

# REAL ESTATE INVESTMENT TRUSTS

## INSIGHTS ON SAUDI ARABIA | Q1 2018

### Key findings

In Saudi Arabia, six new REITs have been listed on the Tadawul, taking the total number of listed REITs on the market to twelve with a total market capitalisation now exceeding USD 2 billion.

While the vast majority of existing REITs are non-thematic, we see the emergence of more thematic REITs as an opportunity for investors.

Pricing dropped over the last two quarters, moving closer in line with more mature markets. Going forward, a greater choice of available REITs is likely to drive prices towards fundamental valuations.

We see investors increasing their focus on fundamentals including income generation and dividend yields as more performance information becomes available.



**RAYA MAJDALANI**  
Research Manager

“As more REITs are listed in Saudi Arabia, we expect the increasing depth of the market to drive pricing closer in line with fundamental valuations and push towards the adoption of best-in-class practices.”

### Viewpoint

Since our last review in November 2017, the REIT market in Saudi Arabia has continued to expand and now surpasses a market capitalisation of USD 2 billion. The number of listed REITs doubled in the last two quarters, with 12 REITs listed on the Tadawul as at the end of Q1 2018.

Looking at the broader landscape, the main development in the GCC has been the introduction of a regulatory framework for the use and listing of REITs in Oman; joining the UAE, Saudi Arabia and Bahrain as GCC countries with established public REIT regulations.

From a regulatory perspective, the Saudi Arabian Capital Market Authority (CMA) has recently proposed some amendments to refine existing legislation including a proposed increase in the minimum capital requirement for new funds, from SAR 100 million to SAR 500 million. A strong and evolving regulatory framework, which has proven to be favorable in more mature jurisdictions, will remain a key objective in the development of the REIT market in Saudi Arabia. This is particularly important given the need to adapt regulations in a dynamic and fast changing investment environment, in the context of the Saudi Vision 2030, which aims to create a business environment that is attractive to investors.

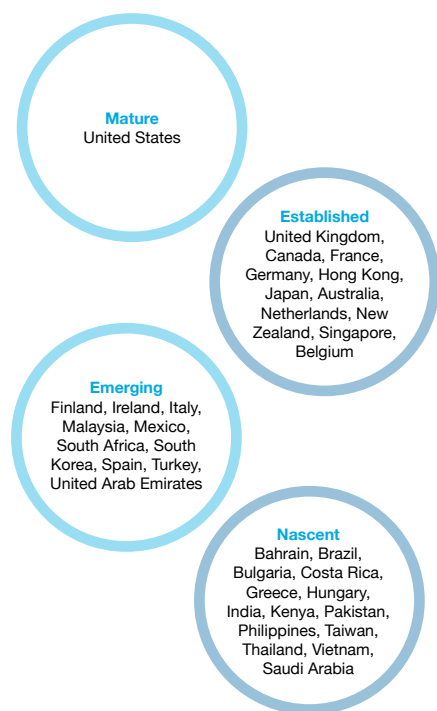
The vast majority of existing Saudi Arabian REITs, have their investments spread across multiple real estate asset classes. This is in part due to a lack of maturity in the market and a constrained pipeline of institutional grade assets. In common with more mature REIT markets, it is likely that thematic REITs will take the lead over diversified REITs in the longer term. Although the blended approach provides important long term benefits, thematic REITs allow investors to gain exposure to specific real estate sectors in line with a specific risk/return profile. This will be particularly important for investors seeking exposure to non-cyclical, defensive sectors such as healthcare and education.

In our previous review, we noted the initial buoyancy of the market where REITs initially traded at a significant premium to Net Asset Value (NAV). This was mainly attributable to large amounts of capital seeking exposure to these REITs compared to the size of the investable universe. Following initial buoyancy, pricing started to moderate in October 2017. At the date of writing, most REITs have pared back early gains and are currently trading below listing price.

As a result, price to NAV has dropped over the last two quarters, moving closer in line with mature markets. Going forward, a greater choice of available REITs is likely to drive prices towards fundamental valuations. In parallel, we see investors increasing their focus on fundamentals including income generation and dividend yields as more performance information becomes available. This will be particularly important for investors looking to adopt a longer term investment approach.

In 2018, we expect more REITs to be listed given the number of approvals that are currently in the pipeline. As more REITs are listed, we expect the level of competition to increase in the market which would translate into a greater focus on the adoption of best-in-class practices in terms of quality of the underlying portfolio, asset management and corporate governance. To this end, the quality of the REIT, both in terms of real estate and asset manager will become paramount which will provide more transparency to market participants and will enable investors to accurately deploy funds in line with a set strategy and risk profile.

FIGURE 1  
Stages of REITs regimes maturity, 2017



Sources: EY Global REIT markets

## The Global REIT Market

### Update

- From mid-2016 to mid-2017 the market capitalisation of the global listed REIT market increased by 4%, exceeding USD 1.7 trillion.
- The United Arab Emirates was moved from the nascent category to the emerging category in the EY classification of REITs regimes maturity. (Fig. 1)

## The GCC REIT market

### Update

#### Saudi Arabia

- In Saudi Arabia, six new REITs have been listed on the Tadawul since Q3 2017, taking the total number of listed REITs on the market to twelve.

- The market capitalisation of the listed REIT universe in Saudi Arabia totaled USD 2.3 billion as at the end of Q1 2018.
- We expect more listings to occur in 2018 given the number of approved REITs and applications that are currently in the pipeline.

#### Other GCC countries

- A regulatory framework for the use and listing of REITs was implemented in Oman in early January 2018, hence joining the UAE, Saudi Arabia and Bahrain as GCC countries which have established REIT regulations.
- Kuwait and Qatar have not yet established regulations for the trading of REITs on their stock exchanges. (Fig. 2)



FIGURE 2  
Key facts about the GCC REIT markets as of Q1 2018

Key information	Dubai, UAE	Abu Dhabi, UAE	Saudi Arabia	Bahrain	Oman
Year law enacted	2006	2015	2016	2016	2018
Regulatory authority	DFSA	FSRA	CMA	CBB	CMA
Exchange / financial centre	NASDAQ Dubai	Abu Dhabi Global Market	Tadawul	Bahrain Bourse	Muscat Securities Market
Number of REITs	2	3*	12	1	0
Estimated number of assets owned	21****	-	76	2	-
Market capitalisation (million USD)	559**	-	2,313***	54	-

Sources: Knight Frank Research, Macrobond, Local Exchanges, REITs news releases and financial statements

Notes: \* incorporated as private REITs in the ADGM;  
 \*\* market capitalisation as of March 30, 2018 calculated by multiplying the total number of shares by the share price;  
 \*\*\* market capitalisation as of March 29, 2018 calculated by multiplying the total number of shares by the share price;  
 \*\*\*\* as of December 31, 2017

# The Saudi Arabian REIT market

## The Regulatory Framework

In Q1 2018, the Capital Market Authority proposed amendments to the initial REITs regulations, which include the following:

- The assets acquired by the REIT are required to have generated net rental revenues in the last 3 years.
- The minimum capital for new funds will be increased from SAR 100 million to SAR 500 million.
- The minimum unitholders from the public will be increased from 50 to 200.

## Investment Approach

### Sector diversification

- Saudi Arabia’s REIT market is currently dominated by non-thematic REITs as 67% of listed REITs have their assets spread across more than one sector.
- This can be partly explained by the lack of institutional grade assets available with long term sustainable income.

- It is likely that we will start seeing the emergence of more thematic REITs as the market gains in maturity enabling investors to gain exposure to specific real estate sectors.
- Although the blended approach provides important long term benefits, the thematic approach can better match the investor’s risk profile. This will be particularly important for investors seeking exposure to non-cyclical, defensive sectors such as healthcare and education. (Fig. 3)

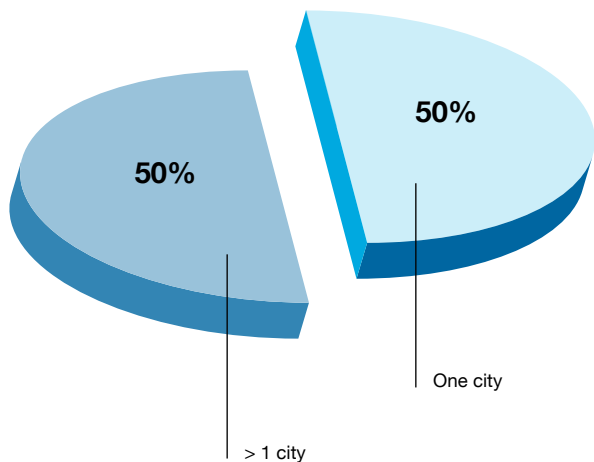
### Geographic diversification

- In terms of geographic diversification, 50% of listed REITs have an exposure to more than one city in Saudi Arabia.
- REITs in Saudi Arabia are allowed to invest up to 25% of their assets value abroad. As the market gains in maturity, it is likely that we will start seeing some REITs investing in neighbouring GCC countries. (Fig. 3)

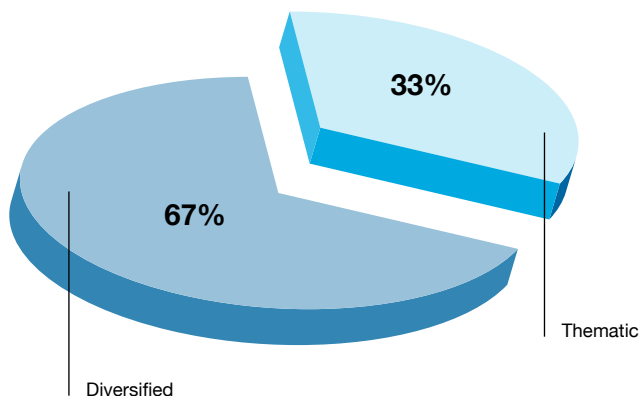


FIGURE 3  
Portfolio allocation of listed REITs as of Q1 2018<sup>1</sup>

Geographic diversification within Saudi Arabia



Thematic vs. diversified investment approach



Sources: Knight Frank Research, Tadawul

Note: (1) Based on REITs listed on the Tadawul up to March 30, 2018

### Price Performance

- Following initial buoyancy we have seen price moderation since late 2017.
- Most REITs have pared back early gains and are currently trading below listing price.
- Average performance of selected REITs stands at -10% from listing date to March 30, 2018. (Fig. 4)

### Pricing

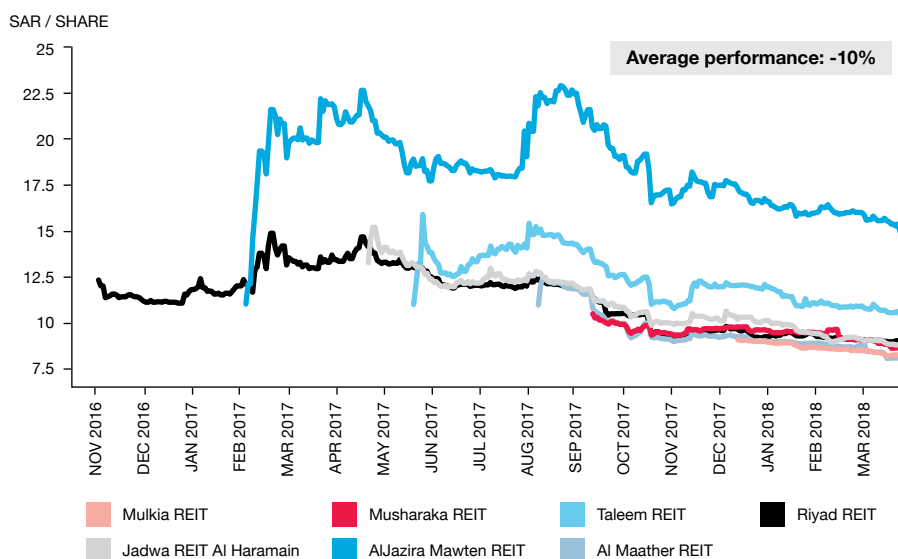
- The initial trend for trading at a premium to NAV was mainly attributable to large amounts of capital seeking a liquid exposure to the real estate market.
- Pricing dropped over the last two quarters to move closer in line with mature markets.
- Greater choice of available REITs, both diversified and thematic, will drive prices towards fundamental valuations.
- More REIT listings will lead to a deeper market, where pricing becomes segmented, and where poorer quality REITs trade at discount to those that follow best-in-class practices. (Fig. 5)

### Dividend Yields

- REITs in Saudi Arabia are required to distribute 90% of their profits to unitholders in the form of dividends.
- As the market matures, dividend yields will be a key performance indicator to watch and dividend growth will be an indicator of long-term success for investors.
- We see investors increasing their focus on fundamental performance including income generation and dividend yields as more performance information becomes available. This will be particularly important for investors looking to adopt a longer term investment approach.
- Our calculations show that REITs in Saudi Arabia offer investors a 6%+ estimated annualized dividend yield which is above the 4% global average. (Fig. 6)

FIGURE 4

Daily closing price of selected listed REITs<sup>1</sup> (from listing date to March 30, 2018)



Sources: Knight Frank Research, Macrobond

Note: (1) only REITs listed before 2018 were included in this graph

FIGURE 5

Price to NAV ratios of selected listed Saudi REITs

Selected REITs <sup>1</sup>	P/NAV as of 28/09/2017	P/NAV <sup>2</sup> as of 29/03/2018	Price to NAV benchmarks
Riyadh REIT	1.23	0.92	Global average <sup>3</sup> 17% discount
AlJazira Mawten REIT	2.11	1.52	UAE average <sup>4</sup> 29% discount
Jadwa Al Haramain REIT	1.20	0.90	UK average <sup>3</sup> 19% discount
Taleem REIT	1.41	1.05	US average <sup>3</sup> 8% discount
AlMaather REIT	N/A	0.82	
Musharaka REIT	N/A	N/A	
Mulkia REIT	N/A	0.83	
<b>Average KSA</b>	<b>1.49</b>	<b>1.01</b>	

Notes: (1) only REITs listed before 2018 are included in the table;  
 (2) NAV as at year-end 2017;  
 (3) UBS as of April 6, 2018;  
 (4) NAV at year-end 2017 and market cap as of March 30, 2018

Sources: Knight Frank Research, Tadawul, Macrobond, UBS, REITs financial statements

FIGURE 6

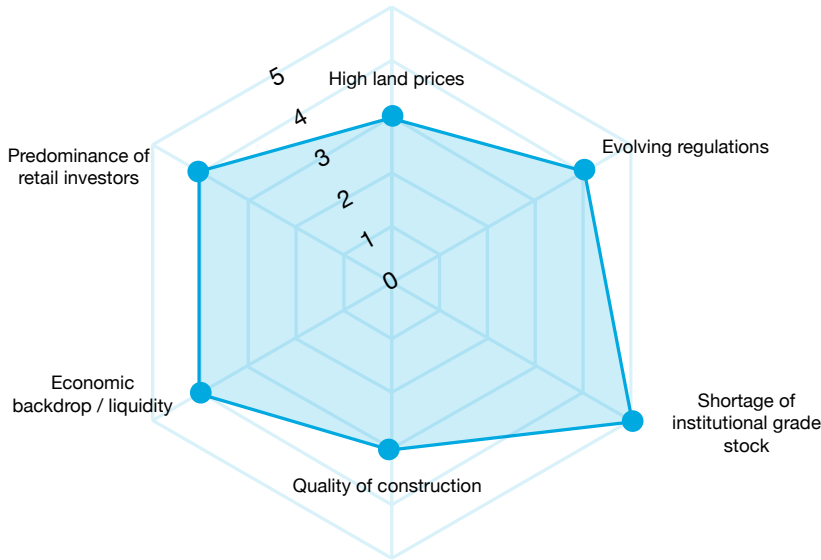
Estimated dividend yields of selected listed Saudi REITs

Selected REITs <sup>1</sup>	Annualized trailing DPS (SAR) as of April 10, 2018	Dividend yields (%) as of April 10, 2018	Dividend yield benchmark
Riyadh REIT	0.56	6.2	Global average <sup>2</sup> 4.0%
AlJazira Mawten REIT	0.50	3.2	
Jadwa Al Haramain REIT	0.50	5.7	
Taleem REIT	0.63	5.9	
AlMaather REIT	0.67	8.3	
Musharaka REIT	0.70	8.1	
Mulkia REIT	0.42	5.1	
<b>Average KSA</b>	<b>-</b>	<b>6.1</b>	

Note: (1) only REITs listed before 2018 are included in the table;  
 (2) FTSE NAREIT Global Index as of March 30, 2018

Sources: Knight Frank Research, Tadawul, REITs financial statements, FTSE

FIGURE 7  
Key challenges facing the REIT market in Saudi Arabia



Source: Knight Frank Research

Note: A higher number reflects a higher risk for the market

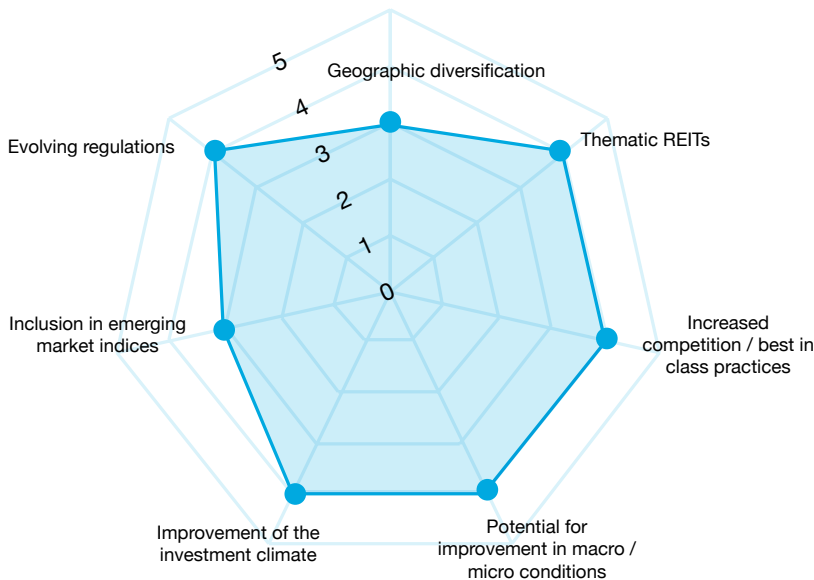
## Challenges and Opportunities

There are number of opportunities and challenges facing the Saudi Arabian REIT market.

- A major challenge will be the availability of suitable assets that can be placed within REIT structures, as the real estate market in Saudi Arabia is generally dominated by a lack of institutional grade stock, compared to mature markets.
- The regulatory framework will remain a critical priority that generates challenges as well as opportunities for fund managers and investors in the REIT market. Strengthening and adapting regulations, which has proven to be favourable in more mature jurisdictions, will remain a requirement for the REIT market.

In Saudi Arabia, this will be particularly important in light of the government’s drive to enhance the investment environment as part of the wider strategic reforms. (Fig. 7 & 8)

FIGURE 8  
Key opportunities ahead for the REIT market in Saudi Arabia



Source: Knight Frank Research

Note: A higher number reflects a more important area of opportunity for the market



STEFAN BURCH  
Partner, Saudi Arabia

“While it is still premature to judge the ramifications for the wider real estate market, REIT regulations signal an important step in the government’s drive to enhance the investment environment as part of the wider strategic reform agenda.”



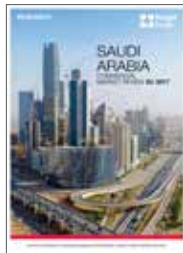
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