



May, 2018

## Executive Summary

### Macroeconomic scenario

The year 2017 ended on a positive note for KSA, with the government implementing several key initiatives and reforms. Although the economy was expected to contract 0.7% in 2017, dragged down by low oil prices, the year proved transformational as the government achieved significant progress in implementing reforms under Vision 2030.

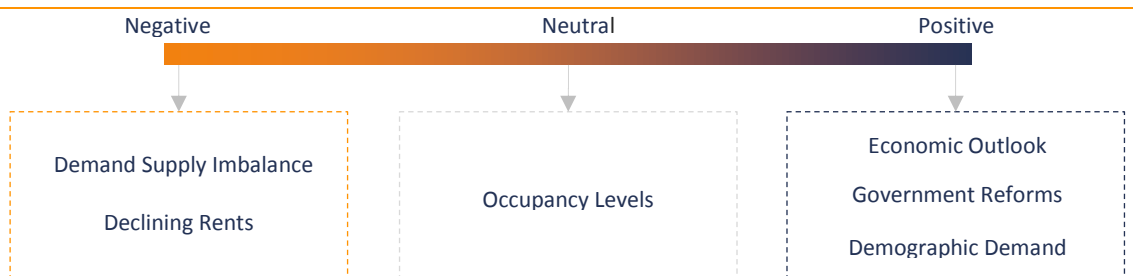
The KSA government announced a progressive and expansionary budget for 2018, intended at boosting economic growth through large infrastructure projects, such as the Neom city and Red Sea projects. The budget is aimed at diversifying the country from an oil-based economy. The government introduced a stimulus package of SAR 72bn, waiving off the fees for small businesses and investors, supporting housing construction. As the reforms under the new budget start to materialize and oil prices move upwards, the economy is anticipated to expand at 1.6% and 2.2% in 2018 and 2019, respectively, according to the IMF’s estimates.

### Real estate market

The long-term outlook for the KSA real estate remains positive despite the muted performance in 2016 and 2017. KSA’s real estate market remained subdued in 2017, with rents gradually softening across classes, while occupancy levels remained low due to tight liquidity in the market, weighed by low oil prices. A lackluster performance from the sector was further exacerbated by factors such as tough financing conditions and the lack of affordability. We think much of the sector woes are behind, and we remain largely positive on KSA’s real estate outlook, driven by improved government measures intended at resolving the key challenges in the sector:

- **Regulatory developments:** Imposition of the white land tax and announcement of large housing schemes are targeted at addressing the shortage of residential units in KSA and spurring growth in residential real estate.
- **Increased loan to value ratio:** SAMA increased the loan to value ratio to 90% in January 2018, aimed at bolstering the residential property market.
- **Religious tourism a large opportunity for real estate sector:** Under Vision 2030, KSA aims at more than doubling its foreign Umrah visitors from 8mn in 2015 to more than 15mn per year in 2020 by increasing its capacity. Ongoing major projects will continue with the construction of the North Haram Development in Makkah and the Dar Al Hijrah City in Madinah, set for completion in Q3 2020 and Q2 2019 respectively.
- **Big-ticket infrastructure projects underway:** Announcement of the smart cities like NEOM and King Abdullah Economic City would drive the demand for high-quality commercial spaces, while Red Sea Project would increase tourist flow, positively impacting hospitality real estate
- **Rising public-private partnership (PPP):** KSA’s government is encouraging the private sector’s participation in the economy. The private sector’s involvement in large-scale residential and commercial projects is likely to ensure timely delivery and resolve operational inefficiencies.
- **Emergence of social reforms:** KSA has allowed licensing regulations for cinemas, lifting a 35-year ban on the screening of movies. This could help revive shopping malls, which would drive demand for retail real estate.
- **Execution of various urban development initiatives:** For instance, infrastructure development and mixed-use community centers, is likely to further drive growth in the real estate sector.

### Real Estate Outlook





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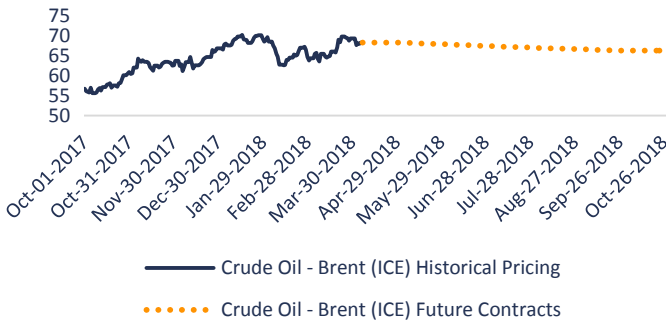
## Investment Highlights

### Increased spending, oil price recovery to drive growth in real estate

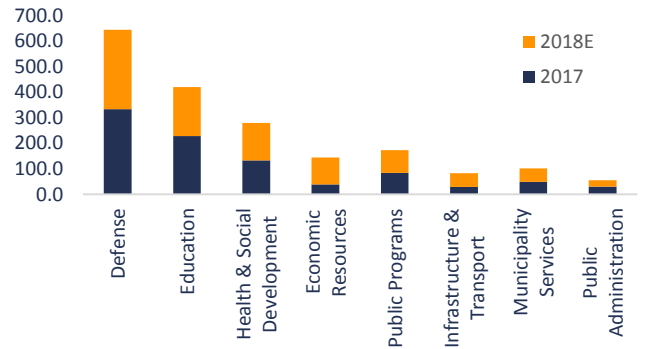
In line with Vision 2030, Saudi Arabia increased its budget spending for 2018 to SAR 978bn vis-à-vis SAR 926bn in 2017. The decision to increase spending is aimed at fueling growth in the non-oil sectors to reduce the country's dependence on oil. Increased spending on transport infrastructure and tourism projects is expected to drive growth in hospitality real estate. Additionally, the announcement of USD 500bn business hub Neom city would attract both domestic and foreign inflow in commercial real estate. Furthermore, in an attempt to aid the economy, the government announced an SAR 72bn stimulus package that includes subsidized loans for first-time home buyers, fee waivers for small businesses, and financial aid for distressed companies. This would have a positive implication on residential and commercial real estate. Recently the oil prices have also crossed USD 70/barrel mark. The recovery in oil prices would restore market liquidity in KSA, in turn boosting the demand for across real estate classes.

**Government's focus on non-oil sectors to spur growth in real estate**

#### Brent crude movement (USD/barrel)



#### Segment-wise budget allocation (SAR bn)



Source: Cap IQ, Ministry of Finance

### PIF–MoH partnership to ease home financing options

In 2017, Public Investment Fund (PIF) and Ministry of Housing (MoH) entered into a partnership to create the Real Estate Development Fund (REDF), aimed at providing prospective home buyers with easy home financing options. The fund is intended at increasing home ownership in Saudi Arabia to 52% by 2020 from the current level of 47%. In 2017, the fund introduced 283,000 products for home buyers. Furthermore, SAMA's decision to cut down payments on home loans to 10% would ease the financial burden of prospective home buyers. PIF forecasts demand for real estate financing options would rise 79% by 2026 from current levels. We expect the availability of easy home financing options under the REDF would result in a sharp uptick in demand for affordable residential units.

#### Real Estate Loans (SAR bn)



Source: SAMA

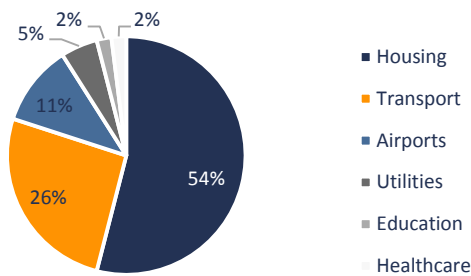


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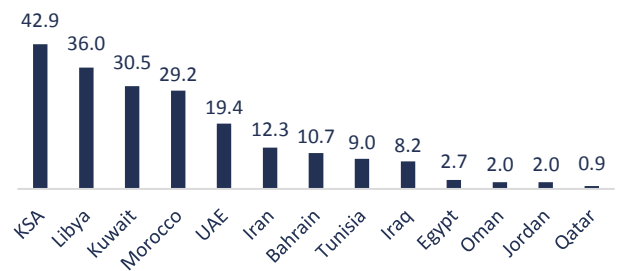
PPPs may prove a game changer

KSA's real estate market is currently characterized by project delays and operational inefficiencies. Decline in oil prices since 2014 further exacerbated the issue as it lowered the level of available government expenditure. Delay in various large-scale housing projects significantly increased the waiting list, thereby forcing the government to find a sustainable solution. Private sector businesses have also shown profound interest in KSA's real estate sector as it offers access to the otherwise unavailable land bank. MoH has thus signed MoUs with private developers for collaborations on large-scale projects which would help resolve challenges. The National Transformation Plan 2020 is further aimed at simplifying PPP activity in KSA by reducing the license approval time. The ongoing Dahiyat Al-Fursan development project in Riyadh is among the largest PPP projects, valued at SAR 75bn. Going forward, PPPs could prove instrumental in expanding the real estate sector's contribution in KSA's total GDP.

PPP by sector



Value of PPPs by Country (MENA Region) (USD bn)



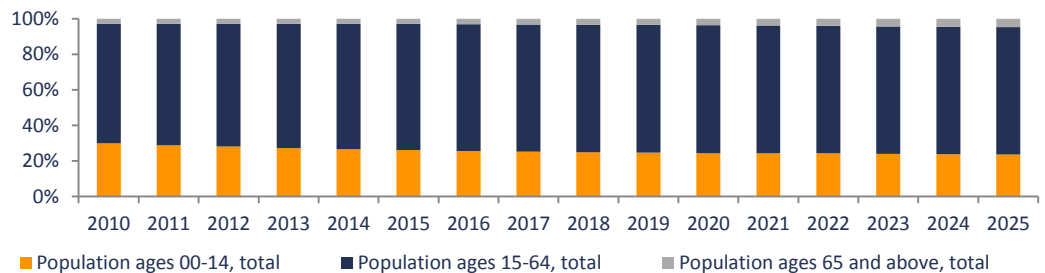
Source: JLL, Meed Projects

Rising population, and favorable demographic a key catalyst

Rising population and favourable demographics, incrementally positive for real estate demand

Increasing population in KSA, coupled with rising disposable income, is likely to ensure sustainable demand for residential units in the country over the long term. The country's population rose at a CAGR of 2.8% over the past decade (2007–17), while expected to expand at a healthy 1.6% CAGR (2017-2025E). According to GASTAT (December 2017), nearly 58.4% of the country's total population was under 34 years, which is the prime earnings age. The young demographic profile augurs well for KSA's real estate sector growth. Further, rising income, urbanization, and growing nuclear families are expected to support the demand in the long term.

Population growth & Demographic Profile – Saudi Arabia



Source: World Bank

REITs listing to boost the demand for income generating realty

Tadawul authorized the listing of REITs in November 2016. Twelve REITs have since been listed on the exchange. REITs are beneficial for both the investor and issuer. They provide the former with access to low-risk, income-generating real estate assets, while benefit the latter by expanding the investor base. Fund flow in REITs in KSA is expected to increase following the country's probable inclusion in the MSCI Emerging Markets Index.



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## Listed REITs – Saudi Arabia

REITs	Listing Date	NAV per unit
Riyad REIT	November 2016	10.23
Al Jazira REIT	February 2017	10.00
Jadwa REIT Al Haramain	April 2017	10.63
Taleem REIT	May 2017	10.00
Al Maather REIT	August 2017	9.82
Musharaka REIT	October 2017	10.00
Mulkia REIT	November 2017	10.00
Mashaar REIT	January 2018	10.00
Al Ahli REIT 1	January 2018	10.00
Jadwa REIT Saudi	February 2018	10.00
Derayah REIT	March 2018	10.00
Al Rajhi REIT	March 2018	13.27

Source: Tadawul data as of May 06, 2018

## White land tax to check land hoarding

*White land tax expected to resolve shortage of residential real estate*

From April 2017, KSA began levying 2.5% tax on undeveloped land in the cities of Riyadh, Jeddah, the DMA, and Makkah, with an aim to stabilize real estate prices and increase the supply of affordable residential units. According to the MoH, the total land area subject to the white land tax in these four cities is 400 million sq. meters. According to the Justice Ministry, the tax was able to reduce real estate prices by 18.5% on average post its implementation, and that the tax reform has thus far achieved the desired effect as there has been a prominent increase in land development in the four cities. Although the tax negatively impacted real estate prices, we think it is likely to drive residential real estate development in the long term, thereby resolving the shortage of residential units in Saudi Arabia. The following table compares real estate prices in 2016 with prices in 2017 (post the implementation of the white land tax).

## Real estate price index values (2017 vs. 2016)

	Residential	Commercial	Agricultural	General
Q1 2016	96.8	90.8	95.2	94.8
Q1 2017	87.6	80.2	94.0	85.5
% change	-9.5%	-11.7%	-1.3%	-9.8%
Q2 2016	95.3	88.0	94.8	92.9
Q2 2017	87.8	78.4	93.8	84.9
% change	-7.9%	-10.9%	-1.1%	-8.6%
Q3 2016	93.2	85.2	94.6	90.7
Q3 2017	88.2	77.6	93.8	84.9
% change	-5.4%	-8.9%	-0.8%	-6.4%
Q4 2016	90.0	81.7	94.3	97.5
Q4 2017	88.0	77.1	93.7	84.6
% change	-2.2%	-5.6%	-0.6%	-13.2%

Source: GASTAT, Ministry of Justice

## Real Estate Sector Overview 2017

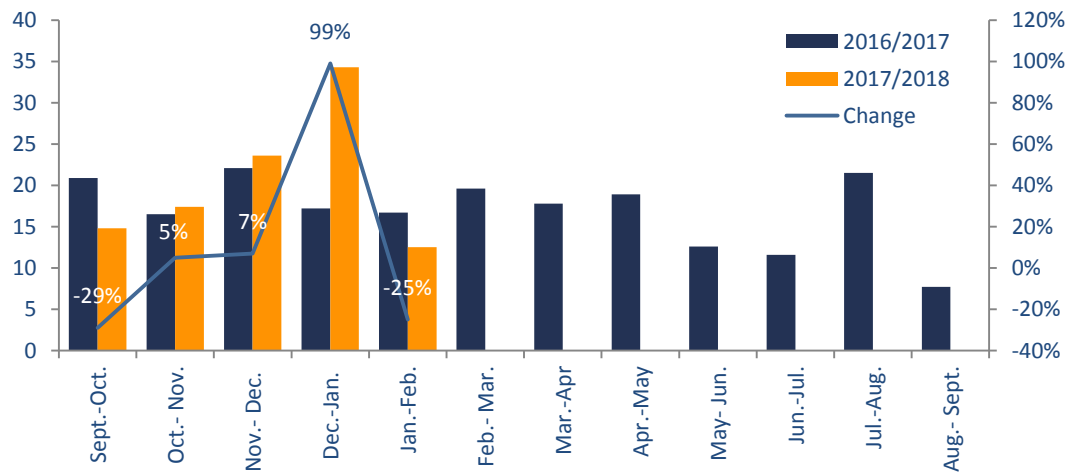
### Market remained subdued amid lack of liquidity

KSA’s real estate market slowed down in 2016, mainly due to subdued economic growth following declining oil prices. This trend continued in 2017 as sale prices and transaction volumes came under pressure due to the lack of market liquidity. The situation was further aggravated by a supply shortage in the mid-to-lower segments and the absence of easy real estate financing solutions. The sector was further dragged down by project delays due to delays in payments to contractors.

However, a recovery in oil prices since November 2017 and a series of government initiatives, including the introduction of REDF and the white land tax, appear to have positively affected the sector. The value of real estate transactions for Hijri year 1438 (September 2016 to September 2017) and Hijri year 1439 (September 2017 to February 2018) is shown below.

Value of real estate transactions (SAR bn)

Real estate transactions revived during Sep’17 to Feb’18 to SAR 106.2bn, up 14.0% YoY



Source: Ministry of Justice

### Mega projects offer attractive investment opportunity

KSA’s government, in 2017, positioned its real estate sector as an attractive investment avenue. Large-scale mixed use properties were positioned as an integral part of the Kingdom’s broader economic plan. These projects include ‘economic cities’ like Neom and luxury tourism plans under the Red Sea project. The PIF also launched a real estate financing company to boost activity by providing easy financing options. This entity would also be a link between investment capital and prospective financing opportunities.





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### Launch of various schemes supporting real estate sector

During 2017, the government implemented various initiatives to spur real estate activity in the Kingdom.

#### Recent government initiatives pertaining to real estate sector (2017)



<b>February 2017</b>	MoH's Sakani program	The program planned to deliver 280,000 residential products in 2017. The Ministry achieved its target for 2017. The second phase of Sakani program was launched in January 2018.
<b>May 2017</b>	Wafi online program	This program intended to sell real estate units before completion with the developers' assurance that the unit would be delivered according to the specifications declared earlier.
<b>October 2017</b>	Launch of Saudi Real Estate financing company	The entity was launched to facilitate real estate financing in KSA.
<b>January 2018</b>	Increase in LTV ratio for first-time home owners	The Central Bank increased the loan-to-value (LTV) ratio to 90%, so first-time home buyers will only have to pay 10% of the property's value to obtain a housing loan.

### Residential Market Review 2017

In 2017, residential real estate in Saudi Arabia witnessed a softening of prices and rent across key cities like Riyadh, Jeddah and the Eastern Province, driven by tight market liquidity. The shortage of residential units in mid-to-lower segment and the introduction of the white land tax also contributed to the decline in prices. The government introduced a levy on expatriate (expat) families from mid-2017. This caused several expats to move their families to their home countries, thus further impacting the demand for residential units.

#### Residential property sale price and change in rent as of Q4 2017

*Residential real estate prices softened during 2017 due to tough market conditions.*

	Riyadh	Jeddah
	Apartment rents down 5% YoY	Apartment rents down 10.9% YoY
	Apartment sale prices down 4%	Apartment sale prices down 8.1% YoY

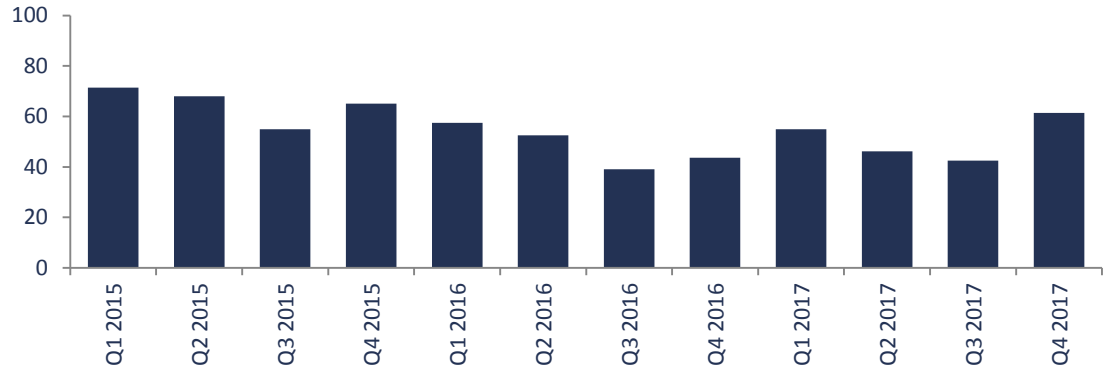
Source: JLL review, Ministry of Justice

In terms of volume, the number of apartments purchased in Riyadh rose 12% YoY, driven by lower prices and high negotiating power of buyers following tough market conditions. In Jeddah, the volume of transactions declined 1.0%, driven by the levy on expats. Overall, the number of transactions in 2017 increased 6.4% YoY.



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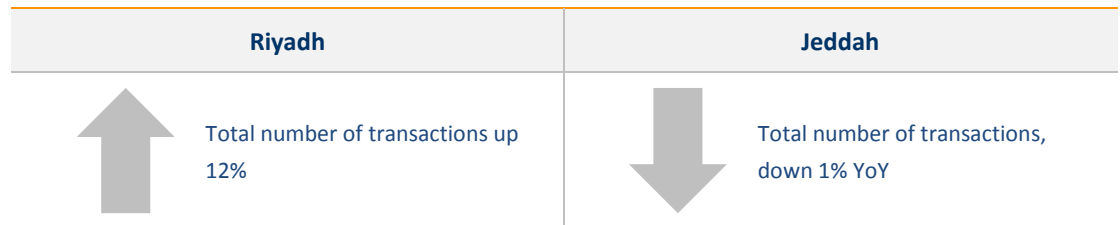
Total number of residential transactions ('000) – Saudi Arabia



Source: Ministry of Justice

Change in volume of real estate transactions in Riyadh and Jeddah as of 2017

The volume trend remained mixed for the major cities.



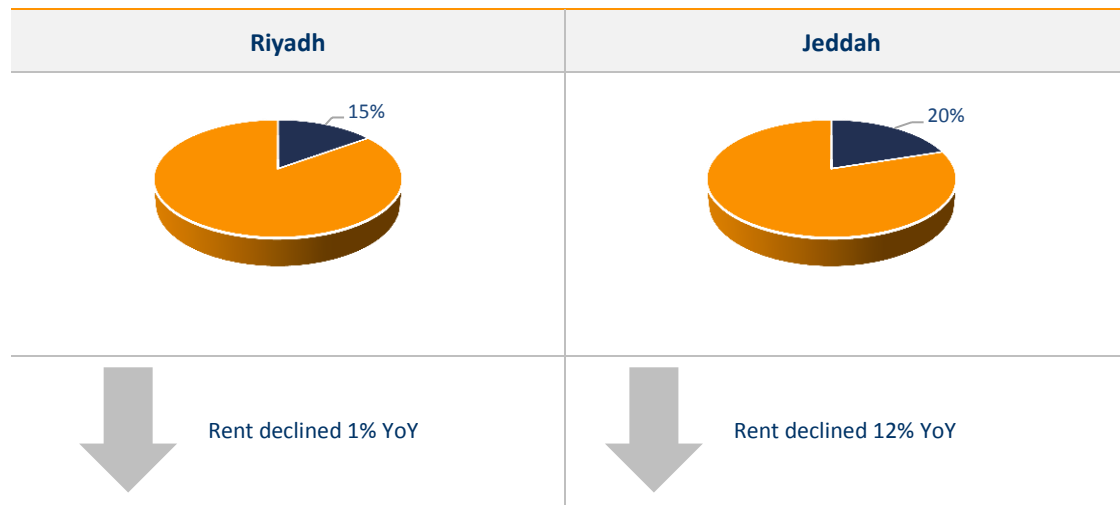
Source: JLL Review, Ministry of Justice

Office Market Review 2017

KSA government remained the prime office occupier in Riyadh in 2017. There has been a lack of office space supply in Riyadh in the recent years therefore main office spaces like Faisaliah Tower and Kingdom Tower remained 100% occupied. The vacancy rate in Riyadh increased to 15% in 2017 from 13% a year ago, while the vacancy rate in Jeddah rose 13 ppt to 20% in 2017, largely driven by demand supply mismatch. The rents softened across all the major cities due to economic uncertainty triggered by low oil prices.

Office vacancy rate and % change in rent as of Q4 2017

Commercial real estate rents softened across all the major cities. Government remained the key occupier in Riyadh.



Source: JLL review, Ministry of Justice



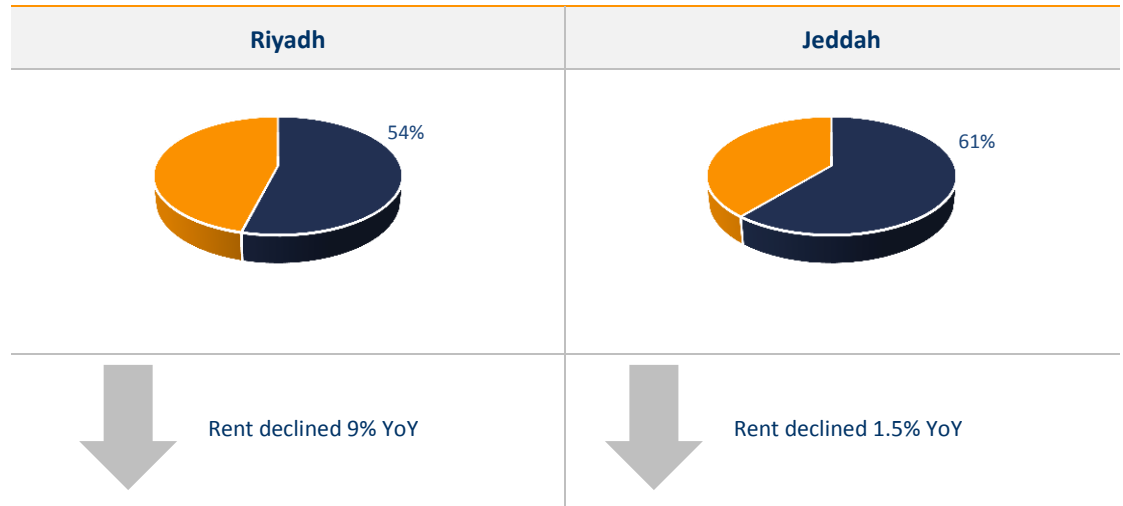
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### Hospitality Market Review 2017

The performance of hospitality segment was disappointing in 2017 with average room rents declining across major cities. The average rate in Riyadh declined 9% YoY to USD 190 in 2017, while in Jeddah average rate dropped 1.5% YoY. In terms of occupancy rates, the hotel market of Riyadh remained unchanged at 54%, while in Jeddah the occupancy levels dropped 7 ppt to 61% in 2017. Lower demand from corporate sector coupled with additional supply contributed to the weak performance of hospitality real estate in 2017.

#### Occupancy level and change in rent as of Q4 2017

Hospitality real estate rents softened with occupancy levels falling across all the major cities.

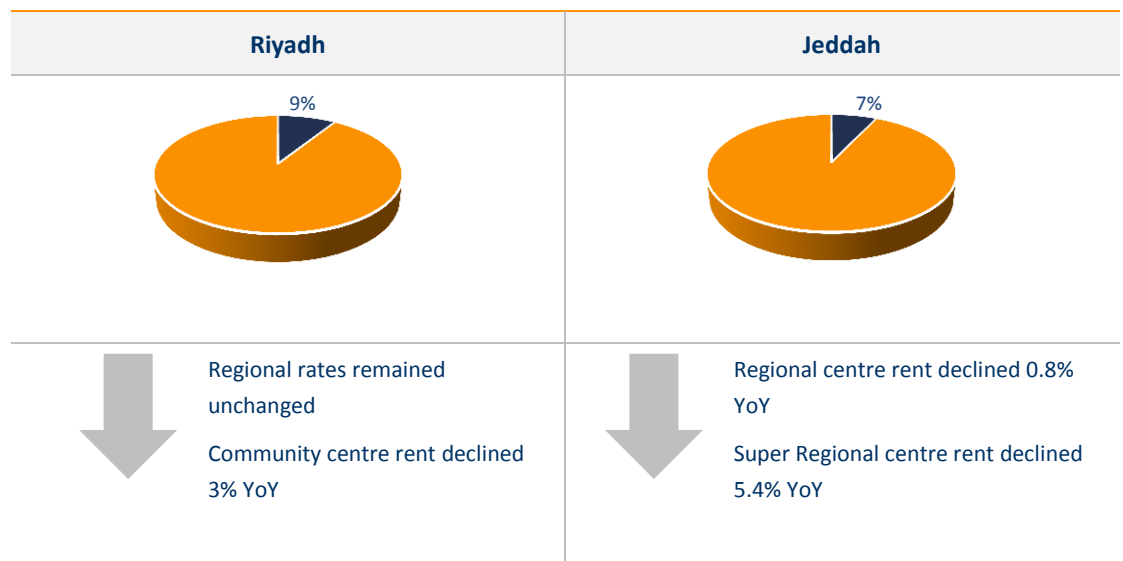


Source: JLL review, Ministry of Justice

### Retail Market Review 2017

The market conditions for the retail segment remained tough in 2017 due to the increase in bargaining power of the tenants. In Riyadh, the average rents of regional retain centers remained unchanged, while the average rent for the community centers declined 3% YoY. In Jeddah, the retail rents declined by 0.8% YoY and 5.4% YoY for regional and super regional centers, respectively. The vacancy rate in Riyadh remained stable at 9%, whereas in Jeddah it declined to 7% towards the end of 2017 vis-à-vis 10% for the previous year.

#### Vacancy rate and % change in rent as of Q4 2017



Source: JLL review, Ministry of Justice



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## Real Estate Outlook 2018

### A year of transformation for real estate sector: 2018

During 2017, the government of KSA announced several initiatives to boost the non-oil sectors of the economy, many of these focused on uplifting the real estate sector. Businesses and investors are seeking new avenues in the Kingdom’s real estate scene. Additionally, citizens are optimistic about the sector’s prospects, driven by the announcement of mega housing projects. We remain largely positive about the outlook for KSA’s real estate in 2018 as the government takes solid steps to diversify the economy under the Vision 2030:

- Increased public spending to stimulate real estate activity**– In the budget announced for 2018, the government increased its spending to SAR 978bn from SAR 926bn in 2017, a 5.6% YoY rise. This would be focused on economic diversification. In addition, the government launched an SAR 72bn package that includes subsidized loans for first-time home buyers, fee waivers for small businesses, and financial aid for distressed companies. We believe the increased spending and several other initiatives like REDF would fuel real estate activity in KSA in 2018.

#### Government spending (SAR bn)



Source: Ministry of Finance

- PPPs offer alternative financing options** – KSA aims to increase private-sector participation in the GDP to 40% by 2020. Additionally, the National Transformation Plan (NTP) seeks to increase the share of PPPs in the real estate sector to 10% by 2020 from the current 5%. PPPs are now increasingly being used to attract private-sector participation in real estate businesses. In 2017, the MoH delivered 50,000 housing units under the PPP scheme. In 2018, the value of projects under the PPP scheme is expected to grow further, with the major exposure in the housing market. Even though KSA’s regulatory framework needs to evolve to facilitate more PPP projects, we believe the Kingdom has progressed significantly on this front, and PPPs, in future, would help mitigate the housing shortage in KSA.

#### Upcoming PPP projects

Date Announced	Project	Status
April 2017	Taif International Airport	Project Awarded
April 2017	Hail Regional Airport	Project Awarded
April 2017	Qassim International Airport	Project Awarded
January 2018	Schools Project Jeddah and Makkah	Project in Tender

Source: Infra PPP World database

Increased spending to double the contribution of real estate sector in economy by 2020

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- Social reforms to aid hospitality and retail sectors** – KSA is planning to issue its first tourist visas in April 2018. The move comes in line with the country’s strategy to boost its non-oil sectors like tourism. The country will now be open to non-Muslim tourists who want to visit places like Jeddah, Riyadh and Mada’in Saleh in the Arabian Desert. This move will have a positive implication of the country’s hospitality real estate which is currently suffering from low demand. Furthermore, KSA has allowed licensing regulations for cinemas, lifting a 35-year ban on the screening of movies. This could help revive shopping malls, which would drive demand for retail real estate.
- Cross-border expansion** – Leading real estate developers in Saudi Arabia are seeking attractive investment opportunities across the border. Recently, Dar Alarkan Real Estate Co. entered the UAE market by launching its first international project worth AED 800mn. The project would be a Roberto-Cavalli-designed residential property in Dubai. As construction activity in the GCC and MENA regions increases, we can expect more Saudi real estate developers to venture into other countries in 2018.

**Factors governing the outlook for 2018 across major real asset classes**





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## REITs Overview 2017

### REIT listing gathers pace in 2017

Real Estate Investment Trusts or REITs are a type of investment instrument that invest directly in income-generating real estate properties through mortgages or underlying real estate. In the jurisdiction of Saudi Arabia, a REIT is a closed-ended investment company that invests in income-generating real estate assets. REITs in KSA are governed by the Capital Market Authority (CMA).

#### Basic requirements of CMA regulations on REITs in Saudi Arabia

<b>Minimum capital</b>	The current minimum capital requirement for a REIT in KSA is SAR 100mn; the nominal value per unit should be SAR 10.
<b>Financing</b>	Total borrowings by a REIT in KSA cannot exceed 50% of the fund's total asset value.
<b>Dividend distribution</b>	A minimum of 90% of the fund's annual net profit should be distributed to unit holders.
<b>Investment Policy</b>	At least 75% of the fund's total asset value should be invested in mature real estate properties generating periodic rental income.
<b>Geographic exposure</b>	Even though a REIT in KSA can invest both locally and internationally, its total exposure outside KSA is capped at 25% of its total value.
<b>Shareholders</b>	A REIT in KSA must have a minimum of 50 holders; at least 30% of the unit holders must be public entities.

Source: CMA REIT instructions

Following Saudi Arabia's recent decision to allow REIT listings on the exchange (Tadawul), we witnessed six REITs enter the bourse in 2017, thus reflecting the increased demand for income-generating real estate assets. Until now, 12 REITs have been listed in Saudi Arabia.

#### Current Status, Fund size and no. of properties owned

REIT	Status	Fund Size (SAR mn)	No. of properties
Al Rajhi REIT	Open for subscription	1622	13
Jadwa REIT Saudi	Open for subscription	1580	5
Al Ahli REIT (1)	Jan. 8, 2018	1375	2
Derayah REIT	Subscription Closed	1172	15
Wasatah REIT	Not listed yet	1080	2
Musharaka REIT	Oct. 2, 2017	880	5
AlNefaie – Umm Alqura REIT Fund	Not listed yet	692	4
Mulkia REIT	Nov. 5, 2017	677	5
Jadwa REIT AlHaramain	April 30, 2017	660	5
SEDCO Capital REIT	Not listed yet	650	7
AlMa'athar REIT	Aug. 22, 2017	614	12
Al Masha'ar REIT	Not listed yet	572	3
Riyadh REIT	Nov. 13, 2016	500	7
Taleem REIT	30-May-17	285	1
AlJazira Mawten REIT	Feb. 15, 2017	118	1

Source: Argaam



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**REITs targeted assets across all classes in 2017**

**Portfolio exposure of REITs in Saudi Arabia is distributed across sectors.**

Looking at a broader perspective, the introduction of REITs in Saudi Arabia is in line with the government's Vision 2030 to spur activity in the real estate sector. With the introduction of REITs in KSA, the investors are offered an opportunity for a more liquid exposure within the real estate sector. Until date, the investment strategy of the REITs listed in KSA has been blended due to the absence of high-quality real estate assets. However, as the real estate market in the Kingdom matures, we would see the emergence of sector-specific REITs that can offer attractive investment opportunities for those seeking exposure to defensive sectors such as education and healthcare.

**Portfolio exposure of KSA REITs**

REIT	Residential	Commercial	Educational	Offices	Stores	Warehouses	Hotels & Hospitality	Industrial
Al Rajhi REIT		✓	✓	✓		✓		
Derayah REIT	✓			✓	✓	✓	✓	
AlMa'athar REIT	✓			✓	✓	✓		
SEDCO Capital REIT	✓	✓		✓			✓	
Riyadh REIT				✓	✓		✓	
Mulkia REIT	✓			✓	✓			✓
Musharaka REIT	✓					✓	✓	
Jadwa REIT Saudi	✓	✓	✓			✓		
AlNefae – Umm Alqura REIT Fund		✓					✓	
Al Masha'ar REIT					✓		✓	
Wasatah REIT							✓	
Jadwa REIT Alharmain					✓		✓	
Al-Ahli REIT (1)					✓		✓	
AlJazira Mawten REIT						✓		
Taleem REIT			✓					

Source: Argaam

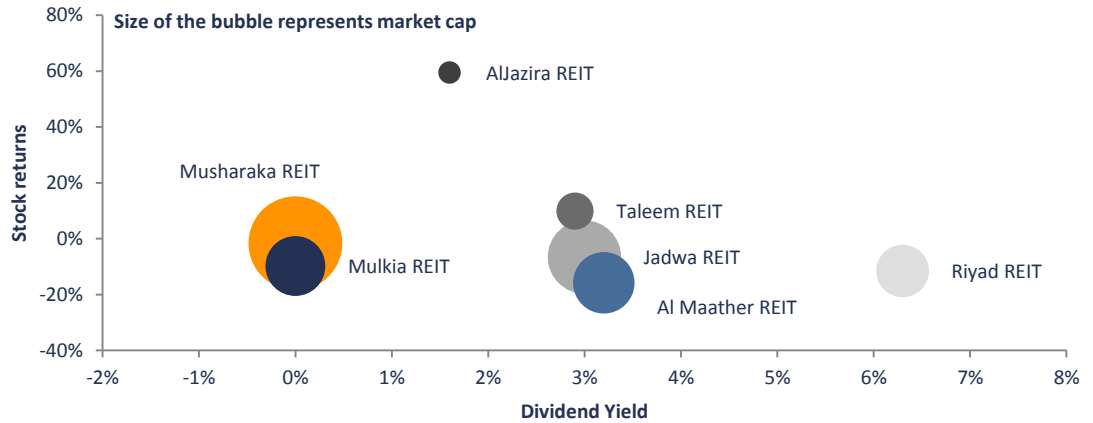


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### Performance remained subdued in 2017

Almost all the REIT IPOs issued in 2017 were over-subscribed. However, the stock performance of REITs in 2017 remained muted; only two of the listed REITs – AlJazira REIT and Taleem REIT – offered positive stock returns of 59.5% and 9.9%, respectively. Among all the REIT players, Riyadh REIT offered the highest dividend yield of 6.2%.

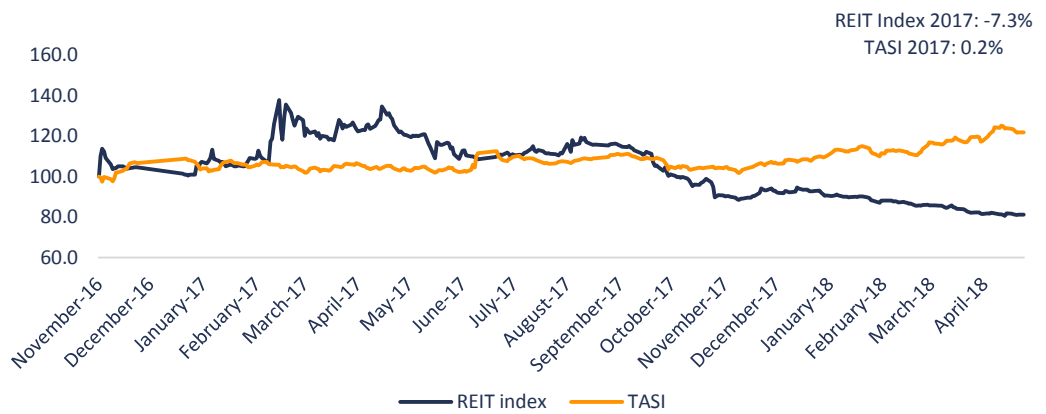
#### Stock returns, Dividend Yield & Market Cap of seven listed REITs in 2017



Source: Bloomberg, Tadawul

The Tadawul REIT index underperformed TASI during 2017. REIT index offered a negative return of 7.3% during 2017 vis-à-vis positive 0.2% returns for TASI. After an attractive return of 19% in REITS (till August 2017), the returns started declining

#### Tadawul REIT Index



Source: Bloomberg, Tadawul



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## REITs Outlook 2018

### *REITs to bring about transparency in real estate sector*

The introduction of REITs in Saudi Arabia provided new investment avenues to investors who otherwise invested their capital in either the stock market or a piece of illiquid real estate asset. From the broad perspective of Vision 2030, REITs would help the government achieve its goal of increasing real estate activity in the country with the help of private players. Additionally, REITs would bring transparency to the existing realty landscape in the country wherein REITs with exposure to poor-quality real estate would trade at a discount to peers with exposure in high-quality assets. Although it is too early to judge the performance of the REIT sector, our outlook remains largely positive as the sector is growing rapidly. As a result, the market becomes more liquid and transparent. The top trends expected in KSA's REIT sector in 2018 are as follows:

- **REITs to act as alternative investment vehicles** – The successful listing of 12 REITs on the exchange shows the demand for income-generating real estate assets is on the rise. REIT as an instrument provides investors easy access to real estate investments that can be traded like stocks. Additionally, investors can diversify into various real estate asset classes. We expect REITs to gain momentum in 2018 as more investors become aware of the advantages they offer.
- **Focus to shift to sector-specific REITs** – The investment strategy of REITs currently operating in Saudi Arabia is blended, i.e. not specific to any particular class of the real estate sector. However, as the market gathers momentum and matures in 2018, we expect the emergence of sector-specific REITs wherein investors would be able to invest in specific sectors such as education, hospitality, and healthcare.
- **Share prices to reflect quality of underlying asset** – In 2017, the listed REITs traded at a premium to their NAV, but prices moderated in the latter half. In 2018, we expect REIT units to trade in line with their NAV and underlying assets as more players enter the market. Due to the entry of more market players, market depth would increase and investors would prefer high-quality real estate assets. Hence, REITs with exposure to low-quality assets would start trading at a discount to peers.
- **MSCI inclusion to attract foreign funds in REIT market** – Saudi Arabia is set to be included in the MSCI Emerging Markets index this year. With this, the inflow of foreign funds in the REIT sector of the country would increase significantly.
- **PPPs to improve the quality of underlying assets** – Saudi Arabia lacks the supply of high-quality real estate assets compared with mature and emerging REIT markets. However, in line with Vision 2030, the government seeks to revamp the real estate sector through the PPP scheme. In 2018, we expect the quality of underlying assets for REITs to improve due to private sector involvement.
- **KSA REITs to venture into global markets** – Currently, most REITs in Saudi Arabia have exposure to local or regional markets. However, in 2018, we expect REITs to increase their exposure in international markets offering high-quality investment assets. This could boost the demand for REIT units in KSA.



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## Top Real Estate and REIT ideas 2018

## Overview of real estate companies in Saudi Arabia

Stocks	2017			Current P/E*	Current P/B*	12-month returns	Description
	ROE	ROA	Dividend Yield				
Arriyadh Development	10.75%	8.94%	4.32%	11.8	1.1	-9.17%	Arriyadh Development Co. was established in 09/02/1414 H. as a Saudi Joint Stock Company. The company operates in construction of retail, residential and office real estate apart from infrastructure development.
Alandalus Property	9.64%	7.07%	8.52%	13.9	1.0	15.10%	Alandalus Property was incorporated in 2006 and operates primarily in the commercial real estate segment. It manages and operates shopping malls and commercial centers.
Taiba Holding Co.	5.52%	4.68%	5.02%	23.9	1.1	-27.73%	Taiba Holding Co. was established in 1988 and operates, manages, invests in real estate properties in Saudi Arabia. It also manages hotels and hospitals in addition to residential and commercial real estate.
Saudi Real Estate Co.	3.82%	1.92%	4.49%	20.2	0.4	9.66%	Saudi Real Estate Co. (Alakaria) was found in 1976 by royal decree. The company develops and manages residential, office and commercial projects like shopping malls.
Makkah Construction & Development	3.49%	3.29%	3.07%	50.5	1.7	-23.22%	Makkah Construction & Development Company was established in established on 13/11/1408 H and develops construction projects close to the Great Mosque of Makkah.
Dar Alarkan Real Estate Co.	2.97%	2.12%	NA	24.8	0.5	111.26%	Dar Alarkan Real Estate found in 1994 is a public shareholding company. The company operates, manages and develops commercial, living and mixed-use spaces.
Emaar The Economic City	2.78%	1.29%	NA	51.8	0.7	-18.19%	Emaar The Economic City was found in 2006 and operates as a real estate development and management company in Saudi Arabia. The company primarily develops the King Abdullah Economic City. It also develops infrastructures; promotes, markets, and sells land within development areas.
Knowledge Economic City	-0.69%	-0.66%	NA	NM	1.2	-28.68%	Knowledge Economic City was established in 2010 and is engaged in the development of an economic zone in Medina.
Jabal Omar Development	-6.27%	-2.18%	NA	NM	1.6	-29.87%	Jabal Omar Development was found in 2006 and is engaged in the development, management, sale, and lease of the Jabal Omar project in Makkah. The company also operates several hotels, including the Marriott.
Red Sea International Co.	-7.99%	-5.01%	NA	NM	0.8	-27.27%	Red Sea International Co. was established in 1967 under the royal decree. The company in engaged in the sale and manufacturing of non-concrete commercial and residential buildings in Saudi Arabia and abroad.
<b>Sector Median</b>	<b>3.23%</b>	<b>2.02%</b>	<b>4.49%</b>	<b>23.9</b>	<b>1.0</b>		

Source: Tadawul, Cap IQ, Price as of 6<sup>th</sup> May 2018





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### Top Picks Real Estate – 2018

- **Arriyadh Development** – Among all the real estate companies listed in Saudi Arabia, Arriyadh Development Co. (Arriyadh) offered the highest ROE, of 10.8%, in 2017 (peer ROE: 3.2%). Additionally, the company offered ROA and dividend yield of 8.9% and 4.3%, respectively. The company appears to be trading at a discount to the sector median in terms of P/E and P/B multiples, providing a cushion for current investment level. Although Arriyadh's stock plummeted 9.2% within the past 12 months, we believe that the stock has an upside potential, given the positive outlook for the real estate sector in 2018. Arriyadh's upcoming key projects include Al Zaheera Region Development and Tilal Tameer (residential).
- **Alandalus Property** – Alandalus Property (Alandalus) offered an attractive ROE of 9.6% in 2017. Furthermore, the company's management announced a dividend of SAR 140mn for 2017, thereby bringing the dividend yield to 8.5% (highest in the sector), while ROA stood at 7.1% in 2017. Alandalus is currently trading at a discount of 42% to its peers in terms of P/E multiple; its stock ran up by 15.1% in the past 12 months. We believe, Alandalus is a good investment bet, given low valuation level and attractive yields. Alandalus's upcoming projects include Stay Bridge Suites Hotel and Al Andalus Square, which are located in Jeddah.
- **Taiba Holding Co.** – Taiba Holding Co.'s (Taiba) ROE and ROA came in at 5.5% and 4.7%, respectively, during 2017, with a dividend yield of 5.0%. The company's stock declined 27.7% over the past year. We believe the stock price has bottomed out and there is ample upside potential for the stock, given its healthy indicators.
- **Saudi Real Estate Co.** – Saudi Real Estate Co. (Alakaria) offered an ROE and ROA of 3.8% and 1.9%, respectively, in 2017, with a dividend yield of 4.5%. In terms of P/E and P/B multiples, Alakaria is trading at a discount of 15.5% and 60.0%, respectively, thereby offering a good investment opportunity to investors. The company's stock ran up by 9.7% over the past 12 months. Some of the company's upcoming projects are Al Rimal (residential) and New Sitten (hospitality). Both are to be located in Riyadh.



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*Overview of REITs in Saudi Arabia*

REITs Name	Current NAV/Unit (SAR)	Current P/B Ratio*	Trailing Dividend (SAR)	Current Dividend Yield (%)	Gross Rental Yield 2017	Trading at premium or discount to NAV	Sector Exposure
RIYAD REIT	10.23	0.88	0.56	6.22	7.01%	Discount	Office, Stores, Hotels
TALEEM REIT	10.00	1.06	0.47	4.44	7.37%	Premium	Educational
MULKIA REIT	10.00	0.8	0.28	3.42	8.05%	Discount	Residential, Offices, Stores, Industrial
AL MAATHER REIT	9.82	0.81	0.26	3.25	8.65%	Discount	Residential, Offices, Stores, Warehouses
JADWA REIT ALHARAMAIN	10.63	0.82	0.26	2.97	6.52%	Discount	Stores, Hotels
ALJAZIRA REIT	10.00	1.46	0.25	1.71	8.43%	Premium	Warehouses
DERAYAH REIT	10.00	0.82	0.10	1.25	NA	Discount	Residential, Offices, Stores, Wrehouses
MUSHARAKA REIT	10.00	0.87	0.00	0.00	8.84%	Discount	Residential, Warehouses, Hotels
MASHAAR REIT	10.00	0.8	0.00	0.00	6.20%	Discount	Stores, Hotels
ALAHLI REIT 1	10.00	0.86	0.00	0.00	NA	Discount	Stores, Hotels
AI RAJHI REIT	13.27	0.68	0.00	0.00	NA	Discount	Commercial, Educational, Offices, Warehouses
JADWA REIT SAUDI	10.00	0.98	0.00	0.00	NA	Discount	Residential, Commercial, Educational, Warehouses
SEDCO CAPITAL REIT	0.00	0.00	0.00	0.00	NA	NA	NA

Source: Tadawul, REIT market report 2017 Century 21, Data as of 6<sup>th</sup> May 2018



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### Top Picks REITs – 2018

- **Riyad REIT** – Riyad REIT has the highest dividend yield of 6.2% among all the REITs listed in Saudi Arabia. Additionally, its gross rental yield stands at 7.0%. In terms of P/B, the REIT is trading at a premium of 7.3% to the sector median. It is currently trading at a discount to its NAV. Riyad REIT has exposure to the office, store and hotel sectors. Overall, Riyad REIT offers a good investment opportunity due to its high dividend and rental yield.
- **Taleem REIT** – Taleem REIT's dividend yield and gross rental yield stood at 4.4% and 7.4%, respectively. Although the REIT is currently trading at a premium to its NAV and sector P/B multiple, we believe the premium is justified, given its high dividend and rental yield, and exposure to defensive sectors such as education.
- **Mulkia REIT** – Mulkia REIT's dividend yield is 3.4% (third highest in the sector). Besides, it has an attractive gross rental yield of 8.0%. In terms of P/B, it is currently trading at a discount of 2.4% to its peers. Moreover, its units are trading at a discount to its NAV, thus giving upside potential to the stock, once the REIT market stabilizes in 2018. Mulkia REIT has exposure to the residential, office, store, and industrial sectors. Considering these factors, we believe Mulkia REIT is a good investment bet.
- **Al Maather REIT** – Al Maather REIT's dividend and gross rental yield stands at 3.3% and 8.7%, respectively. It is trading at a discount of 1.2% to its peers in terms of P/B multiple. The REIT has exposure to defensive sectors such as warehouses, which would ensure consistent rental income. Thus, we expect Al Maather REIT to perform well in 2018.



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## Risks & Unknowns – Real Estate Sector

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- **VAT implementation might lead to project delays** - KSA implemented a 5% VAT on goods and services from January 2018, consequently spiking the cost of goods and services. The implementation is likely to lead to an increase in the cost of fuel and construction materials, which would adversely affect the cash flow of real estate developers. This could in turn delay projects over the short to medium term. Moreover, VAT would increase the cost of buying commercial or residential spaces; only first-time home buyers with unit purchases valued up to SAR 850,000 are exempt from VAT.
- **Rising interest rates might hurt real estate loans** – In March 2018, KSA raised its repo and reverse repo rates by 25 basis points to 2.25% and 1.75%, respectively. KSA usually follows the Fed's rate hike due to its currency peg to the US dollar as a Fed-led rate hike might lead to capital flight. Yet another spell of Fed rate hikes (expected 2-3 times in 2018), would influencing KSA to further raise its interest rates. This would result in higher loan expense for property buyers, thus negatively affecting the demand for real estate loans. Overall, an increase in interest rates might affect the demand for real estate units.
- **Expat levy to reduce the demand for residential units** – Effective July 2017, KSA implemented an expatriate (expat) levy on the dependents of expat employees. In January 2018, the Saudi Ministry of Finance announced it would levy a monthly expat fee of SAR 300–400 on private companies hiring expats. This caused an exodus of expats from the Kingdom, thus adversely affecting the demand for residential realty in KSA.
- **Volatility in oil prices might restrain government finances** – Activity in KSA's real estate sector slowed down in 2015 and 2016 following the decline in oil prices. Any such volatility in the future might impact government spending, thereby subduing activity in the real estate sector. Furthermore, due to the oil price decline, the government could adopt austerity measures such as subsidy removal, which affects consumer spending and may hurt real estate demand.

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**Overweight:** The Target share price exceeds the current share price by  $\geq 10\%$ .

**Neutral:** The Target share price is either more or less than the current share price by 10%.

**Underweight:** The Target share price is less than the current share price by  $\geq 10\%$ .

**To be Revised:** No target price had been set for one or more of the following reasons: (1) waiting for more analysis, (2) waiting for detailed financials, (3) waiting for more data to be updated, (4) major change in company's performance, (5) change in market conditions or (6) any other reason from FALCOM Financial Services.

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