Saudi home ownership and by the government focus on the real estate sector as part of the economic diversification process.

RAYA MAJDALANI
Research Manager

"The residential market remains under pressure as the rising affordability challenge and the lack of suitable supply for middle and lower tier buyers continue to weigh on the sector. In H1 2019 we have seen a significant pick up in transaction volumes across key cities which indicates that the market may be heading towards the bottom of its cycle."

Please refer to the important notice at the end of this report

Introduction

The residential market continued to soften in 2018 as highlighted by lower levels of transactions and a correction in rental and sales prices across the major cities in Saudi Arabia. In the first half of 2019, prices appear to have remained under pressure while transactions volumes have picked up significantly across the key cities, indicating that the market may be heading towards the bottom of its cycle.

The trend towards a weaker residential market was initially triggered by the economic slowdown that started to be felt in 2016; so far, the sector has failed to recover. A combination of factors has prolonged the downturn namely the departure of expatriates from the Kingdom, continuing affordability challenges and the lack of stock targeted at lower to middle tier buyers.

The main target of the government is to increase Saudi home ownership to 52% by 2020 and 70% by 2030. Various initiatives are underway to get Saudi nationals on the housing property ladder. The Sakani affordable housing program, which is now in its third year, and the various regulatory efforts to expand the mortgage market are a case in point.

Despite current headwinds, drivers for the market appear to be positive for the longer term. The government focus on the real estate sector as part of the diversification process of the economy is seen as a catalyst for a more active residential market over the coming years. Moreover, the various urban regeneration initiatives, which are underway, are expected to play a vital role in responding to changing demand dynamics.

FIGURE 1
Key government targets in relation to the real estate sector

- Increase real estate sector growth to 7% per year by 2020
- Increase the size of the mortgage market to SAR 500 billion by 2020
- Increase Saudi home ownership from 47% to 52% by 2020 and 70% by 2030
- x2 Double the real estate contribution to GDP to reach 10% by 2020

Source: Knight Frank Research, NTP, Ministry of Housing

FIGURE 2
Government spending

Source: Knight Frank Research, IMF economic outlook database April 2019 edition, SAMA

FIGURE 3
Government revenues

Source: Knight Frank Research, IMF economic outlook database April 2019 edition, SAMA

Macroeconomic Overview

Following a slight contraction in 2017, Saudi Arabia's GDP growth recovered in 2018, reaching 2.2% according to the latest IMF estimates. The return to growth has been underpinned by a combination of favourable factors including a recovery in oil prices, a gradual acceleration in the growth of the non-oil economy and the government's shift away from a tight fiscal policy that started in 2018.

Higher oil prices are alleviating pressures on the country's fiscal position and paving the way for an expansionary fiscal policy. According to IMF estimates, Saudi Arabia's GDP growth is expected to remain on a positive trajectory, averaging 2.1% over the five year forecast period.

Despite remaining low by historical standards, the Purchasing Manager Index (PMI) - a non-oil economy tracker - rose to 56.8 in March 2019 supported by higher new orders and outputs despite falling employment. Being well above the neutral 50 mark, the latest reading of the PMI points to an expansion in non-oil sectors and a significant recovery of the index from its lowest level on record registered in April 2018 (51.4) to its highest level in more than a year.

This trend is in line with the fact that non-oil GDP growth has been gradually accelerating reaching 2.1% in 2018 up from 1.3% in 2017 and 0.2% in 2016. The non-oil economy is benefiting from the spillovers of oil price recovery and the ongoing reform plans aimed at restructuring the economy and decreasing its reliance on the hydrocarbon sector.

Both the Vision 2030 and the National Transformation Plan (NTP) are set to remain a central element of economic policy over the coming years and provide further support to the expansion of the non-oil private sector.

The employment market has been at the forefront of the economic agenda particularly as Saudi Arabia rolls out the Saudization plan aimed at boosting national employment in the private sector, placing a special focus on youth and women participation in the workforce.

So far, this has entailed the introduction of levies on expats in the form of fees on dependants and the implementation of a plan restricting employment in certain sectors to Saudi nationals. Statistics from the labour force survey suggest that the total number of expats in the employment market continued to decline in 2019 while the unemployment rate among Saudis has edged down to 12.5% in Q1 2019 compared to 12.8% in 2017, marking the lowest level of unemployment since Q4 2016.

From another perspective, Saudi wages have increased by c. 4% since the beginning of 2017, outpacing inflation, a reflection of how Saudization is affecting local economic conditions.

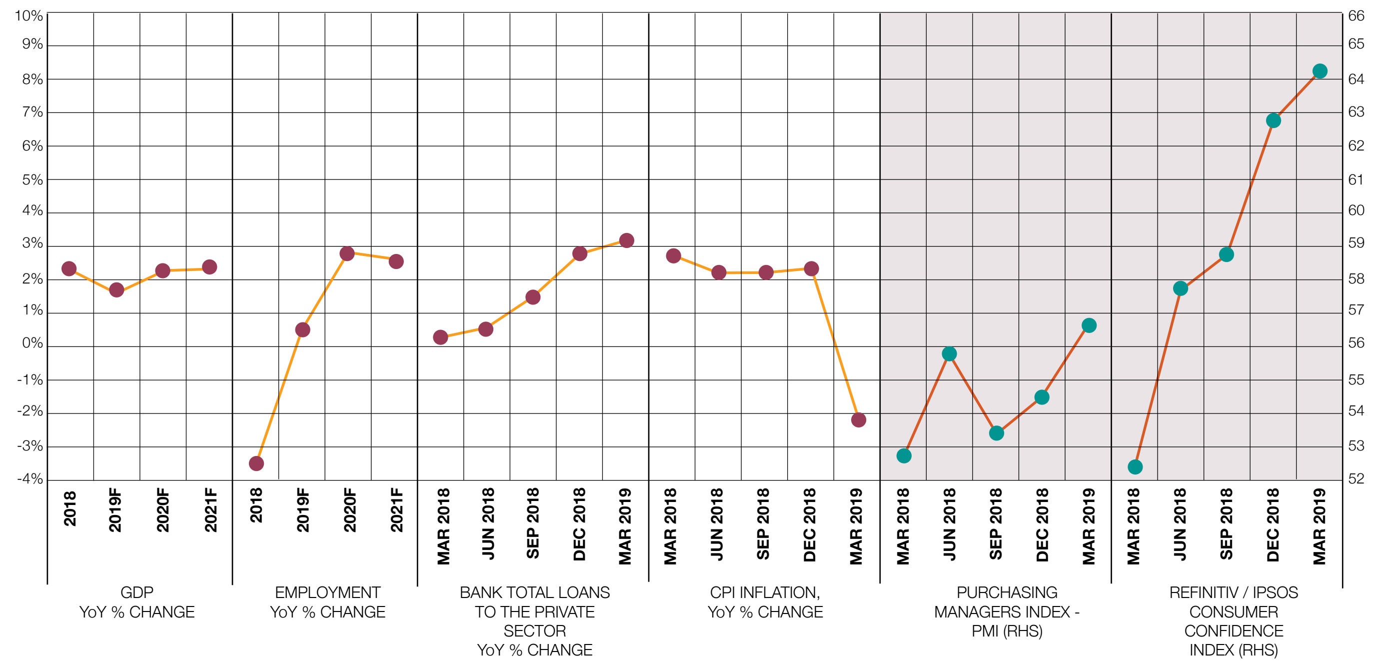
There are signs that the recovery in general economic conditions that started in 2018 is slowly filtering through into the wider system. The acceleration in banks' lending to the private sector following several years of sluggish growth is a case in point and is seen as crucial in driving consumer spending in Saudi Arabia in the short to medium term.

Private sector loan growth came in at 3.1% YoY in March 2019, which was the fastest pace of expansion in more than two years and coincides with an improvement in consumer confidence.

Consumer spending in Saudi Arabia is likely to remain underpinned by subdued price pressures now that the effects on consumer prices from last year's VAT introduction has faded away. More recently, inflation rates have fallen into negative territory mainly the result of declining housing rents.

FIGURE 4

Key economic indicators



Source: Knight Frank Research, IMF, Macrobond, Oxford Economics, IPSOS/Refinitiv

Residential Sector Overview

The real estate sector has been a keystone of government initiatives in recent years. Regulatory efforts such as the white land tax, 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.

Boosting home ownership and growing the mortgage market are two key initiatives aimed at reforming the residential market through the Real Estate Development Fund (REDF) and the Saudi Refinance Company (SRC).The aim of these two entities is to strengthen the home finance market through offering a broader range of options and products.

These initiatives have been designed in part to ensure that the real estate sector realises the goals set out in the National Transformation Plan (NTP) including doubling the sector's contribution to economic output throughout the period to 2020 and increasing growth to 7% per annum.

Housing is one of the biggest areas of spending under the NTP with an allocated budget of SAR 59 billion over five years, an encouraging step for the sector. At circa 65% of the total real estate market, a sustainable and vibrant residential sector is vital to achieving the ambitious reforms as set out in the NTP and Vision 2030.

In the medium term, the implementation of various urban regeneration initiatives including mixed-use communities and ongoing investment in infrastructure looks set to act as a catalyst for a more active residential market over the coming years.

The residential market continued to soften in 2018 as highlighted by lower levels of transactions and a correction in rental and sales prices across the major cities in Saudi Arabia.

While this downward trend was initially triggered by the economic slowdown of 2016, market conditions remain challenging despite the recovery in economic growth that occurred in 2018. The departure of around 1.5 million foreign workers and their dependants in 2017 and 2018, has significantly impacted demand for residential assets in key cities.

We note that the challenge of housing affordability has been rising in key cities across Saudi Arabia due to subdued growth in household income and a mismatch in the provision of stock which has historically targeted the upper end of the market.

Soft market conditions have led to an increase in the volume of residential transactions in Q1 2019 (+63% YoY) and in Q2 2019 (+46% YoY) indicating a pick-up in activity. This coincides with an improvement in consumer confidence in Saudi Arabia, and an acceleration in mortgage lending following a phase of more moderate growth rates.

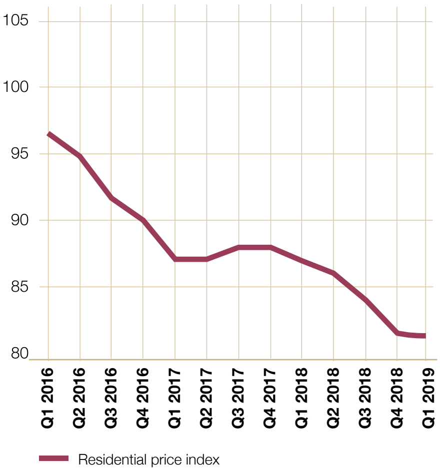
The Refinitiv/Ipsos consumer confidence index has significantly improved throughout 2018 and 2019, hitting a level of 64.1 in March 2019 up from 52.4 a year earlier.

In addition, statistics from the Saudi Arabian Monetary Authority (SAMA) points to a further acceleration in residential real estate loans provided by banks in Q1 2019 to +22% YoY, picking up from +16% in 2018, +10% in 2017 and +8% in 2016. Bank loans allocated to residential real estate totalled SAR 153 billion at the end of Q1 2019.

Going forward we see the potential for demand to strengthen as average household personal disposable income is set to grow by 17% between 2018 and 2023 according to Oxford Economics.

FIGURE 5

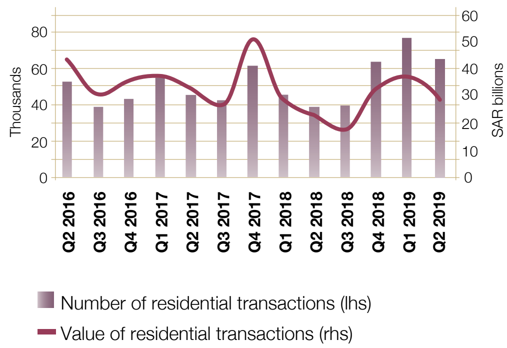
KSA Residential price index



Source: Knight Frank Research, General Authority for Statistics

FIGURE 6

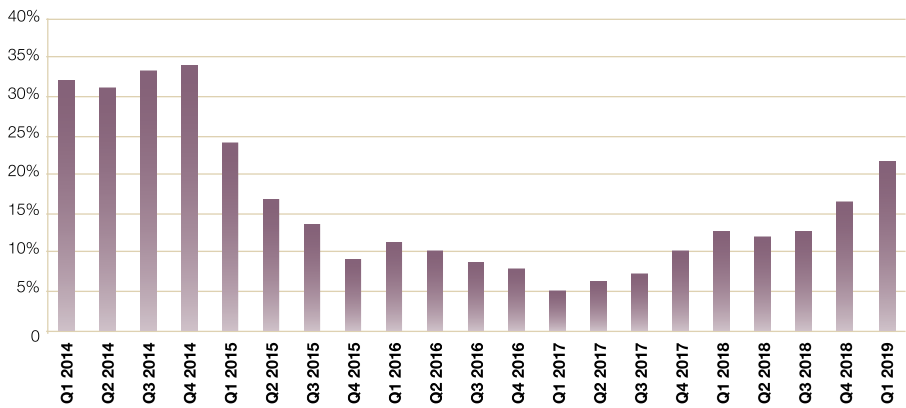
KSA total number and value of residential transactions



Source: Knight Frank Research, General Authority for Statistics

FIGURE 7

Banks total residential loans to the private sector – YoY % Change



Source: Knight Frank Research, SAMA

Demand

Demand for residential assets in key cities has been weakening since 2016. This trend started to be felt along with the economic slowdown that occurred in 2016 and was further exacerbated by the departure of a large number of expatriate families starting 2017. This has prompted nationals to adopt a wait and see approach, postponing their purchases, amidst an ongoing decline in property prices across the city.

Other factors, such as rising affordability pressures and the lack of suitable supply aimed at middle and lower tier buyers, continue to pose systemic challenges in the residential market, prolonging its downturn.

Despite current headwinds, drivers for the residential market appear to be more positive for the longer term as we expect the housing market to remain supported by government efforts to boost home ownership among Saudis, the focus on the real estate sector as part of the diversification process and various urban regeneration initiatives.

This view is further supported by the changing social dynamics driven by the country's young demographic profile. This social change, aided by mounting affordability pressures, is driving demand away from traditional standalone villa properties towards community, lifestyle-focused developments offering modern amenities.

Furthermore, we expect falling household sizes to underpin demand for higher density development providing smaller and more efficient units that are affordable due to a reduction in size rather than build quality.

Supply

Traditionally developers have overlooked the mid-to-lower end of the market while focusing on large villa accommodation and developments in the luxury segment where historically the largest margins have been found. This has exacerbated supply/demand imbalances in the mid-to-lower end of the market.

In Riyadh, urban boundaries have significantly expanded over the past five decades with the majority of developments currently taking place beyond King Salman Road as the city continues to grow in a northerly direction due to the availability of land further away from the city centre.

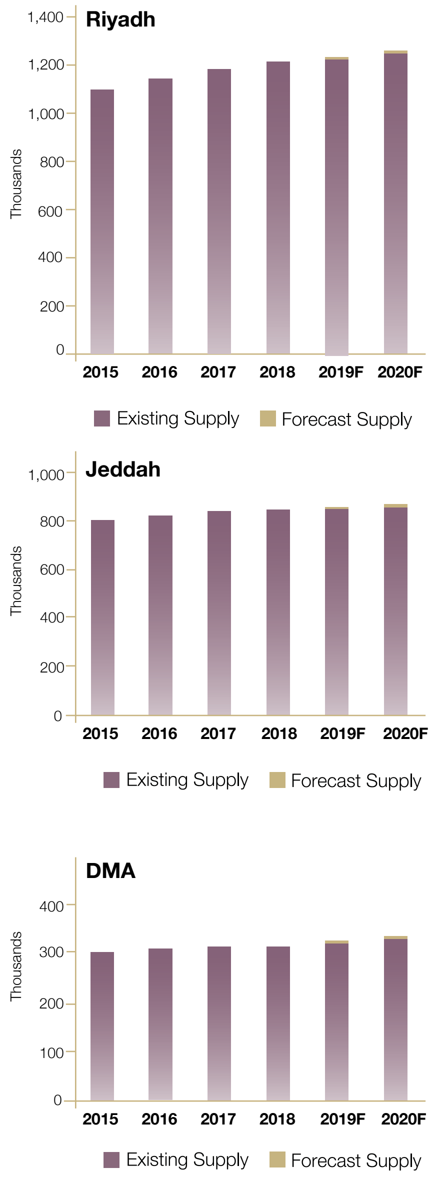
In Jeddah, oncoming supply is being mostly geared towards middle-income housing with the north of Jeddah increasingly seeing the majority of development activity. This will prompt further lifestyle focused developments and urban growth to the north of the city over the next couple of years as land availability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

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 limited availability of residential land following many years of strong development activity.

The Sakani housing scheme that was launched by the Ministry of Housing to get Saudi residents on the property ladder is playing a key role in triggering development activity in the affordable segment of the housing market.

Around 580,000 products were allocated in 2017 and 2018 including mortgage loans, cost-free land plots, under-construction residential units and completed residential units. In 2019, the target is to allocate 200,000 additional products to a number of beneficiaries across the different regions.

FIGURE 9
Existing and future supply of residential units



Source: Knight Frank Research

FIGURE 8
Change in the volume and value of residential transactions

Riyadh

	2017	2018	H1 2019
Value	-3%	-30%	+56%
Volume	+15%	-4%	+66%

Jeddah

	2017	2018	H1 2019
Value	-21%	-41%	+50%
Volume	-1%	-18%	+56%

Dammam & Khobar

	2017	2018	H1 2019
Value	-9%	-34%	-18%
Volume	-2%	-12%	+32%

Source: Knight Frank Research, Ministry of Justice

Performance

In Riyadh, the number of residential transactions increased by 66% on a YoY basis in H1 2019. The value of residential transactions witnessed a significant 56% increase over the same period mainly driven by a surge in transaction volumes as prices remain under pressure.

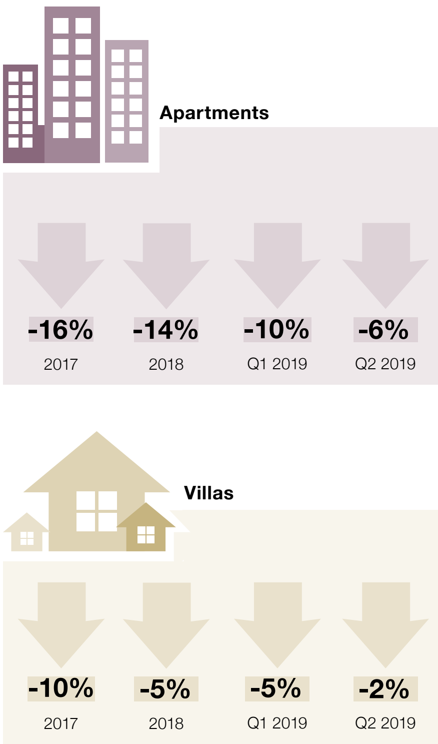
Sale prices for apartments declined by 6% on a YoY basis in Q2 2019, while villa sale prices saw a 2% decline over the same period.

In Jeddah, the number of residential transactions increased by 56% on a YoY basis in H1 2019, indicating that the market may be heading towards the bottom of its cycle. The value of residential transactions in Jeddah witnessed a significant 50% increase over the same period mainly driven by a jump in transaction volumes as prices remain under pressure.

Villa and apartment sale prices have registered declines of 5% and 8% respectively on a YoY basis in Q2 2019.

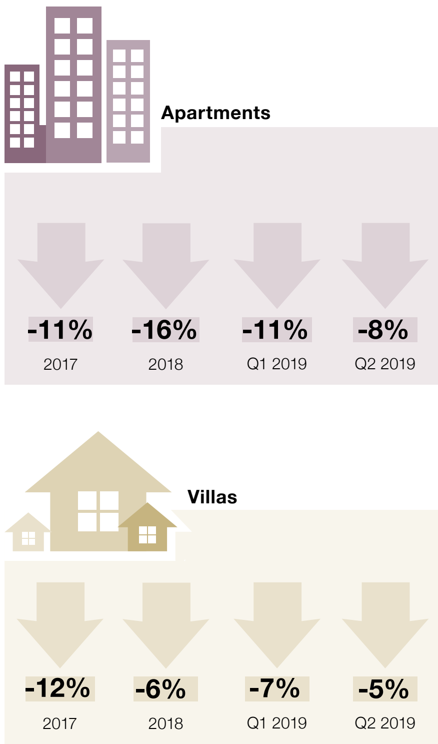
The residential market in the Dammam Metropolitan Area (DMA) saw an improvement in transaction volumes during H1 2019 (+32% YoY) following two consecutive years of decline. Residential prices failed to recover, with the total value of residential transactions dropping by 18% on a YoY basis in H1 2019 and the residential price index for the Eastern Province maintaining its downward trajectory heading into 2019.

FIGURE 10
YoY Sale prices growth, Riyadh



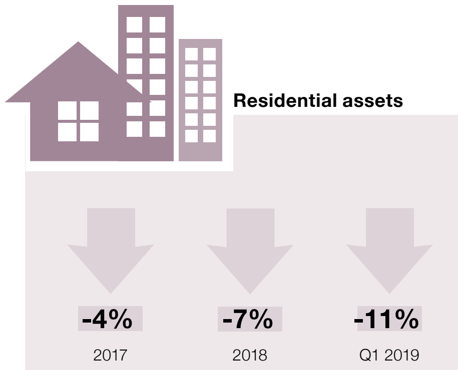
Source: Knight Frank Research

FIGURE 11
YoY Sale prices growth, Jeddah



Source: Knight Frank Research

FIGURE 12
YoY Sale prices growth, Eastern Province*



Note: *based on the GaSTAT residential index for Eastern Province

Source: Knight Frank Research, GaSTAT

Outlook

Despite the downward pressures on the residential market within the Kingdom in recent years, we expect the sector to recover in the short to medium term, as ongoing diversification efforts and regulatory initiatives to stimulate the sector start to materialise.

As the rate of urbanisation continues to increase, the issue of affordable residential real estate is likely to escalate. However, the government is actively looking to ease these pressures, with the roll out of the Sakani program and initiatives to enable greater access to the mortgage market.

From a longer term perspective, the development of megaprojects such as mixed use communities and large scale infrastructure projects will play a vital role in responding to new demand dynamics while spurring meaningful urban regeneration in key cities across the Kingdom.

STEFAN BURCH
Partner, Saudi Arabia

"The government focus on the provision of affordable housing stock for the Kingdom's burgeoning population is seen as a catalyst for sustainable development. Over the longer term, these initiatives are expected to transform Saudi Arabia for the better, improving the quality of life of the local community, a central objective of the Kingdom's leadership."

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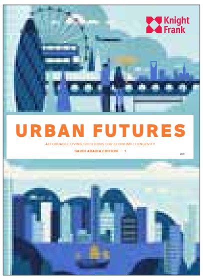

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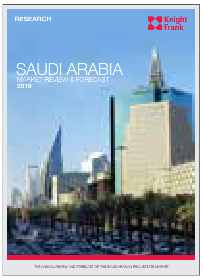

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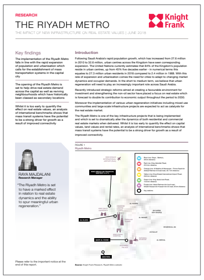

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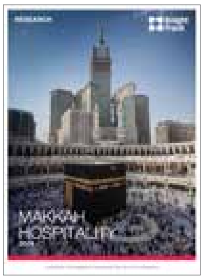

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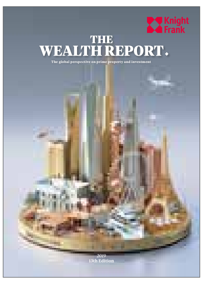

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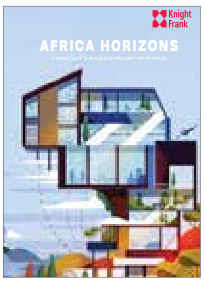

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