

*Prime office
demand rising*

*Retailers struggling with
post-Covid landscape*

*Jeddah's hospitality market
continues to outperform*



Saudi Arabia Commercial Market Review

Q3 2021

A large, stylized number "125" in a white, serif font, positioned in the bottom right corner of the page. Below the number, there is a small line of text that reads "125th anniversary in property for 125 years".

125
125th anniversary in property for 125 years

MARKET ROUNDUP

Saudi Arabia is the region's largest economy and has a population of around 35 million, strongly suggesting that there is room in the Middle East for more than one business hub

The performance of the office market in Saudi Arabia is a tale of Riyadh vs the rest of the country. Momentum appears to be building around the 'Program HQ' initiative, which has seen over 40 multinational businesses recently announcing plans to make Riyadh the base for their regional HQ's. The burgeoning demand for Grade A office space in the capital has unsurprisingly placed upward pressure on lease rates, which have risen 2.9% in the last 12 months.

Inadvertently, businesses from elsewhere in the Kingdom are also opting to relocate to the capital, which is creating much more subdued conditions elsewhere in the country.

Clearly, the decision to position Riyadh as a regional rival to Dubai

comes with its own challenges. These revolve around the quality and quantum of office space available, access to a global and diverse pool of talent, as well as taxation differences (VAT in Saudi Arabia stands at 15%, compared to 5% in Dubai and the UAE) which adds to overall business expenses, as well as the cost of living.

All that said, Saudi Arabia is the region's largest economy and has a population of around 35 million, strongly suggesting that there is room in the Middle East for more than one business hub. As it stands, the only global hub city between Cairo and Mumbai is Dubai, so it would be in the region's interest to see another complimentary hub, be it Riyadh or another city in Saudi Arabia. History shows us that



regional hub cities often compliment and support one another's growth, rather than "rival" each other. The trifectas of Paris, London and Frankfurt, or indeed Hong Kong, Singapore and Kuala Lumpur give us a glimpse of what the region's economic landscape may look like in the future.

Elsewhere, the retail sector continues to struggle to find its feet. The pandemic has driven a permanent shift to the digital world and many of the pandemic-induced shopping habits appear to be permanent. Retailers who fail to transition or offer an enhanced digital experience will find it difficult to remain competitive. Operators too cannot afford to be complacent. Developments that

do not cater to the swell in demand for public realm amenities will first see footfall decline, followed by the departure of retailers, as is the case in the Dammam Metropolitan Area, for instance.

In contrast, the hospitality sector is experiencing a speedy recovery, with Riyadh benefiting from a resumption in corporate and business travel. Elsewhere, Jeddah continues to enjoy a surge in hotel room demand, fuelled by persistent domestic demand that is being met with a relatively limited number of quality hotel rooms, however this is set to change with a near 51% increase in rooms to almost 26,000 expected by the end of 2023.

OFFICE MARKET

RIYADH

Unlike elsewhere in the Kingdom, rents for prime office properties continued to outperform in the year to Q3 2021. Average Grade A rents have risen by 2.9% in the 12 months to the end of Q3, while Grade B rents have declined by 1.4% over the same period, reflecting the ongoing flight to quality by occupiers, which is driving rents down for more secondary space.

A steady stream of requirements from international corporates wishing to set up their business in Saudi Arabia is adding to the upward pressure on rents for best-in-class space. Indeed, the government's "Program HQ", which is designed to attract businesses from around the region to hub out of Riyadh, appears to be gaining traction, with 44 companies, including Siemens and Unilever, declaring their intention to do so by 2024 at the recent Future Investment Initiative conference in Riyadh.

Al Arabia, for instance, has recently announced its plans to relocate its headquarters from Dubai to Riyadh's King Abdullah Financial District. Looking ahead, demand for Grade A office space is expected to intensify as blue-chip multinationals are unlikely to settle for anything less, further driving the growing delta between the performance of Grade A and Grade B rents.

JEDDAH

The pandemic continues to hamper the office market in Jeddah and demand for office space across all segments of the market remains sluggish.

Adding to the challenges facing the city are the government's plans to transform Riyadh into the Kingdom's primary commercial nerve centre. This initiative has begun to drive demand away from Jeddah, as companies are choosing to relocate to Riyadh.

Furthermore, hybrid working models are increasingly prevalent, particularly among international businesses, which is further undermining any recovery in office demand. In fact, our research has shown that many businesses in Jeddah are planning to permanently reduce their office footprints by between 20%-30%.

The confluence of these factors has resulted in very subdued conditions, with average lease rates remaining relatively flat for Grade A office space over the last 12 months, while Grade B rental rates have declined by 1.2% over the same period. Unsurprisingly, the city-wide occupancy rate has fallen by two percentage points in Q3 and now stands at 76%. We expect the vacancy rate to rise further as new supply enters the market. Indeed, some 410,000 sqm is due to complete between now and 2023.

Looking ahead, we anticipate that the market will remain firmly in favour of tenants, at least over the short to medium term. The flight to quality is also expected to persist as occupiers move to capitalise on the weakness on the market.

DMA

Mirroring Jeddah, demand for office space in the Dammam Metropolitan Area (DMA) market remains subdued, which is undermining the performance of rents. Indeed, average rental rates are down across the board in all segments, when compared to this time last year. Grade A lease rates have fallen by 1.6% over the last 12 months, while Grade B rents have slipped by 4.4% over the same period.

On the supply front, there were no significant completions in DMA in Q3, leaving the total office supply relatively unchanged at 1.25 million sqm. However, with a 28% increase in total stock to 1.6 sqm forecast by 2023, rental rates are likely to remain suppressed.

All that being said, the recent rebounding of oil prices is inevitably going to be positive for the local economy and a continued recovery in oil prices will eventually drive new demand as it has done historically.

Our view however, remains unchanged as the quantum of new supply means a supply-demand parity will remain unattainable over the medium term. As a result, rents and occupancy rates are likely to soften further.

Key trends



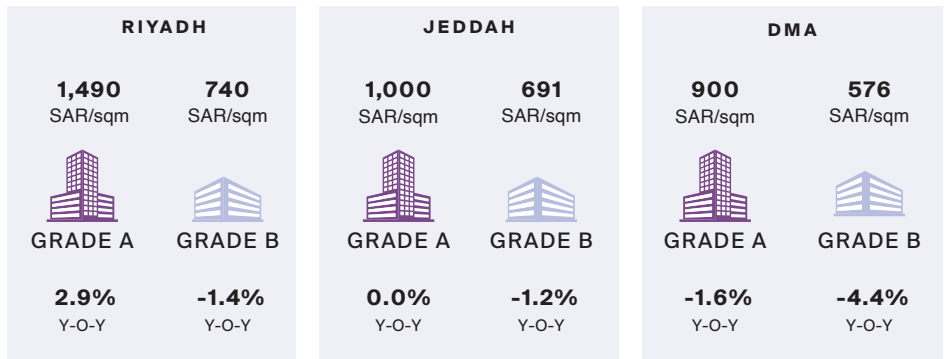
The unemployment rate among Saudi nationals has recovered to pre-pandemic levels, falling to 11.3% in Q2 2021, down from 14.9% in Q2 2020, aided in part by the government's efforts to reshape the economic and real estate landscape of Saudi Arabia as part of Vision 2030, which is driving a rapid increase in corporate activity. "Program HQ", as outlined above is emerging as a key part of the National Transformation Plan.



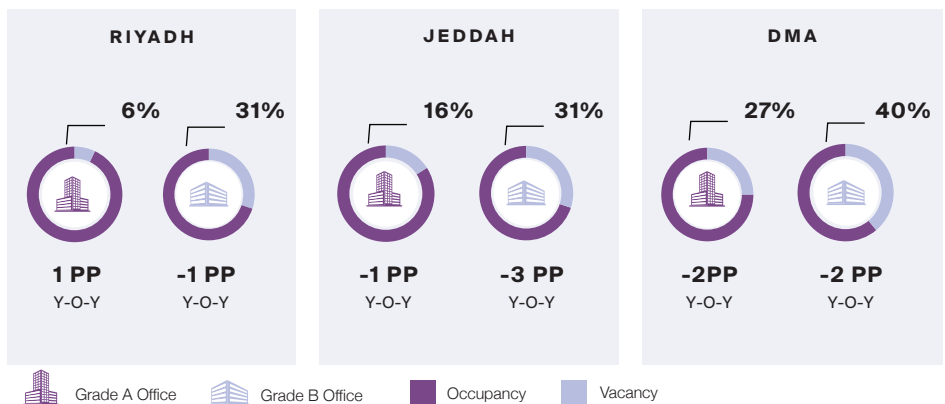
The 44 companies that have announced plans to establish their regional headquarters in Riyadh are expected to bring SAR 67 billion worth of investment to the economy and provide 30,000 job opportunities by 2030. Clearly, this suggests that demand for office space is not only being created, but is likely to be sustained, at least in Riyadh.

Market Performance Indicators

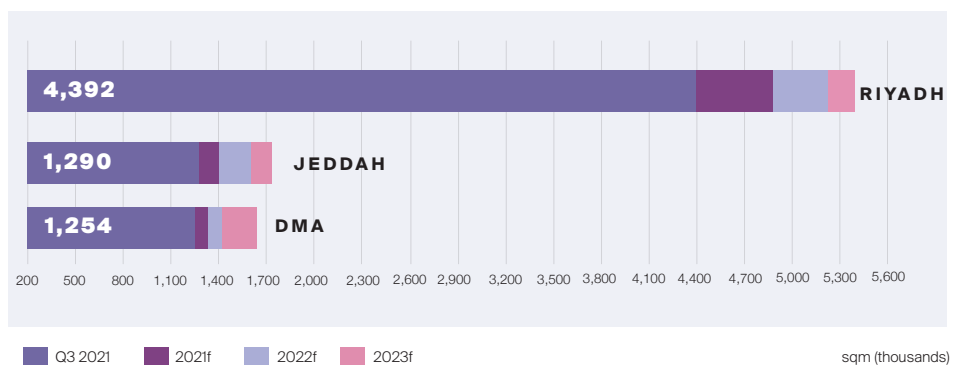
Grade A and B rental rates and YoY % change as at Q3 2021



Grade A and B vacancy as at Q3 2021



Forecast office supply



Source: Knight Frank

RETAIL MARKET

RIYADH

Demand from retailers for new space continues to soften in Riyadh. The slowdown in demand is predominantly linked to the substantial increase in supply in recent years. And new supply continues to trickle on to the market. During the first nine months of 2021 alone, the city has seen the completion of over 155,000 sqm of space, pushing the capital's total stock to over 3 million sqm.

Adding to the market's challenges has been an intensification of online shopping habits and subsequent price competition amongst online retailers. As e-commerce gains further prominence, traditional retailers are diversifying their offering in an effort to secure their customer base by providing better customer experiences and an increased range of leisure and entertainment facilities. It is our view however that additional physical supply will negate these efforts to an extent, keeping rents and occupancy levels under pressure over the medium term.

In the year to Q3 2021, average regional and super-regional mall lease rates registered a marginal decline of 0.7%, while community mall lease rates dropped by 2% over the same period.

For now, malls, shopping centres and lifestyle-retail developments have experienced more foot traffic as COVID-19 restrictions have eased and life begins to normalise.

We expect rents will continue to soften as new space completions look set to accelerate. In fact, the city's total stock is expected to rise by one million sqm (or 23%) by 2023.

JEDDAH

Like Riyadh, rents in Jeddah's retail market faltered during Q3, with average regional and super-regional mall rents falling by 1% in the 12 months to the end of Q3. Community mall rents also declined by 2.5% over the same period.

Shifting consumer preferences have highlighted the mismatch between the type of retail in the market and what retailers are demanding. Anecdotal evidence has shown that retail operators who have failed to respond to changing market dynamics by improving their public realm and supporting amenities have seen a flight of retailers to developments that offer a superior customer experience and include attractive lifestyle and public realm aspects.

Traditional malls tend to allocate a large portion of the space to anchor tenants, including hypermarkets and big stores; however even these retail landscape mainstays have begun to adapt, with new developments such as Avenue Mall Obhur and Jawharat Mall, due to complete in 2024, scaling down on space allocated to anchor tenants, and instead focusing more on F&B and family entertainment, such as cinemas.

DMA

The Dammam Metropolitan Area (DMA), like other markets in the Kingdom, is experiencing sluggish performance across all retail segments. The average lease rates for super-regional and regional malls declined by 1% in the 12 months to end of Q3, while average community mall rents fell by 2.1% over the same period.

In terms of supply, there have been no significant completions in Q3, leaving the total stock relatively unchanged at about 1.2 million sqm. Despite this, the occupancy rate increased by one percentage point to reach 89%. Anecdotal evidence suggests that a fall in consumer spending, combined with the particularly deep impact of the pandemic on the sector, has meant that some retailers have scaled down operations to shore up their margins, while others have decided to exit the market altogether.

This has left the market over-supplied with conventional retail space that is now considered outdated by the growing younger generation, mainly due to the lack of customer experience elements that are prevalent in larger retail complexes, or shopping malls. This is evident by the success of newer lifestyle developments that focus on experience and offer brands that resonate with the local population (e.g., Ajdan Walk, Khobar, Corniche Park Khobar and Patio Mall Dammam).

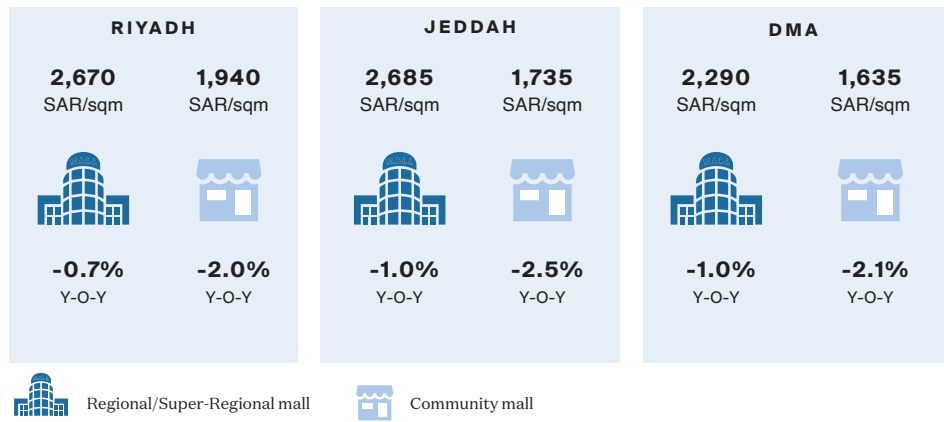
Key trends



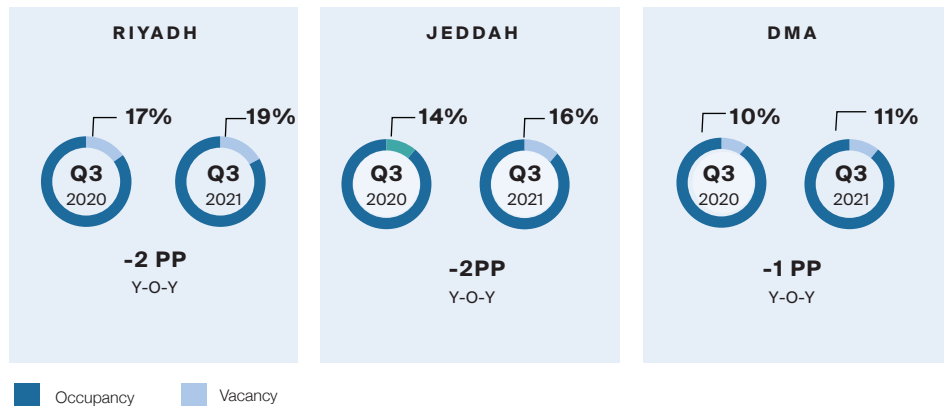
Despite the economic headwinds and mobility restrictions caused by COVID-19, retailers who made timely decisions to launch parallel online stores and redesign their physical stores to accommodate changing customer preferences not only survived, but also created new revenue streams. However, merchants who neglected shifting demand patterns, or could not (or would not) make the transition to the digital world have and will likely continue to struggle to stay afloat. In fact, total worldwide e-commerce retail sales increased by 25.7% in 2020 to USD 4.2 trillion and are anticipated to increase further by 16.8% this year to USD 4.9 trillion (eMarketer). We expect a similar trend to play out in Saudi Arabia.

Market Performance Indicators

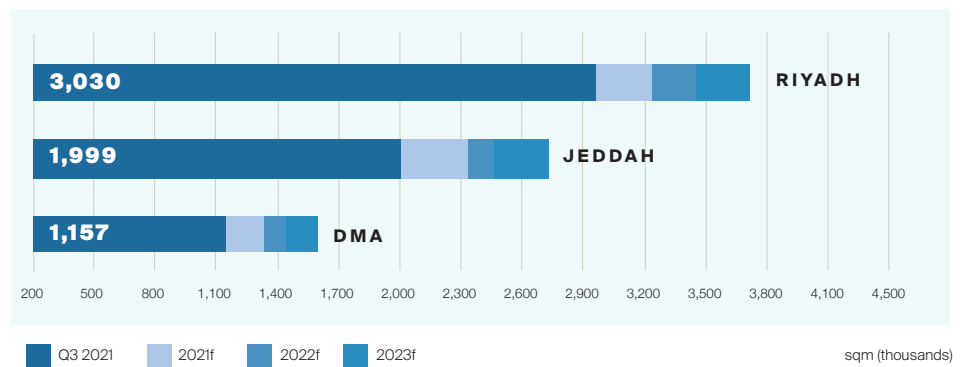
Retail market lease rates as at Q3 2021



Retail occupancy rates



Forecast retail supply



HOSPITALITY MARKET

RIYADH

As travel restrictions ease, residents, tourists, and business visa holders are able to travel to Saudi Arabia again. As a result of these relaxed restrictions, Riyadh's hospitality market has begun to witness an upturn in performance. In fact, in the year to September, occupancy levels increased by 7.7%, while RevPAR levels increased by 1.5% over the same period. ADRs in Riyadh however dropped to SAR 516, still 5.7% lower than this time last year.

Despite this, we expect to see further improvement in Riyadh's hospitality performance as the impact of the pandemic works its way out of the equation. Furthermore, improving economic activity and business growth will drive demand for corporate and leisure tourism in the city.

In addition, this year's Riyadh Season, which runs to March 2022 and includes over 7,000 events, making twice the size of the previous running of the event in 2019, is expected to significantly boost the hospitality sector in the capital.

JEDDAH

Jeddah's hospitality market continues to outperform the rest of the country. The resumption of Umrah pilgrimage for international visitors following a 17-month closure was one of the main drivers of Jeddah's relative outperformance over the summer, alongside the first cruise ship departing Jeddah's Islamic port in July. The uptick in demand for hotel rooms in the city has persisted into Q3 and as a result, in the year to September, Jeddah's ADR rose by 14.4% to SAR 686.

Occupancy levels meanwhile also increased by 35.5% to 51%. At the same time, the RevPAR levels increased by 54.9% to SAR 226 over the same period.

Moving ahead, Jeddah's hospitality market is expected to excel, fuelled in part by Saudi Arabia's first Grand Prix, set to be held in the city in early December. A host of award-winning international music superstars are also scheduled to perform at the event, boosting the city's appeal domestically and within the region.

Furthermore, social distancing restrictions are slowly easing in Makkah, allowing Umrah pilgrims to arrive in greater numbers, which again will boost demand and drive up occupancy levels.

DMA

The hospitality market in DMA is also benefitting from the easing of travel restrictions and return of corporate and business tourism. In fact, in the year to September, average ADRs are up by 2.6% to SAR 432, while occupancy rates have increased by 7.6% over the same period to stand at 55.8%. Unsurprisingly, market-wide RevPAR levels rose by 10.4%.

DMA's hospitality market buoyancy is predominantly being driven by Al Khobar's traditional beach side appeal. ADRs in DMA increased by 7% in the year to September to SAR 477, and RevPAR increased by 13.8% over the same period. In contrast, Dammam's market continues to soften, with ADRs dropping by 19.7% to SAR 267 and RevPAR declining by 10.1% to SAR 141 over the course of 2021.

Positively, total quality hotel supply in DMA remains stable and in fact, there were no completions during Q3 2021. Looking ahead, however, considering projects that have broken ground, total room supply is expected to increase by 20% to over 14,000 keys by the end of 2023.

Key trends

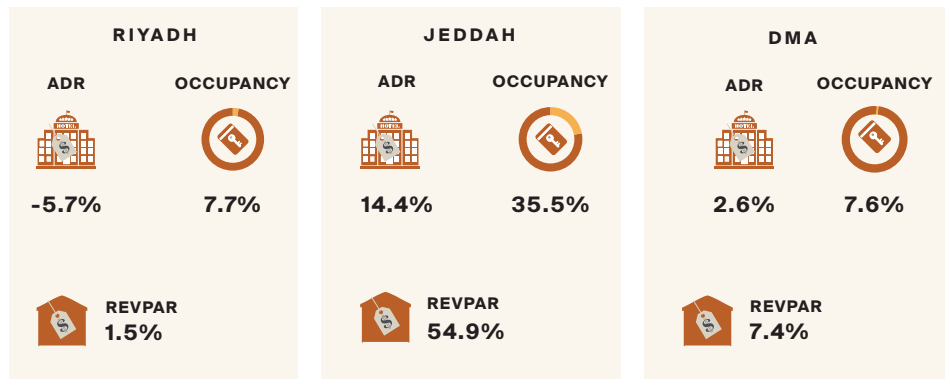


The Saudi government has established a SAR 15 billion Tourism Development Fund as part of the first phase of its National Tourism Strategy, focusing on multiple destinations around the Kingdom, including Aseer and Al-Ahsa. This is one of several initiatives announced by the Saudi government in recent years to diversify the economy and develop a strong entertainment and tourist industry.

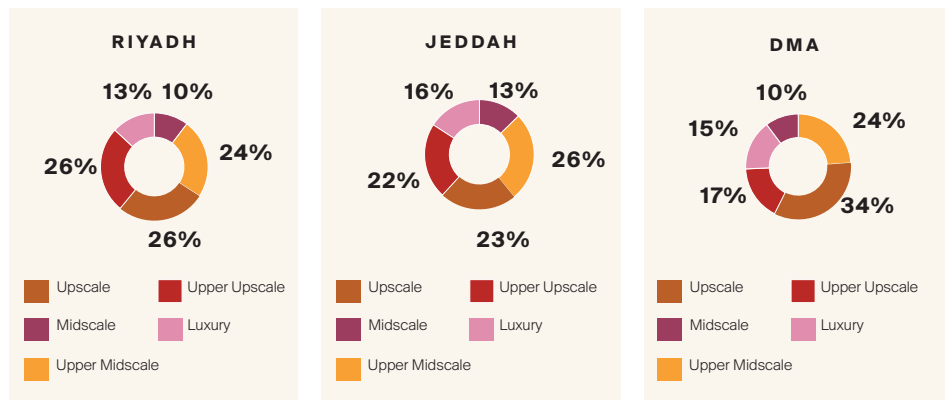
The Tourism Development Fund offers a variety of products to corporations and private sector investors, including debt, equity and guarantees. The fund is expected to play a critical role in facilitating inward investment into the sector, while at the same time driving its rapid expansion.

Market Performance Indicators

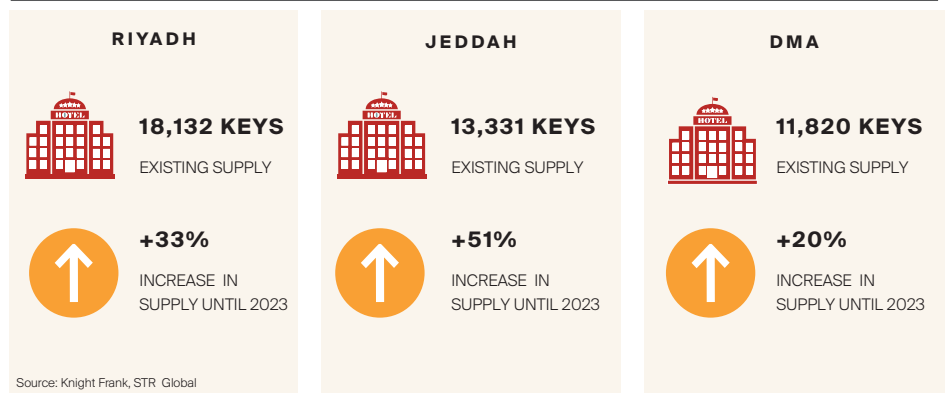
KPIs - ADR, Occupancy and RevPAR - Y-o-Y % change YTD Sep 2021



Existing quality hotel supply market segmentation YTD Sep 2021



Existing and upcoming quality hotel supply



Source: Knight Frank, STR Global

KEY CONTACTS

Harmen De Jong

Partner
Real Estate Strategy & Consulting
+966 56 3045 356
Harmen.DeJong@me.knightfrank.com

Stephen Flanagan, MRICS

Partner
Head of Valuation & Advisory, MENA
+966 55 8866 480
Stephen.Flanagan@me.knightfrank.com

Pedro Ribeiro

Partner
Retail Advisory, KSA
+966 112 890 703
Pedro.Ribeiro@me.knightfrank.com

Talal Raqaban

Partner
Valuation & Advisory, KSA
+966 50 0556 308
Talal.Raqaban@me.knightfrank.com

Khalil Al Arab

Associate Partner
Sales and Leasing Agent, KSA
+966 112 890 719
Khalil.AlArab@me.knightfrank.com

Yazeed Hijazi

Manager
Real Estate Strategy & Consulting
+966 54 525 4794
Yazeed.Hijazi@me.knightfrank.com

Faisal Durrani

Partner
Head of Middle East Research
+971 4 4267 698
Faisal.Durrani@me.knightfrank.com

Amar Hussain

Data Manager
MEA Research
+966 55 2323 036
Amar.Hussain@me.knightfrank.com

Balqaise Fayadh

Intern
MEA Research
+966 112 890 775
Balqaise.Fayadh@me.knightfrank.com

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Contact Us

1st floor, Building WH01, Al Raidah Digital City, Riyadh, Kingdom of Saudi Arabia, +966 11 2890 700,
12th floor, The Headquarters Business Park, Jeddah, Kingdom of Saudi Arabia

