



Real value in a changing world

World Winning Cities

Global Foresight Series

The Gulf's Powerhouse

Saudi Arabia's Real Estate Market



The Gulf's Powerhouse

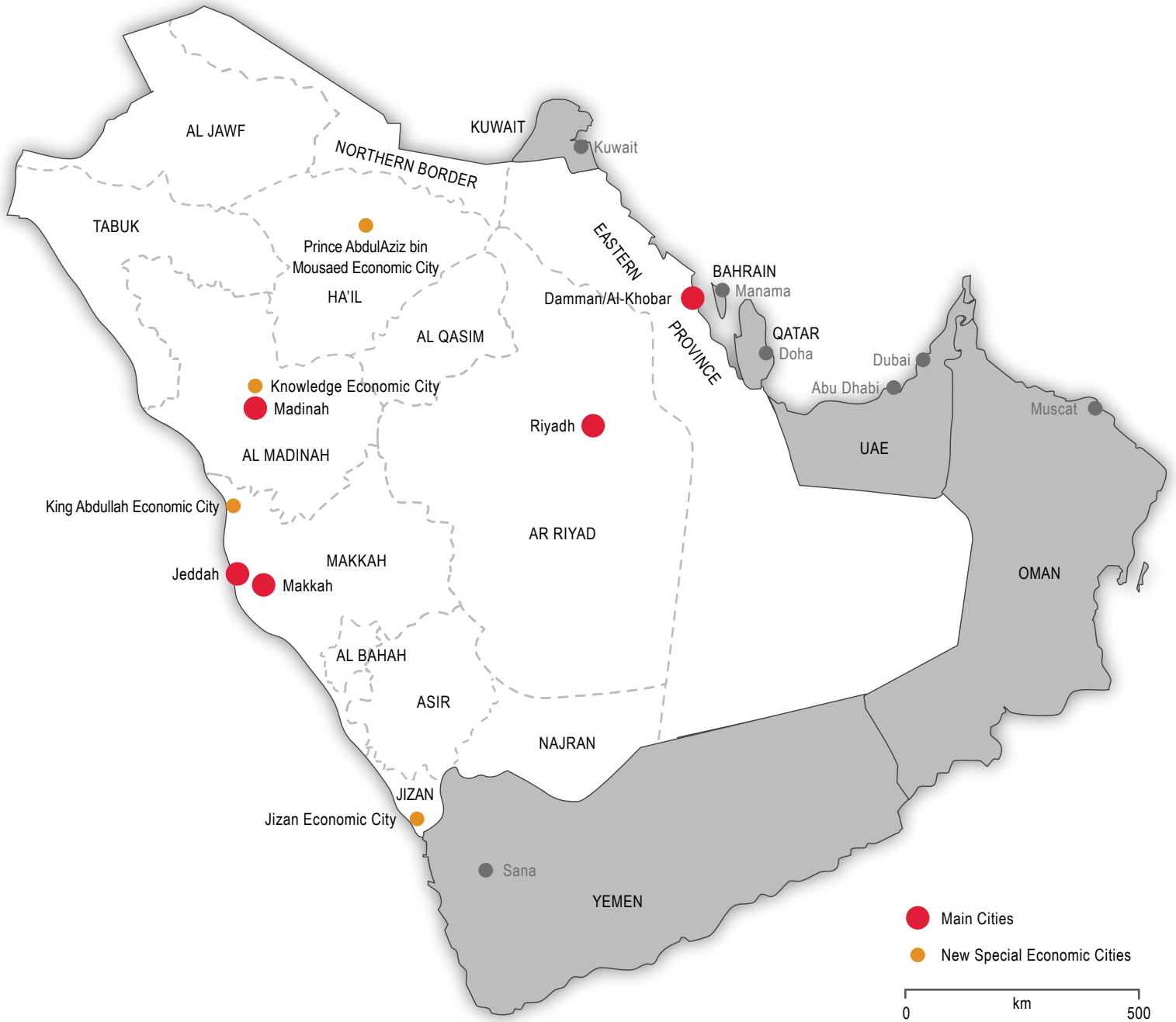
Economy – Key Features

- The Kingdom of Saudi Arabia (KSA) is the largest country in the GCC. The Kingdom occupies ¼ of the Arabian Peninsula and holds 25% of the world's confirmed oil reserves.
- Unlike other GCC countries, Saudi Arabia has a large domestic market, with considerable spending power. While other smaller economies of the region, and notably UAE, serve as 'global gateways', Saudi Arabia has an important role as a regional hub.
- A key trigger for the country's ongoing reforms is its rapid population growth. The Kingdom's population grew from 6.2 million in 1970 to 25 million in 2008. About 47% of Saudis are now below 20 and another 38% are between 20 and 40.
- To respond to the needs of a growing population, Saudi Arabia is now opening up to the outside world. Accession to the World Trade Organisation and the reduction of corporate tax on foreign-owned firms has resulted in an impressive economic boom since 2000.
- Foreign direct investment inflows increased almost ten-fold from USD 183 million in 2000 to USD 17.5 billion in 2007 respectively, accompanied by equally impressive growth in domestic investment.
- Economic growth exceeded 5% a year between 2003 and 2007 with 7.2% forecast for 2008. Economic growth is expected to remain robust in 2008–09, largely driven by strong public sector expansion and increased foreign direct investment.
- The country has seen rapid advances in its business environment, which is feeding through to the real estate market. In Jones Lang LaSalle's 2008 Real Estate Transparency Index, Saudi Arabia was the sixth biggest improver globally.

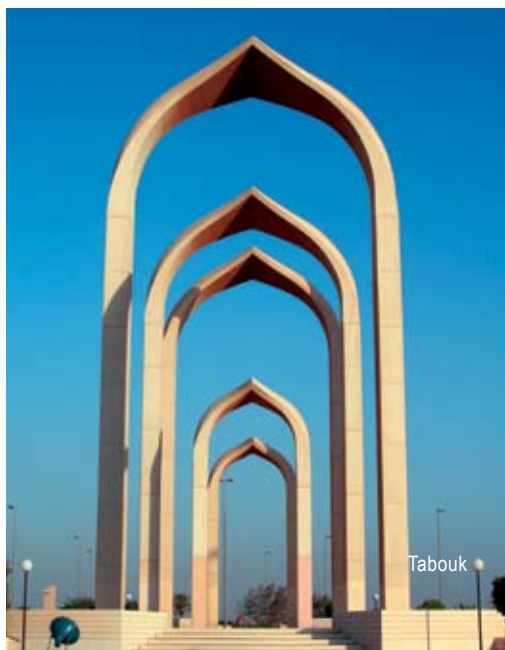
Executive Summary

- Saudi Arabia is by far the largest real estate market in the Gulf, as well as being one of its fastest growing. Benefiting from its new era of leadership, the Saudi commercial real estate stock is expected to virtually double in size to stand at nearly 30 million sq.m.¹ by 2012.
- The fundamental engine driving the Saudi economy and real estate market is domestic population and economic growth, unlike other GCC economies where growth has been largely based on overseas residents and employers.
- Opportunities for foreign involvement in the real estate market are expected to increase significantly over the next five years, and the market is poised for lift-off. The Saudi real estate market is becoming more transparent, with further important reforms currently underway, most notably the new mortgage law, which will open up the residential market to low and middle income Saudis.
- Continuing urbanisation will be a major driver of real estate growth. As well the rapid expansion of its existing cities (notably Riyadh and Jeddah), six Special Economic Cities (SEC's) are being developed, which by 2020 are expected to account for up to 30% of the Saudi economy and house 4–5 million people.
- The residential sector provides the strongest potential. A major opportunity arises in the provision of more affordable housing for a rapidly growing and youthful population. The current shortfall is estimated to be as high as 500,000 dwellings, which could rise to one million by 2012.
- While there are ambitious plans for substantial additional residential stock over the longer term, more new housing will need to be provided over the next 3–4 years if the current shortfall in the middle and low income segments of the market is not to increase.
- The retail sector offers opportunities for developers to respond to the strong demand from a young population for modern retail malls. Leisure activities will be an important driver of mall development. Successful malls are likely to be those that offer innovative entertainment formats and the best quality retail management.
- Office market activity will be driven by local demand, in contrast to other GCC office markets. Riyadh will consolidate its position as a major office market, although there are also likely to be opportunities in the office sector in Jeddah and Dammam/Al-Khobar. Major new schemes in the pipeline will encourage a flight to quality, while increasing congestion will support the continued development of office areas away from CBD locations.
- Saudi Arabia offers a unique niche market for religious tourism focused on the holy cities of Makkah and Madinah. Major constraints on growth are being addressed, releasing significant opportunities for the hospitality sector. A co-ordinated and managed approach between the government agencies responsible for regulating the hospitality and tourist sector of the economy is required to realize the full potential of this sector.
- Saudi Arabia has by far the largest industrial market in the region, presenting significant opportunities, particularly in the logistics sector. This sector is currently underdeveloped but is expected to see rapid growth, with the creation of specialist logistics parks over the next five years. This will result in major opportunities for foreign developers and investors.
- Despite its significant growth potential, Saudi Arabia faces a number of challenges that need to be tackled for its full potential to be realised. Recent progress has been made, but challenges remain in respect of market transparency, delays in implementing reforms and continued restrictions on foreign ownership.

¹ Gross building area of the offices, retail and hotels sectors. Excludes industrial and residential sectors.



Al Faisaliyah Tower, Riyadh



Tabouk



Kingdom Centre, Riyadh

Five Pillars of Real Estate Growth

Fig 1: GCC Countries – Key Indicators, 2008

	Population Million	Total GDP USD Billions (at PPP)
KSA	25.0	608
UAE	5.5	162
Kuwait	3.6	147
Qatar	1.4	77
Oman	2.9	66
Bahrain	0.8	27

PPP – Purchasing Power Parity
Source: EIU September 2008

1. The Powerhouse of the Gulf Region

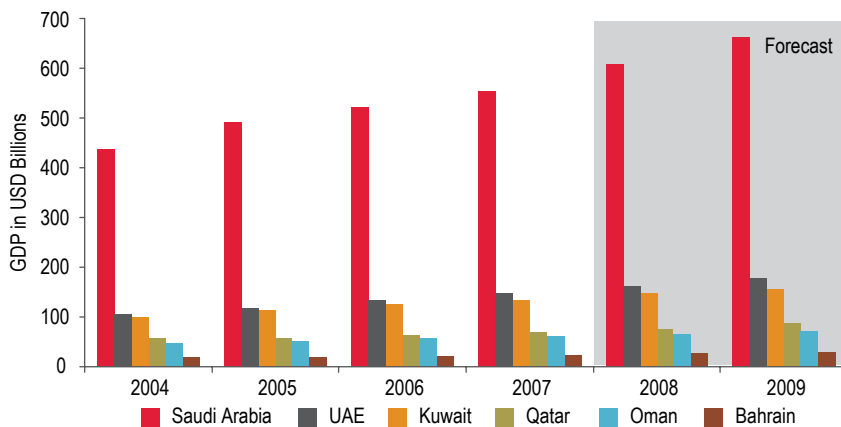
The Kingdom of Saudi Arabia (KSA) is by far the largest economy of the GCC², it is the industrial powerhouse of the Gulf and with its new era of leadership has a huge potential requirement for quality real estate, underpinned by strong economic fundamentals and increasing economic diversification.

Dominated by Oil, but now Diversifying

Saudi Arabia holds 25% of the world's confirmed oil reserves, making the Kingdom the most strategically important country in the region.

The hydrocarbons sector is currently dominant, with oil-related activities accounting for 35–40% of GDP. However, the government is actively seeking to diversify the economy by developing non-oil based sectors. Massive oil revenues are funding high public spending in infrastructure and education, and with oil prices forecast to stay high, government spending is expected to remain the principal driver of growth. The non-oil private sector is forecast to expand by some 7% in 2008–09, providing a strong boost in demand for commercial real estate.

Fig 2: Economic Growth: KSA v GCC Countries



Source: EIU September 2008

2. Demography is Destiny

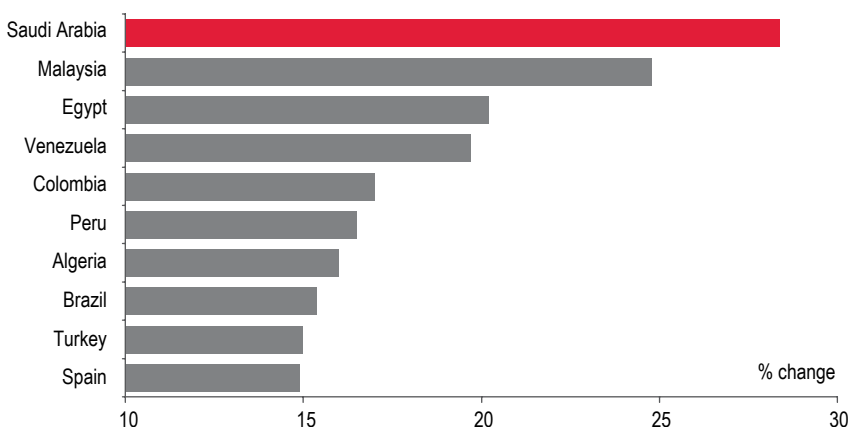
Rapid Population Growth

Social, economic and real estate developments in Saudi Arabia are being strongly impacted by the dramatically changing demographic profile of the Kingdom.

Saudi Arabia is not only the largest of the GCC countries (accounting for over 60% of the region's population), it also continues to experience one of the world's steepest rises in population; from 6.2 million in 1970 to over 25 million in 2008, and fast growth continues at 2.5% per year.

A large number of young Saudi's are now entering adulthood and setting up families. This will have a major impact on the economy, and will boost demand for modern retailing. It is also generating enormous pressures on the country's residential market.

Fig 3: World's Fastest Growing Large Countries Population Growth 1998–2008



Countries with population over 20 million and GDP/Capita over USD 5,000
Source: United Nations, 2007

Job Creation will Boost Real Estate Demand

With a rapidly expanding workforce, the country needs to expand, diversify and improve work opportunities. While the government sector has been expanding, new private sector employment is also required. As a consequence, Saudi Arabia is gradually opening to global markets, stimulating growth in business formation and embracing international competitiveness.

² Gulf Cooperation Council (GCC) comprises of the Kingdom of Saudi Arabia, Bahrain, Kuwait, Oman, Qatar and the United Arab Emirates.

3. "10x10" Vision is Taking Shape

Reforms boosting Economic Competitiveness

The government is proactively seeking to achieve rapid and sustainable economic growth. A key objective is to become among the world's 10 most competitive nations by 2010 – its "10x10 Vision" – through opening up its market, inviting inward investment, improving the business environment and capitalizing on the Kingdom's competitive strengths as the global capital of energy with a youthful population.

Accession to the World Trade Organisation (WTO) and the reduction of corporate tax on foreign-owned firms (down from 45% to 20%) has dramatically increased foreign direct investment, which is up ten-fold since 2004.

Moving up the Value Chain

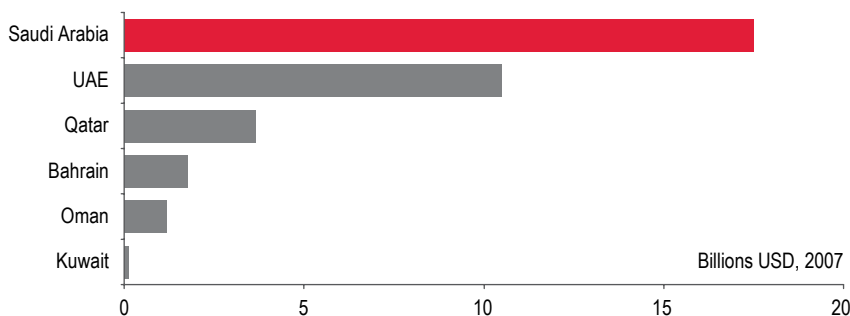
The government is targeting high-value services and knowledge-based industries, including education, life science and health, as well as Information and Communication Technology (ICT). The King Abdullah University of Science and Technology (KAUST) being built north of Jeddah (with a total investment of USD 25 billion) is a key component in promoting life sciences and information technology. The Knowledge Economic City, being constructed near Madinah will also play a key role in developing the Kingdom's technology base.

4. Active City Building

Rapid Urbanisation

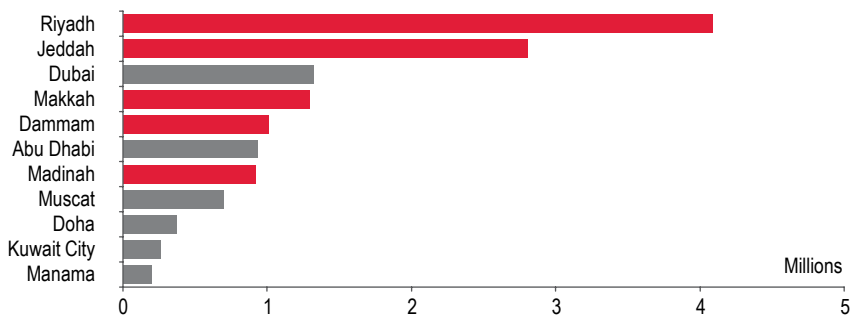
The majority of the Kingdom's population are city-dwellers, and the country contains four out of the five largest cities in the GCC region. Its urban population has grown by over nine million between 1990 and 2008 as Saudi cities continue to accommodate more than ½ million new urban dwellers a year. Most urban growth is occurring in Riyadh, the capital, and in urban clusters along the Red Sea Coast (Jeddah, Makkah and Madinah) and Eastern Province (Dammam/Al-Khobar). Six new economic cities are also planned (see overleaf).

Fig 4: Saudi Arabia is the greatest recipient of FDI among the GCC countries



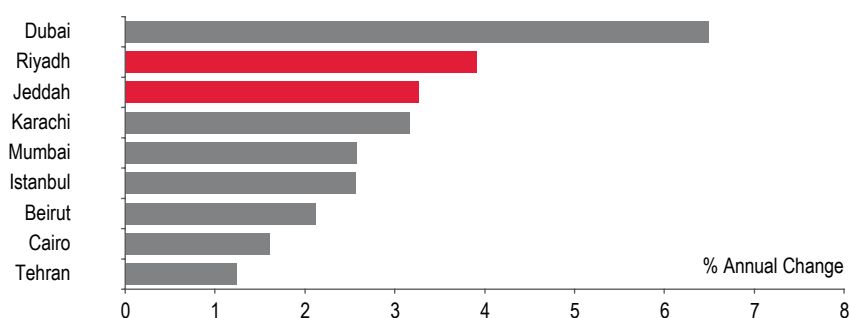
Source: EIU, 2008

Fig 5: GCC – City Population, 2008



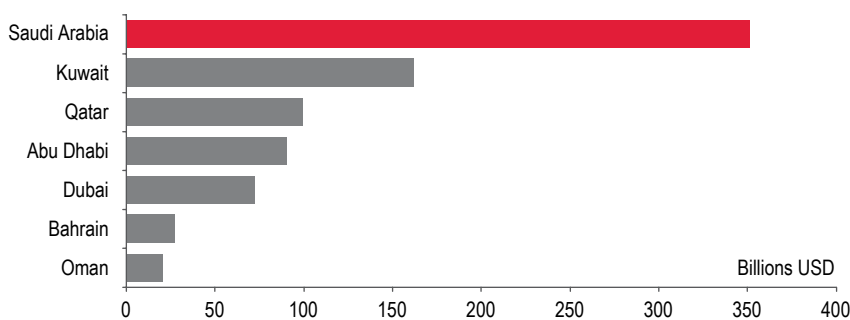
Sources: National Sources

Fig 6: GCC, City Population Change, 1998–2008



Sources: United Nations, 2007

Fig 7: GCC, Stock Market Capitalization



Data as at 06/10/2008
Source: Various

Special Economic Cities

Ambitious Urban Development

An important component of the Kingdom's economic development strategy is the creation of six Special Economic Cities (SEC) that are expected to provide substantial long term real estate opportunities. The Saudi Arabian General Investment Authority (SAGIA), the government agency responsible for the country's development strategy, is initially creating four integrated Economic Cities:

- King Abdullah Economic City (KAC) in Rabigh, north of Jeddah
- Knowledge Economic City in Madinah
- Prince AbdulAziz bin Mousaed Economic City in Ha'il
- Jizan Economic City on the Red Sea Coast

A further two Economic Cities are being planned, one each in Tabuk and the Eastern Province.

An Evolution of the SEZ Concept

The new cities are to combine the status of a privileged business operating environment, typically found in Special Economic Zones, with state-of-the-art infrastructure and comprehensive, fully integrated new urban development. As cities rather than zones, they represent the ultimate Saudi innovation to the Public-Private-Partnership (PPP) concept. By 2020 the Special Economic Cities are expected to account for between one third and one quarter of the Saudi economy, generating more than 1.3 million direct jobs and accommodating 4-5 million people.

Smart Cities

Some of the world's top ICT firms are partnering to develop new-generation urban environments. Cisco is working with Emaar to launch King Abdullah Economic City (KAC) – touted as the world's first 'Smart City'. An hour away from Jeddah and close to Makkah and Madinah, upon completion KAC will have two million inhabitants and aims to become a major economic centre on a global scale. The city creators are confident that they will be setting new world standards for urban development, and are at the forefront of the movement to create knowledge-intensive urban economies.

5. Improving Transparency

A More Transparent Real Estate Market

Economic reforms and the ongoing improvements in the ease of doing business in Saudi Arabia are positively impacting the real estate market, which has seen major improvements in transparency in recent years. In Jones Lang LaSalle's 2008 Real Estate Transparency Survey, Saudi Arabia registered one of the biggest improvements, ranking 6th globally in terms of increased real estate transparency between 2006 and 2008.³

One of World's Top Reformers

The improvement in real estate transparency echoes evidence from more general surveys such as International Transparency 'Corruption Perceptions Index' and the World Bank 'Ease of Doing Business'. The World Bank recognizes Saudi Arabia as one of the world's top reformers and in its 2008 report improved its rating by 10 places to 23rd out of 178 markets.

Among the factors contributing to the opening up of the economy have been:

- The long-awaited Mortgage Law was passed by the Shura Council

in July 2008. Once approved by the Council of Ministers, this is expected to thoroughly re-shape the real estate environment, providing much wider access to property ownership for Saudis

- A new Capital Markets Law was approved in mid-2003, strengthening the operation of the stock market
- The 2004 Tax Law reduced corporate income tax on foreign companies from 45% to 20% (except in certain sectors)
- In 2005, Saudi Arabia removed the minimum capital investment requirements on foreign investors and a new government procurement law was also passed under which 100% foreign-owned companies could bid for government contracts

In August 2008 Saudi Arabia made another dramatic step towards opening up its economy by allowing foreigners access to the Saudi stock exchange (Tadawul) through indirect swap agreements. The Saudi stock exchange (Tadawul), with over 120 listed companies and a market capitalization of nearly USD 400 billion, is the largest in GCC region and 11th largest in the world.

³ Open for Business, Real Estate Transparency in the Middle East & North Africa, Jones Lang LaSalle Real Estate Transparency Index, 2008

**Fig 8: Jones Lang LaSalle Real Estate Transparency Index
World's Most Improved Markets, 2006–2008**

Market	Change in Score 2006–2008	2008 Composite Tier
Dubai	1.04	3
Romania	1.02	3
Ukraine	0.76	3
Russia	0.57	3
Egypt	0.56	4
Saudi Arabia	0.52	4
Poland	0.36	2
Czech Republic	0.34	2
Panama	0.33	4
China	0.33	3

Source: Jones Lang LaSalle, LaSalle Investment Management

Residential – It's a Numbers Game

- Saudi Arabia has a fast growing and relatively young population, along with a declining average household size. These factors are driving demand for additional residential dwellings in all major urban areas
- A major opportunity arises in the provision of affordable housing for the fast growing middle income segments of the market

Increasing supply shortages

The total stock of residential units across Saudi Arabia was approximately 3.95 million (as at the beginning of 2008). This represents a significant under-supply in relation to the current demand with this under-supply estimated to be as high as 500,000 dwellings.

The current housing shortage looks set to worsen over the next few years. The small amount of stock (380,000) set to enter the market between 2008 and 2012, compares to an estimated growth in the number of households across the Kingdom of circa one million over the same period.

In addition to the growth of the population, Saudi Arabia is also experiencing a gradual trend towards smaller family units. The current average household size in Saudi Arabia is estimated to be 5.7. We estimate the total household size will decline to 5.2 by 2012, resulting in a further boost in housing demand.

In response to increasing demand, developers have proposed a number of major new residential projects. Many of these projects are unlikely however to come to the market before 2012.

To address the short term short fall serious efforts will need to be made to accelerate the development of residential dwellings within some of the major projects (particularly in the Special Economic Cities).



Real Estate Market Overview

Compared to other GCC states, the Saudi real estate market is at an early stage of development. It is however poised for lift-off, with demographic fundamentals and massive infrastructure investment providing the basis for growth and a positive outlook for most sectors of the real estate market.

The residential sector offers the greatest potential. With an estimated residential stock of 875 million sq.m. in 4 million dwellings, the Saudi residential market is more than ten times larger than any other Gulf market.

The commercial market in Saudi Arabia is also by far the largest in the GCC, with a total of nearly 18 million sq.m. of office, hotel and retail space. This is expected to increase to nearly 30 million sq.m. by 2012.

A key characteristic of the Saudi market is that demand is primarily generated by local buyers and not foreign investors. Acquisitions, trading and holding of land is widespread among Saudi families.

New Mortgage Law

Opening up the residential market

The draft mortgage law has yet to be approved by the Council of Ministers before a Royal Decree is issued by the King. This law is expected to be enacted before the end of 2008.

The law is designed to allow much wider access to property ownership in a country where currently 43% of the population own their own home.

Jones Lang LaSalle believes that approval of the law will have many positive implications for the residential real estate market and the broader Saudi economy. It is anticipated that it will:

- Remove any doubts about the non-compliance of mortgages with Shariah principles
- Ease current pressures on residential prices
- Greatly increase the number of Saudis that can afford to switch from the rental sector to own residential real estate for the first time
- Stimulate additional supply and thus provide more homes for Saudis
- Reduce inflation rates that have impacted the economy in recent years
- Bring new real estate firms to the Kingdom

- Improve building standards as only qualified housing will be eligible for mortgage-backed financing
- Improve transparency as developers will be required to be licensed to qualify for approval for financing

Growth of banking sector

The new mortgage law will also lead to the establishment of new funds and open new channels of financing residential development.

The new law is expected to result in:

- Entry of new players into the market, increasing the range of funding options available to purchasers of residential dwellings
- The establishment of new standards for home finance
- Introduce new capital market instruments
- Stimulate further Islamic financing through new Shariah compliant products
- Provide large companies with ability to offer tradable financing bonds
- Encourage the regulation and greater transparency in the brokerage sector
- Introduce securitized mortgage products
- Create a secondary mortgage market

Remaining Challenges

The mortgage law will not cover all existing property as it explicitly only relates to loans for property having proper permits. It is estimated that 30–40% of existing residential property in Saudi Arabia lacks proper licensing resulting from a lack of official planning approvals. This diminishes the portfolio of eligible assets available for securitisation.

The potential impact of the new law could be hindered by weak landlord protection, vague valuation procedures, lack of property insurance and the lack of a registry for real estate transfers. Eligibility criteria (monthly income minimum limits applied by banks) will also limit access by low income Saudis.

Moving Ahead

While the new mortgage law will not by itself be a panacea for all the challenges currently facing the residential market in Saudi Arabia, there is no doubt that it marks an important step in improving the system.

Once fully approved this law could stimulate the overall economy by providing new development opportunities and accelerate the flow of foreign capital into Saudi Arabia, a process which the Saudi government is already encouraging through other strategic incentives.



Affordability issues

Much of the new housing that is being developed is targeting the upper end of the market and is not affordable to the increasingly large number of younger Saudis now joining the workforce. With limited access to finance at the moment, affordability is a genuine issue.

With the passage of the new mortgage law, we expect mortgage finance will play an increasingly important role in the low and mid-income housing segment.

Strong performance

Saudi Arabia is at the early stages of a boom in residential real estate prices and rents.

The price of residential land in Riyadh has increased by 20% per annum between 2003 and 2007, with average house prices in Riyadh increasing by 16% per annum. However, prices are among the lowest in the region; suggesting that the recent history of significant price rises should not, in isolation, give cause for concern.

The residential boom has not been confined to the sales market, with rents also increasing markedly in recent years. Average residential rents have risen at 25% per annum over the past five years (2003–07) in Riyadh, Jeddah and Damman/Al-Khobar.

With rents increasing ahead of sale prices in recent years, residential yields have trended downwards. In Riyadh, average yields currently vary from 6% to 9.5%. Despite this compression, residential yields in Saudi Arabia are typically higher than in other GCC markets, which is likely to result in additional pressure on prices over the next few years.

Fig 9: Anticipated Residential Supply – Major Projects

Project	City	Completion	Units
Al Qasr	Riyadh	2008	4,000
Shaams Al Riyadh	Riyadh	2010	8,000
Jeddah UDC	Jeddah	2011	45,000
Jeddah Gate	Jeddah	2012	6,000
Khobar Lakes	Khobar	2012	2,000
Nakheel, Old Airport	Jeddah	2016	8,000
Al Wasl Riyadh	Riyadh	2017	55,000
Jeddah Hills	Jeddah	2017	20,000
Jeddah Land Project	Jeddah	2018	8,000

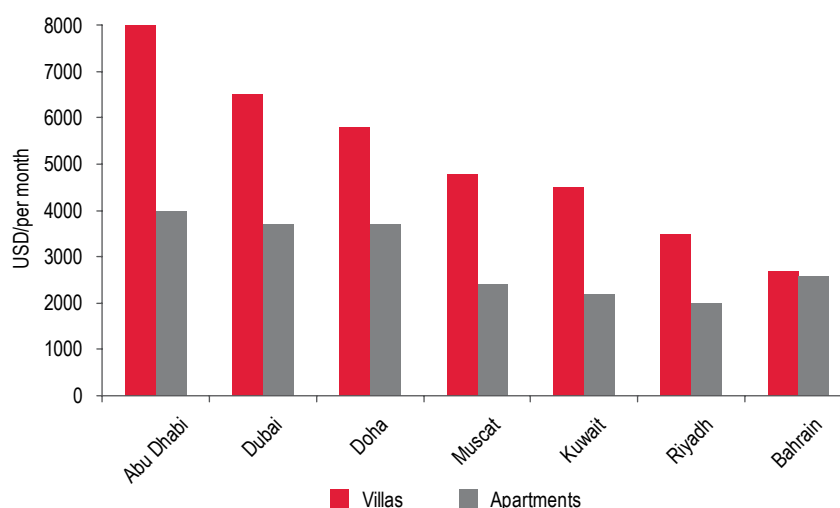
Source: Jones Lang LaSalle, 2008

Fig 10: Residential Sales Prices, Q3 2008

	Villas USD / sq.m	Apartments USD / sq.m
Riyadh	1,200	943
Dubai	4,590	4,800
Abu Dhabi	3,300	6,000
Doha	5,500	3,153
Kuwait	2,500	3,700
Bahrain	2,500	2,800
Muscat	2,400	3,000

Source: Jones Lang LaSalle, 2008

Fig 11: Residential Rentals, Q3 2008



Source: Jones Lang LaSalle, 2008

Retail – A Leisure Activity

Saudi retail industry is one of most dynamic in the region

- Robust demand for modern retail malls from a young population
- Leisure activity will be an important driver of mall development
- Successful malls will be those offering the most innovative entertainment formats, good tenant mix and best quality retail management

The Saudi retail industry is one of the largest and most dynamic in the region. It is however highly fragmented and remains largely dominated by single-outlet operations with a much lower level of international retailer involvement than other GCC markets.

Growing number of retail malls

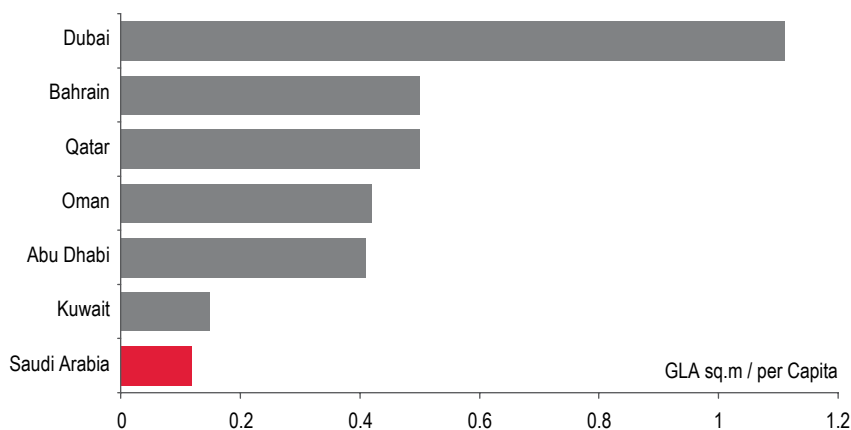
The concept of retail malls is less developed in Saudi Arabia than in surrounding GCC markets, with a greater reliance upon neighbourhood stores, traditional souks (markets) and street front retailing.

The level of mall based retail space per person in Saudi Arabia is expected to increase from its current level of around 0.12 sq.m per person to between 0.5 and 0.6 sq.m, as the concept of retail malls increases in popularity over the next few years.

The large young population in Riyadh and Jeddah has led to the faster adoption of more modern retail trends (i.e. higher brand consciousness and international awareness). Given the challenging weather, its land-locked location and the lack of alternative entertainment options in Riyadh, 'shopping' is emerging as a key leisure activity.

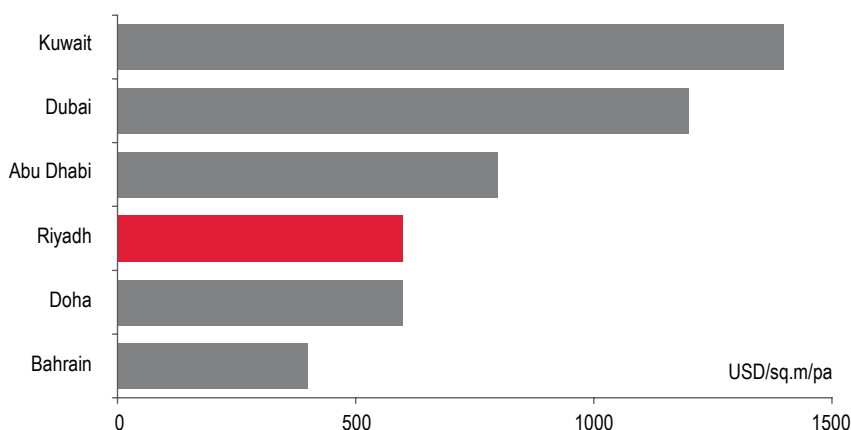
Retail malls are a key source of entertainment within Saudi Arabia. A critical success factor for mall developers is therefore the ability to innovate and introduce new forms of entertainment for the whole family. Children's entertainment forms an important potential attraction, as 30% of the population of Saudi Arabia is less than 14 years of age.

Fig 12: Retail GLA per capita in GCC



Source: Jones Lang LaSalle, 2008

Fig 13: Average Rents, Regional Malls, Q3 2008



Source: Jones Lang LaSalle, 2008

The trend towards hypermarket based retail malls is expected to continue in the near future, with good demand for space from both major (anchor tenants) and individual store operators.

Retail spending dominated by local population

The retail sector is flourishing in the Kingdom with total retail spending estimated to be in the order of SAR160bn (USD 43bn).

In most cities within Saudi Arabia, the retail market is heavily dependent on the local population. However, growing religious tourism means that tourists now contribute 5–6% of national retail revenues. Average retail spending per visitor in 2007 was around USD 300. Tourist arrivals across Saudi Arabia are expected to increase from 13 million in 2007 to some 15 million in 2008.

Retail rents are increasing

While retail rents in Saudi Arabia remain low by international standards, they have increased by around 15% pa over the last two years. Rents in prime locations on King Fahd Street in Riyadh are now in the order of SAR 2,500 per sq.m. Strong demand for space in new malls in both Riyadh and Jeddah has resulted in these centres securing rents almost double those of the older centres.

Shopping as a leisure activity

The Kingdom's low retail GLA per capita and its high population and tourism growth make the retail market a highly attractive sector for both occupiers and investors. The absence of good leisure facilities and the climate further promote retail malls as shopping continues to develop as a key leisure activity for families.

Foreign investment in retailing

From March 2007, foreigners are allowed to participate in wholesale or retail business activities in Saudi Arabia. However, the Saudi Arabian General Investment Authority (SAGIA) has specified that the following requirements must be met:

- Foreign equity must be limited to 51%; from 2009 the government may allow up to 75%
- Minimum foreign investment of SAR 20m (USD 5.33m)
- Minimum of 15% Saudi employees to be trained each year
- Minimum size of outlet may be prescribed by SAGIA.

Non-Saudi producers of goods are also allowed to appoint local Saudi agents as their representatives to sell their products and/or services in Saudi Arabia.

Appointment of a Saudi commercial agent often facilitates penetration of foreign business into Saudi Arabia's market without establishing a direct presence.

This is an important move for foreign consumer product manufacturers as it will enable them to consolidate their presence in Saudi Arabia and have more control over the distribution of their products.



Offices – Flight to Quality

Banking, IT and business services are boosting demand for quality offices

- Much of the existing office stock does not meet corporate standards
- The major new planned schemes will **encourage a flight to quality**
- Increasing congestion may result in movement away from CBD locations

Saudi Arabia is not currently a regional commercial market, but the local market is sufficiently large to attract an increasing number of multinational corporations. The Kingdom's recent membership of WTO has encouraged additional demand from the banking, IT and business service sectors.

The Saudi Arabian office market shares some of the same characteristics as other markets across the GCC region. In most cities, there is currently a shortage of high specification office space that meets international corporate standards. There are, however, major new developments planned which will increase supply of quality space, and encourage companies to upgrade their accommodation.

Increasing Future Supply

There was approximately 6.7 million sq.m of office space across Saudi Arabia at the beginning of 2008. A further 4 million sq.m of supply has been announced to come on-stream over the next four years, potentially resulting in a total stock of over 11 million sq.m by 2012. Not all of this announced space is however expected to materialize on schedule as projects face increased competition and possible delays.

The majority of the new stock is expected to be delivered in Riyadh, Jeddah and Dammam/Al-Khobar. Riyadh is the major commercial centre within Saudi Arabia and is the region's largest office market with a current stock of circa 3.4 million sq.m. This could potentially reach over 5 million sq.m by the end of 2012.

Significant supply in non CBD office sector

Unlike other GCC markets, a significant proportion of the office stock in Saudi Arabia is located outside of the major CBDs. Furthermore, increasing congestion may encourage greater movement away from CBD locations. Among the major suburban office parks are the following:

- **Information Technology and Communication Complex (ITCC).** The Public Pension Agency is developing a special technical complex on a 45 hectare campus site in Riyadh. This project is expected to deliver around 100,000 sq.m. of office space over the coming five to six years.
- **The King Abdullah Bin Abdulaziz Science Park (KASP)** was established in 2002. Development work is in progress on a 35 hectare site to the north of the King Fahd University of Petroleum & Minerals (KFUPM) in Eastern Province.
- **King Saud University Science Park.** This project is being developed on a 120 hectare site in Riyadh.



- King Abdullah Financial District (Riyadh) will be the headquarters for the Capital Market Authority (CMA) and the Stock Exchange (Tadawal), and for financial institutions and other services providers such as accountants, auditors, lawyers, analysts, rating agencies, consultants and IT providers.
- The King Abdullah Financial District is anticipated to be the largest financial district in the Middle East. The site is approximately 160 hectares which is expected to accommodate over 3 million sq.m of office space.

Back in the CBD

With the removal of earlier caps on the height of buildings, a new wave of high rise office developments are expected in the centres of both Riyadh and Jeddah.

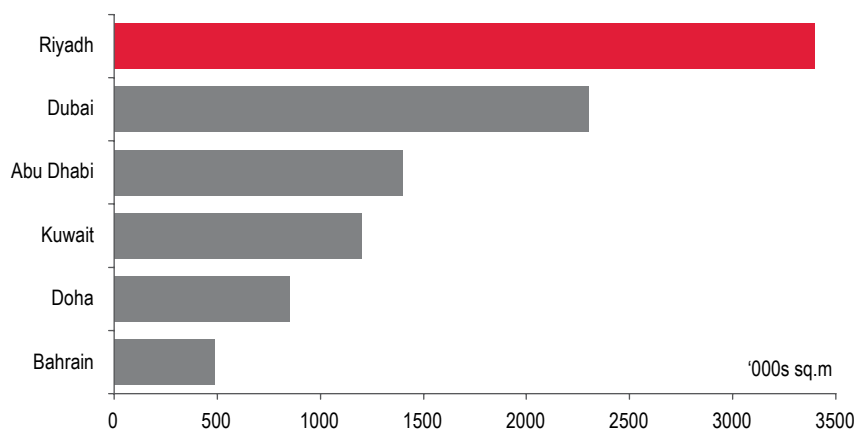
Towers currently proposed in Jeddah include Dubai Towers Jeddah (over 300 m), Lamar Towers (310m) and Headquarters Business Park (250 m). In Riyadh, three new high rise towers are being developed – including Alrajhi Tower at 352m. This is in addition to the two existing landmark towers – Kingdom Tower (302 m) and Al Faisaliah Tower (267 m).

Buoyant rental performance

With low vacancy rates, office rents in Riyadh have increased by as much as 40% over the last three years, but we expect rent inflation to slow in the light of proposed new additions to supply. There is nonetheless latent demand for better quality buildings which is likely to continue to push prime rents higher.

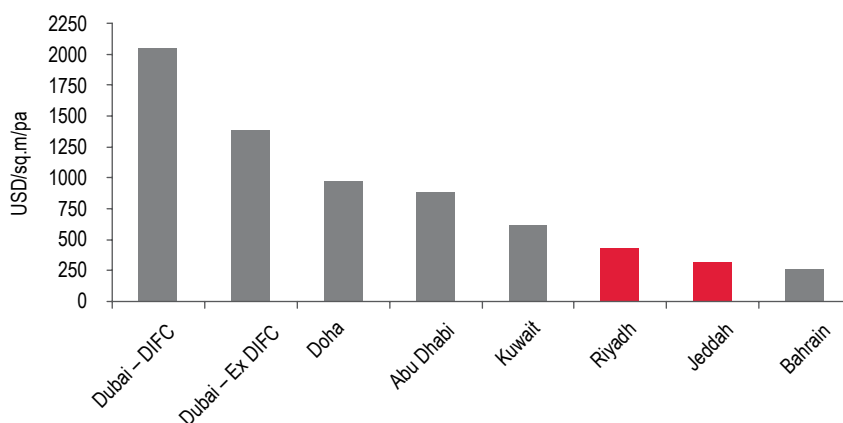
Given the strength of current demand in Riyadh, rents and prices are expected to continue to increase over the next two years. As new supply comes onstream, the market is then expected to stabilise. As with other maturing office locations, a two tier market is expected to emerge across Saudi Arabia, with continued demand for projects that offer an international investment grade product, while vacancies may increase on poor quality stock.

Fig 14: Total Office Stock, Q3 2008



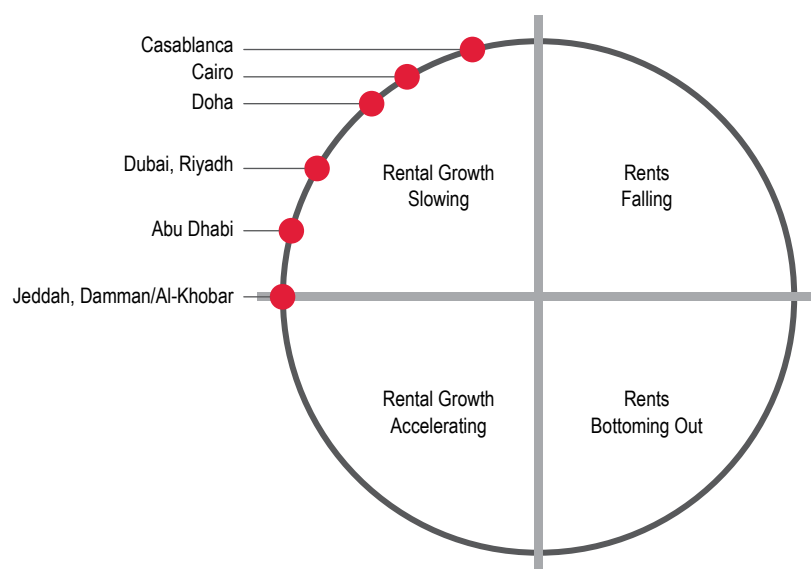
Source: Jones Lang LaSalle, 2008

Fig 15: Average Office Rents, Q3 2008



Source: Jones Lang LaSalle, 2008

Fig 16: Office Clock Q2 2008



Source: Jones Lang LaSalle, 2008

Hotels – A Unique Opportunity

- A unique niche market for religious tourism focused on the holy cities of Makkah and Madinah
- The level of business travel is increasing as the Saudi Arabian market opens up. This is likely to generate significant opportunities for the hospitality sector, especially in Riyadh and Jeddah
- Supply constraints need to be addressed by a co-ordinated and coherent approach by the various government agencies responsible for regulating the hospitality and tourist sectors

Importance of religious tourism

Saudi Arabia benefits from a unique niche market as the world's leading destination for religious tourism. The vast majority of the 13 million tourist visitors in 2007 comprised of religious visitors to Makkah and Madinah. This sector of the tourism market has grown strongly in recent years with a 36% increase in hotel nights between 2006 (112 million bed nights) and 2007 (158 million nights).

The potential for religious tourism is remarkable. There are estimated to be some 1.6 billion Muslims in the world, with this figure growing at approximately 3% per year. With income levels rising rapidly in many Muslim countries, the number of those seeking to make the Hajj or Umrah pilgrimage is likely to continue to increase over the next few years.

The boom in religious tourism has contributed to land in the holy cities becoming among the most expensive real estate in the world today. Land prices range between USD 70,000 to USD 110,000 sq.m.

In addition to religious tourism, there are some leisure tourism opportunities elsewhere in the Kingdom. Jeddah is likely to benefit from the Red Sea tourism focus of the Supreme Commission for Tourism (SCT) as outlined in their Red Sea Tourism Vision 2025. The authority plans to develop 19 resorts on the Red Sea coast in Jeddah. In 2006, the SCT eased restrictions on non-religious tourism and allowed group tourist visas from selected countries.

Increase in business travel

Restrictions on business travel are also being eased, which is boosting hotel demand in Riyadh and Jeddah. In addition to increased domestic business travel, multi-entry visas for foreign businessmen were introduced in 2007, with the period of stay ranging from six months to one year, depending on nationality.

Timeshare gains acceptance

Timesharing is becoming increasingly popular in the Kingdom as new schemes have been developed in compliance with Islamic principles.

Not surprisingly, timeshare developments are focussed on the cities of Makkah and Madinah. There is strong demand for these properties from Muslims seeking to purchase properties in the holy cities which they can utilise for a few weeks of the year and rent out for the remainder.

Timesharing projects in Makkah include the Zamzam Tower and the Caravan Towers (which are operated by Starword Hotels under Le Meridien brand).

Increasing hotel supply

International visitor arrivals and domestic travel have increased in recent years, resulting in high occupancies and healthy revenue per average room in the major hotel markets across Saudi Arabia. While a number of new international operators have entered the market, the major cities of Riyadh, Jeddah and Dammam/Al-Khobar have not seen any significant recent additions to the stock of five star hotel accommodation.



Only 6% of the current hotel room supply of 125,000 rooms across Saudi Arabia is of five-star quality, with a further 19% of four-star quality. The two holy cities of Makkah and Madinah top the list in terms of share of total hotel rooms.

Many hotel projects are currently in various phases of planning or development in the major cities of Riyadh, Jeddah, Makkah, Madinah and Dammam/Al Khobar.

We estimate that there are 20 new hotel projects currently underway in the Kingdom including the USD 710m Jabal al-Kaaba development in Makkah, which includes nine hotels with 10,000 rooms.

Until recently, the most prominent feature of hotels in Saudi Arabia was the sole proprietorship status. This is starting to change as international operators such as Accor, Marriott, Sheraton, and ICH either enter the market or add new properties to existing portfolios.

Uneven hotel performance

The Ministry of Commerce controls hotel room rates, although greater flexibility has been allowed in 2008. The Ministry is understood to be considering the current room rate ceiling.

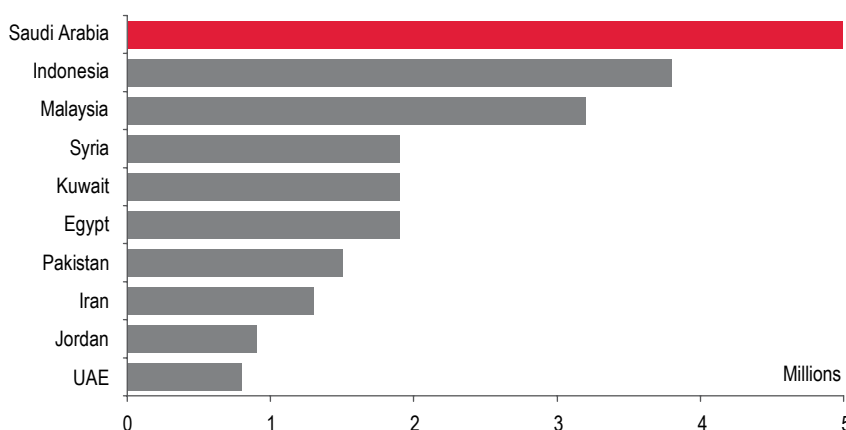
Seasonality plays an important role in the Saudi hospitality industry. During the holy month of Ramadan the cities of Jeddah, Makkah and Madinah experience above average occupancy rates and ADRs (Average Daily Room Rates). Jeddah is the key entry point for religious tourists. On the other hand, the capital city of Riyadh typically experiences a slowdown in business travel during Ramadan.

The four and five star categories of the hotel market are expected to perform most strongly over the next few years, given the supply shortages in these sectors.

According to Deloitte's benchmark survey of hotels, occupancy rates for quality hotels increased from 68% to 80% in 2007. Similarly, average room rates increased from SAR 800 to SAR 915, raising the average RevPar to SAR 700.

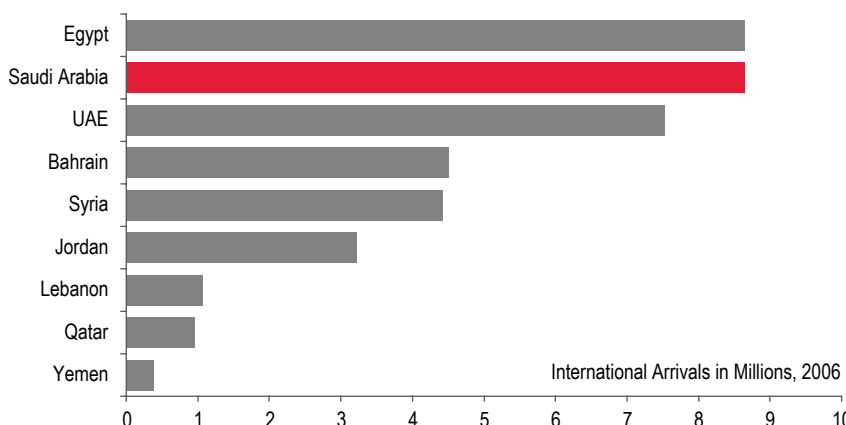
A boom in religious tourism is boosting Saudi's hospitality sector

Fig 17: Muslim Travellers



Source: Miscellaneous

Fig 18: International Arrivals into Region



Sources: World Tourism Organisation, 2006
UAE Ministry of Economy

Industrial – Region's Largest Market

Logistics sector offers huge potential for specialist developers

- The logistics sector, while at a very early stage in its development, is expected to develop dramatically over the next five years and offers potentially significant real estate opportunities

Given its huge oil and gas reserves, the availability of large areas of relatively cheap land and its sizeable labour pool, Saudi Arabia has developed as the major industrial centre of the Middle East.

Large stock of industrial real estate

There is currently more than 1,600 million sq.m. of industrial land across Saudi Arabia in industrial cities monitored by the Saudi Organisation for Industrial Estates and Technology Zones (SOIETZ). In addition, a separate Royal Commission controls the industrial cities of Jubail (1,000 sq.km) and Yanbu (185 sq.km).

The importance of the industrial sector is further reinforced by the large amount of additional supply currently under construction across the Kingdom.

Open to foreign investment

Foreign companies have been permitted 100% ownership of industrial projects in Saudi Arabia since 2000. Foreign investors are no longer required to take local partners and may own property for their own commercial activities.

The Saudi Organization for Industrial Estates & Technology Zones has issued invitations to private sector investors to develop 17 new industrial estates where land is available for rent. Given that such sites can only be used for their own industrial purposes and there is no ability to trade to other parties, there are limited real estate opportunities available to foreign developers or investors in the industrial market.

Logistics potential

A well-developed logistics infrastructure is recognised as an important pre-requisite for many of the government's economic growth initiatives. As a result, a number of massive infrastructure projects have been launched across Saudi Arabia. These include the following:

- SAR 56bn railway expansion programme
- SAR 19bn land bridge connecting Jeddah with Riyadh through a rail network.
- SAR 22.5bn Makkah and Madinah rail link to Jeddah
- SAR 5.6bn expansion of King Abdulaziz International Airport
- SAR 221mn Tabuk Airport expansion
- SAR 188mn Yanbu Airport expansion
- SAR 2bn road expansion programme (24,000 km of new roads)

The government is aiming to develop the Jeddah and KAEC ports as major transshipment hubs for the region, competing with Dubai's Jebel Ali ports.

A SAR1.9bn (\$0.5bn) expansion of Jeddah port is scheduled for completion by the end of 2009. The KAEC port zone will be the largest in the region with a capacity of 20mn TEUs per annum.

Fig 19: Industrial Estates Planned, 2008

Industrial Estate	Total Land Area (Million/M ²)	Area to be Developed (Million M ²)	City
Industrial Estate in Sudayr	258	10	Riyadh
Industrial Estate in Al-Kharj	100	5	Riyadh
Industrial Estate in Jizan	39	1	Jizan
2nd. Industrial Estate in Jeddah	8	3.5	Makkah
Industrial Estate in Arar	2	1	Arar
Total	407	20.5	

Despite this massive spending on transport related infrastructure, the warehousing and logistics sector still remains in its infancy. Much of the existing logistics sector is managed by companies that are in JV with global operators such as DHL and Fedex.

There are currently few modern purpose-built warehousing and logistics centres in Saudi Arabia. This situation is expected to change dramatically over the next five years with the emergence of new, professionally managed, specialist logistics facilities. The development of

such facilities provides a major new opportunity for real estate players such as Prologis, who have developed specialist skills in these areas in other emerging markets such as CEE and China.

Rental levels

Within industrial estates rents for warehousing varies from USD 100 to USD 160 sq m. depending upon the type of industrial goods and the location of the industrial estate. Rents are higher in privately managed industrial estates and vary from USD 150 to USD 250 sq m.



Challenges for the Real Estate Sector

- Despite Saudi Arabia's significant growth potential, a number of challenges to realising its full potential remain
- The government has recognised the challenges and has made progress in tackling issues such as modest transparency, delays in implementing legislative reforms and opportunities to increase foreign ownership
- The government is also tackling issues such as bureaucracy and labour shortages which have resulted in extended delays in developing real estate projects in the past

Labour shortages in construction sector

A major problem facing the industry is the difficulty in securing adequate labour, and skill shortages are driving up wage costs. This bottleneck is being faced across most industries, and because wage levels are among the lowest in the GCC, companies are finding it difficult to attract construction workers. The government is considering ways of increasing local employment in the construction sector to avoid constraining the growth of the real estate sector.

Increasing construction prices

Rising raw material prices have been affecting the industry negatively. Construction costs are expected to rise annually by 15%, which in some cases is forcing construction companies to compromise on quality standards.

Project delays

Red tape, combined with constraints on availability of contractors and labour, and rising material costs, are resulting in significant project delays and problems in adhering to completion schedules.

Delay in passing/implementing reforms

The government still needs to pass the mortgage law to facilitate the development of the real estate sector. However, we do not see this as a major risk given that it has been specifically mentioned in the government's recent inflation mitigation plan.

Limited transparency

Despite recent progress, the market remains less transparent than some others in the GCC region, with vague and sometimes unclear rules in relation to areas such as transfer rights.

There is also a lack of transparency in the implementation of property regulations such as foreign ownership law.

High levels of future supply

Close co-operation between the government and private sectors will be required to ensure the significant real estate pipeline that is planned for the Special Economic Cities is matched by strong demand from both residential and commercial users. Attention to the phasing of future supply in the Special Economic Cities will be important in addressing this issue.

Market speculation

Steps need to be taken to ensure the Saudi Arabian market avoids excessive speculative investor activity which has resulted in rapid increases in real estate prices in other emerging real estate markets.

Current reliance on energy sector

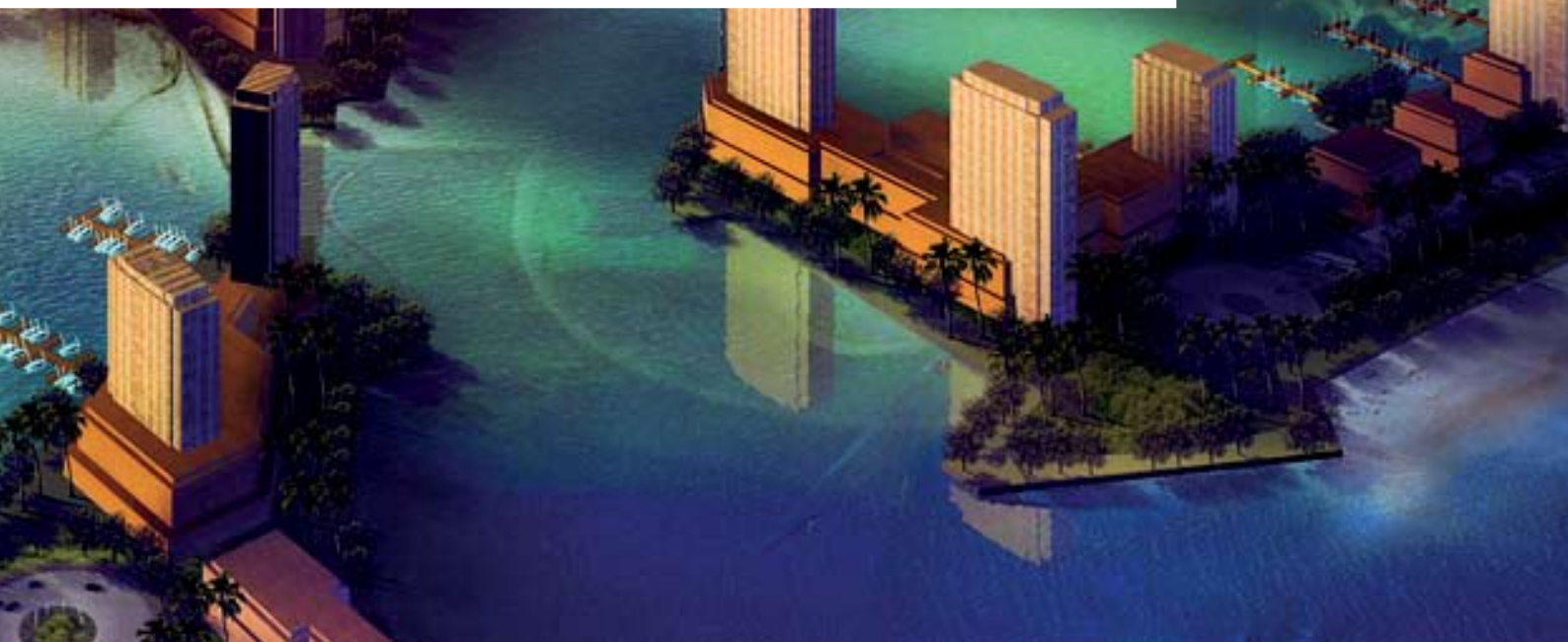
The government has recognised the need to diversify economic activity away from its current dependence on the energy sector and this will create opportunities across a broad range of sectors going forward.

Given that hydrocarbons could still account for around 50% of the Saudi Arabian GDP by 2010, energy prices will continue to be a vital factor driving liquidity and government revenues. Although a sharp fall in oil prices could potentially affect sentiment towards the real estate market, there is scope in government finances to accommodate a significant fall in oil prices from their recent record levels.

Fig 20: Strengths and Weaknesses of the Saudi Arabian Real Estate Market

Strengths / Opportunities	Weaknesses / Challenges
Young and fast growing population	Accommodating rapid population growth
Massive oil revenues	Current high reliance on energy sector
Infrastructure investment	Labour shortages
Special Economic Cities (SECs)	High levels of potential future supply
Gulf's largest real estate market	Housing affordability
Strong domestic real estate demand potential	Limited foreign participation in real estate
Structural reforms are opening up the market and helping transparency	Delays in implementing reforms
New mortgage law could transform the residential market	Project delays

Source: Jones Lang LaSalle, 2008



Jones Lang LaSalle Regional Headquarters

Chicago

200 East Randolph Drive
Chicago, IL 60601
tel +1 312 782 5800
fax +1 312 782 4339

London

22 Hanover Square
London W1A 2BN
tel +44 20 7493 6040
fax +44 20 7408 0220

Singapore

9 Raffles Place, #39-00
Republic Plaza,
Singapore 048619
tel +65 6220 3888
fax +65 6438 3360

Jones Lang LaSalle MENA Offices

Dubai

Burj Dubai Business Square
Building 1, Office 403
P.O. Box 214029
Dubai, UAE
tel +971 (0) 4 426 6999
fax +971 (0) 4 365 3260

Abu Dhabi

Al Niyadi Building
10th Floor
Offices 1003 & 1004
Airport Road
P.O. Box 36788
Abu Dhabi, UAE
tel +971 (0) 2 443 7772
fax +971 (0) 2 443 7762

Jeddah

Enso Serviced Offices
Saudi Business Centre
Office 122
P.O. Box 13711
Jeddah, 21414
Saudi Arabia
tel +966 2 651 5333
fax +966 2 652 0700

Riyadh

Al Hoshan Building
Office 302
3rd Floor, Western Tower
El Ehasa Street (Pepsi)
P.O. Box 9629
Riyadh, 11423
Saudi Arabia
tel +966 1 472 8309
fax +966 1 472 9478

Contacts

To find out how Jones Lang LaSalle can assist in making real estate decisions in Saudi Arabia, contact:

John Harris

Joint Head of Saudi Arabia
Jones Lang LaSalle
+ 966 1 472 8309
email: John.Harris@jll.com

Abdollah Al-Faadhel

Director
Jones Lang LaSalle
+ 966 1 472 8309
email: Abdollah.Faadhel@jll.com

Authors

Craig Plumb

Head of Research, MENA
Jones Lang LaSalle
+971 (0) 4 426 6999
email: Craig.Plumb@jll.com

Fayyaz Ahmad

Research, Saudi Arabia
Jones Lang LaSalle
+966 1 472 8309
email: Fayyaz.Ahmad@jll.com

Jeremy Kelly

National Director
World Winning Cities
+44 (0)20 3147 1199
email: Jeremy.Kelly@eu.jll.com

www.joneslanglasalle.com

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