Surge in foreign investment licenses

Riyadh retail and office demand grows

Hospitality sector boosted by world-class events

Saudi Arabia Commercial Market Review

Summer 2022

OFFICE MARKET

RIYADH

The economic transformation plans in Saudi Arabia continue to attract international businesses wishing to be a part of the unfolding Vision 2030 and the business opportunities being created. In fact, the Ministry of Investment issued 2,056 new foreign investment licenses in Q4 2021, up 358% year on year and the highest number of licenses ever issued in a single quarter.

The record spike in foreign investment licenses is creating and sustaining a steady stream of office demand from international businesses seeking to establish a presence in Saudi Arabia, with a particular focus on Riyadh.

> “The record spike in foreign investment licenses is creating a steady stream of office demand.”

This is helping to boost rents, especially for prime space. Indeed, average prime rents have increased by 6.5% to SAR 1,560 psm over the last 12 months. Grade B rents also rose by 4% over the same period, reflecting the depth of demand for office space in the capital, which is quickly finding itself in the midst of a shortage of high-quality space.

Occupancy rates have also improved, with the prime office market enjoying 96% occupancy, up 3% on the last three months and the highest level in at least five years. At the same time, Grade B occupancy levels increased by four percentage points to reach 72%.

We expect demand for prime and best-in-class space will continue to rise from both international corporates and newly formed public-private sector companies, fuelled by continuing government-led economic reforms and the ongoing solidification of Riyadh as the country's commercial heart.

JEDDAH

Mirroring Riyadh, demand for office space in Jeddah has started to pick up, albeit at a slower pace. This resurgence is being underpinned by new public sector entities (many linked to new real estate projects), establishing a presence in the Red Sea coastal city. This includes the likes of ROSHN, Uptown Jeddah, Al Ballad Development, and Jeddah Central, all of whom have recently opened new offices in Jeddah.

We have also seen a slow, but steady reversal in decisions to reduce office footprints in Jeddah that were taken during the pandemic. As we gradually move past Covid-19, businesses are rapidly retuning to the office on a full-time basis, catalysing the growing demand for offices in Jeddah.

The sustained growth in office demand is reflected in the performance of prime office rents over the last 12 months. Average prime rates increased by 2.5% during Q1, while Grade B rents experienced a decline of 0.5% over the same period.

Unsurprisingly, prime office vacancy rates decreased by one percentage point in Q1 and now stand at 84%, while vacancy rates across Grade B offices remained flat over the same period. We expect lease rates and vacancy levels to remain under pressure in the short to medium term as new supply enters the market. Indeed, some 410,000 sqm is due to complete between now and 2024.

Looking ahead, we expect demand to continue improving, driven by the increasing number of international firms seeking to establish a presence across the Kingdom, with Jeddah resuming its position as the country's “second city”. Office requirements will be bolstered by public sector entities relocating or expanding their footprints in Jeddah. However, as noted above, the city's large supply pipeline will continue to remain a drag on the office market's performance in the short to medium term.

DMA

The recent rebound in oil prices is helping to boost economic activity and job creation levels in the Dammam Metropolitan Area (DMA). The resultant impact is a rise in office demand, with a focus on Grade A space.

The increasing demand has helped to lift rents at the top of the market, with Grade A rents climbing by 2% to SAR 920 per sqm in Q1. Elsewhere, Grade B lease rates, on average, decreased by 2.8% to SAR 575 psm as occupiers shy away from more secondary, older stock in favour of newer, modern buildings.

Unsurprisingly, vacancy rates are also creeping up. Prime space in the DMA has experienced a one percentage point improvement in vacancy levels to 74% in Q1 2021, while Grade B offices have seen a rise in vacancy levels of two percentage points to 37%.

On the supply front, a small commercial development at Prince Mohammed Bin Fahad Road was delivered to the market, adding 6,000 sqm to the DMA's office supply. With this small addition, the total office stock in the DMA now stands at 1.26 million sqm. A further 18% increase to 1.62 million sqm is forecast by 2024.

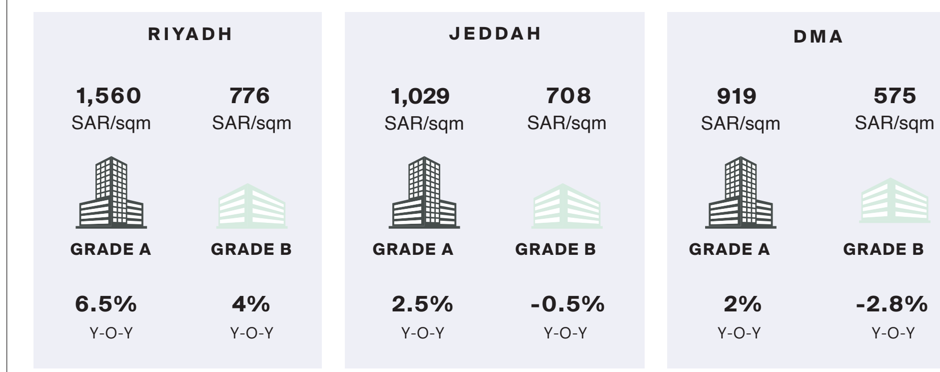
Key trends

The Saudi Ministry of Investment awarded 2,056 foreign investment licenses in the fourth quarter of 2021, a 358% increase from 449 licenses in 2020. The momentum generated by economic recovery and various reforms implemented by the Saudi government to diversify its economy has fuelled the surge. As a result, the total number of new foreign investment permits reached 4,439 in 2021, up 251% from the previous year.

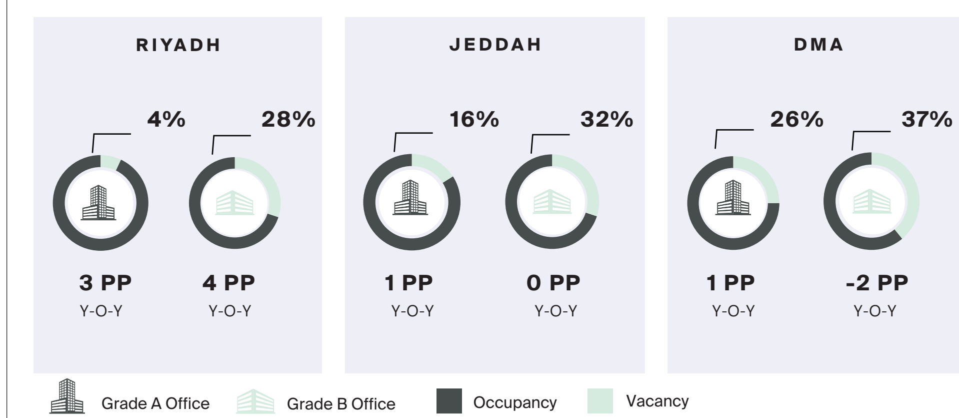
The Saudi Crown Prince announced the launch of the National Investment Strategy (NIS) in October 2021, which will be a key enabler in delivering on Vision 2030. The NIS will catalyse the Kingdom's Vision 2030 and economic development strategy.

Market Performance Indicators

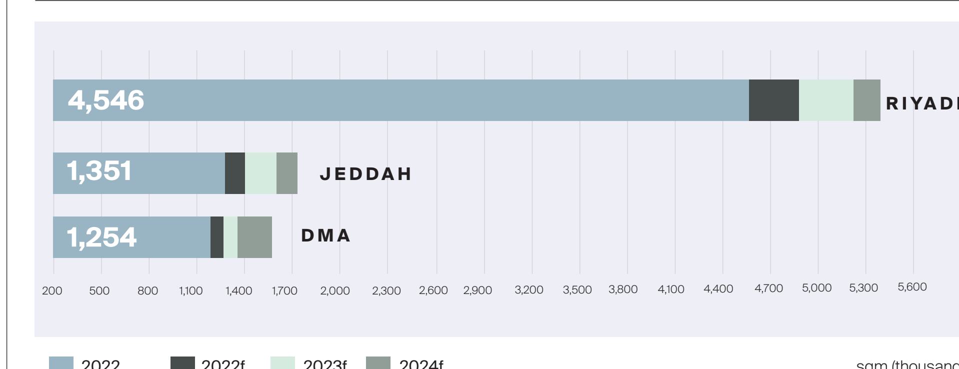
Grade A and B rental rates and YoY % change as at Q1 2022



Grade A and B vacancy as at Q1 2022



Forecast office supply



Source: Knight Frank

RETAIL MARKET

RIYADH

It appears that the fortunes of the retail sector are on the cusp of reversing. As outlined above, The Ministry of Investment issued 2,056 foreign investment licenses in the final quarter of 2021. 44% (907) of theses were linked to the retail and e-commerce sectors.

Indeed, we have noted a steady stream of requirements from international retailers looking to enter the Kingdom, particularly Riyadh, putting upward pressure on rents. Malls are the primary target for these new entrants and regional and super-regional mall lease rates are beginning to creep up as new requirements gather pace. On average, larger malls (SAR 2,716 psm) have seen rents increase by 1% over the last 12 months.

The retail landscape in Saudi Arabia is becoming increasingly competitive. Traditional retailers are encountering challenges, especially as e-commerce penetration grows and consumer behaviour and expectations shift increasingly online. This is driving retailers to rapidly expand their omnichannel offerings, while also shifting their focus to experiential retail.

Consumers seek to mix the pleasures of conventional shopping with the convenience of new technologies and only those landlords and businesses that are receptive to this change will thrive.

Vision 2030 is changing the Kingdom's retail landscape dramatically. With 56% of Saudi's population below the age of 35, the country has a young and dynamic demographic. They have been exposed to international brands and fashion labels, restaurant experiences and edutainment overseas. And as these international retailers arrive in their droves, they are being readily welcomed and absorbed into the retail fabric.

Indeed, in Riyadh alone, 290,000 sqm of restaurant-led retail developments, including 275 new restaurants, spread across 16 lifestyle retail developments, have been completed since the launch of the National Transformation Plan in 2016, ushering in a thriving food scene in the capital.

JEDDAH

In contrast, demand for new retail space in Jeddah has remained subdued. That said, mixed-use developments featuring a diverse F&B mix, entertainment, and recreational components have maintained a 90-95% occupancy rate. with footfall and dwell times boosted by a shift in consumers' focus to entertainment and experiences. Those mall owners that have been slower to adapt to shifting consumer behaviour have experienced a flight of retailers to developments that offer a superior customer experience and appealing lifestyle and public realm aspects.

Unsurprisingly, retail rents in Jeddah have weakened in the last year, albeit marginally. Over the last 12 months, rents in larger malls have dropped by 1% to SAR 2,655 psm, while community mall lease rates have declined by 1.7% over the same period.

The overall vacancy rate in Jeddah has edged upward by two percentage points to 15%. Larger malls and lifestyle-oriented developments continue to fare better than community malls and Grade B retail centres, both of which continue to experience increased vacancy levels.

New supply continues to trickle onto the market, adding to the challenges faced by the retail sector. In 2021 alone, over 90,000 sqm of space was delivered, pushing the total stock to over 2 million sqm. With new completions set to accelerate, we expect rents to remain under downward pressure. One million sqm of new retail space is due by the end of 2024, representing a 50% increase on current levels.

All that being said, well-designed and lifestyle-oriented retail developments will likely show more resilience to the challenging market conditions.

> **"New supply continues to trickle onto the market in Jeddah, adding to the challenges faced by the retail sector."**

DMA

The DMA's retail scene continues to remain subdued, prolonging a trend that began in 2016. Lease rates at community malls (SAR 1,635 psm) are now 1.2% lower than this time last year while rents at super-regional and regional malls have held steady at SAR 2,300 per sqm.

Vacancy rates across community malls and neighbourhood centres are trending higher than in super-regional and regional malls. The market-wide vacancy rate across DMA's super-regional and regional malls stands at 11%. No immediate improvement is expected, particularly given the swelling supply pipeline.

The existing retail supply in the DMA is estimated at 1.62 million sqm. This is expected to exceed 1.78 million sqm by the end of 2024. The balance of retail supply will shift in favour of the super-regional malls, which will account for 43% of the total retail supply by 2024.

As the retail supply continues to expand, we expect retailers and landlords to concentrate their efforts on lifestyle, leisure, and entertainment elements in shopping malls as they seek to boost dwell times, while also mitigating the ever-growing threat posed by online shopping. Entertainment and diverse F&B offerings have already become an essential part of retail schemes and this looks set to intensify as supply rises and the competition heats up.

SAUDI ARABIA COMMERCIAL MARKET REVIEW | SUMMER 2022

Key trends

Saudi Arabia's e-commerce market has grown rapidly in recent years. The Saudi government's attempts to establish a robust digital infrastructure to enhance digital payments in the Kingdom have spurred the sector's rapid expansion. Saudi Arabia emerged as the world's 27th largest e-commerce market in 2021, with US$ 8bn in revenue, double that of the regions next largest economy – the UAE. Given the exceptional user penetration, e-commerce revenues are projected to reach US$ 12.2 bn this year (Statista). Looking ahead, ecommerce revenue is expected to grow at an annual rate of 18.8% between 2022 and 2025, crossing US$ 20 bn by 2025.

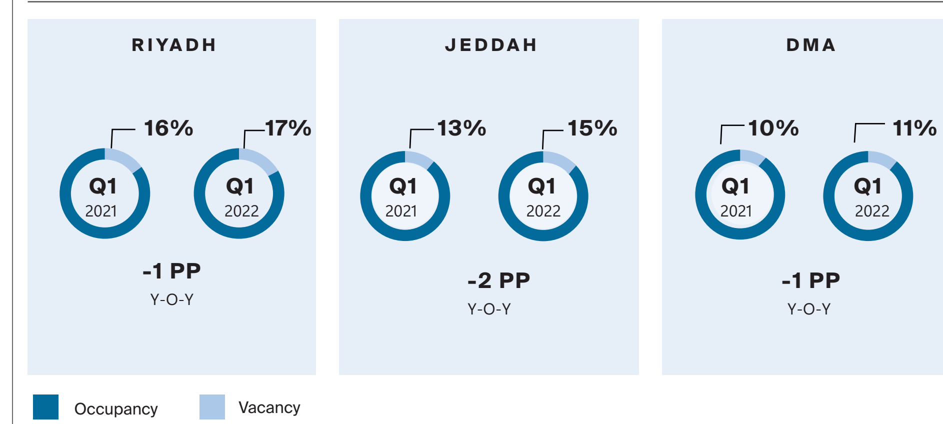
The Saudi electronic payment system "Mada" revealed that the volume and value of e-commerce sales had seen exponential growth over the last 12 months. The value of online sales increased by 184% to reach SAR 23 bn last year (SAMA).

Market Performance Indicators

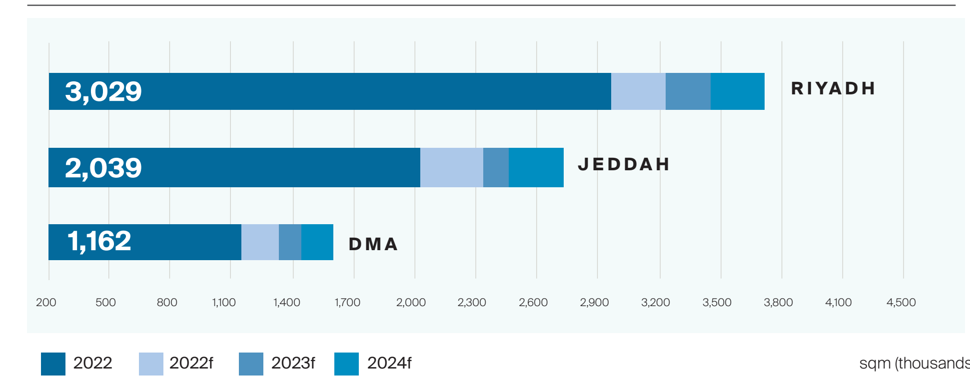
Retail market lease rates as at Q1 2022

	RIYADH		JEDDAH		DMA	
	Regional/Super-Regional mall	Community mall	Regional/Super-Regional mall	Community mall	Regional/Super-Regional mall	Community mall
SAR/sqm	2,716	1,950	2,655	1,720	2,300	1,635
Y-O-Y	1%	-1.4%	-1%	-1.7%	0%	-1.2%

Retail occupancy rates



Forecast retail supply



Source: Knight Frank

HOSPITALITY MARKET

RIYADH

In the first quarter of 2022, Riyadh's hospitality sector continued to outpace the rest of the country. The second edition of the six-month long Riyadh Fair, which closed on 31 March, contributed to this outperformance. Furthermore, more than 15 million people attended Riyadh Season during the five-month festivities. The record number of visitors helped to boost the sector's performance significantly.

Average daily room rates (ADR), for instance, grew by nearly 29% to SAR 712 per night in the year to March 2021, while occupancy levels soared from 47.4% to 72.9%. The revenue per available room (RevPAR) climbed by almost 90% to SAR 519, the highest level since the pandemic began. Additionally, Riyadh's demand for hospitality has been bolstered by the notable increase in corporate and business travel as global travel restrictions have continued to ease.

The city's hotel room supply has also continued to expand to cater to the growing demand. Considering only projects that have broken ground, the number of keys is expected to increase by 26% by the end of 2024 to 24,550 rooms. This increased supply will boost the share of the 5* market to 44% from 37% at present.

We expect the hospitality sector to continue to recover over the medium term as Riyadh remains a focal point for tourism and business growth, supported by governmental infrastructure and tourism investments in line with Vision 2030.

“Riyadh's hotel room supply has also continued to expand to cater to the growing demand.”

JEDDAH

Jeddah's hospitality market has experienced softer conditions than Riyadh, with ADR slipping by 2.8% to SAR 676 per night over the last 12 months.

However, Jeddah's ADR hit SAR 803 per night during March, the highest since September 2019, supported by the second edition of the Jeddah Grand Prix. Additionally, the full resumption of the Umrah pilgrimage ahead of Ramadan for international and local visitors was also a key driver of the city's relative outperformance in March. Other KPI's have also showed an improvement in March, with occupancy levels rising by 19.4% to 55.1%, while RevPAR increased by 43.5% to SAR 669.

Jeddah's hospitality market is expected to continue recovering this year. The second edition of Jeddah Season, which launched in May, attracted over 200,000 visitors in just three days. The event is expected to be twice the size of the 2019 edition and visitor numbers are expected to be significantly higher, boosting the performance of the city's hospitality sector.

These events promote Jeddah's rich cultural and traditional heritage, adding to the city's growing standing as a holiday destination for both domestic and international tourists.

DMA

Unlike Riyadh and Jeddah, the hospitality market in the Dammam Metropolitan Area (DMA) has experienced fragmented performance. ADR fell by 8.1% to SAR 410 in the 12-months to the end of March, which contributed to an improvement in occupancy levels which reached almost 63% over the same period. Unsurprisingly, the higher occupancy levels resulted in a 10% increase in RevPAR to SAR 235.

The marked increase in occupancy and RevPAR in DMA's hospitality market is predominantly driven by Dammam, where occupancy levels increased by 32.2% to 62.5% at the end of March.

In terms of hotel supply, only considering projects that have broken ground, the market is expected to increase by 23% to nearly 15,000 keys by 2024.

Hotel occupancy in the DMA is relatively volatile, generally characterized by seasonality, with high levels of visitors during March and April, which fall away sharply during the summer months and this year is expected to be no different.

SAUDI ARABIA COMMERCIAL MARKET REVIEW | SUMMER 2022

Key trends

HOTEL

During 2021 Saudi Arabia jumped by ten places to 33rd globally in the Travel and Tourism Development Index (World Economic Forum). This stunning improvement is reflective of the government's initiatives and reforms to position the Kingdom as a key tourist destination.

By 2030, the Accor Group will cement its place as Saudi Arabia's largest hotel room operator, doubling the number of rooms it manages to almost 28,000.

Hilton hotels will leapfrog from fifth place currently to emerge as the country's second biggest brand, with almost 19,000 rooms under management by 2030.

Market Performance Indicators

KPIs - ADR, Occupancy and RevPAR - Y-o-Y % change YTD (Q1 2022)

RIYADH

ADR 28.4%
OCCUPANCY 47.4%
REVPAR 89.3%

JEDDAH

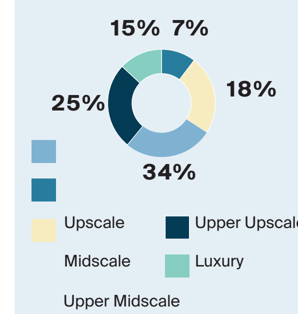
ADR -2.8%
OCCUPANCY 10.3%
REVPAR 7.2%

DMA

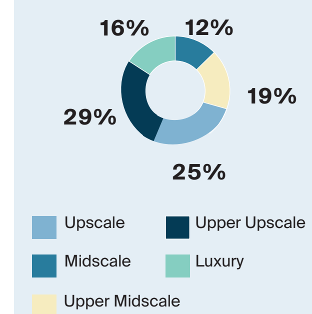
ADR -8.1%
OCCUPANCY 19.7%
REVPAR 10.0%

Existing quality hotel supply market segmentation YTD (Q1 2022)

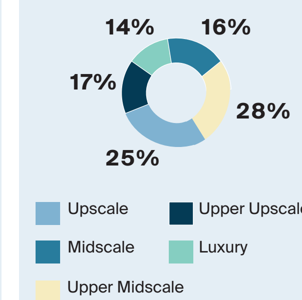
RIYADH



JEDDAH



DMA



Existing and upcoming quality hotel supply

RIYADH

19,446 KEYS
EXISTING SUPPLY

+26%
INCREASE IN SUPPLY UNTIL 2024

JEDDAH

14,237 KEYS
EXISTING SUPPLY

+38%
INCREASE IN SUPPLY UNTIL 2024

DMA

12,176 KEYS
EXISTING SUPPLY

+22%
INCREASE IN SUPPLY UNTIL 2024

Source: Knight Frank, STR Global

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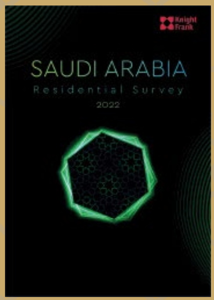

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