Saudi Arabian Real Estate: Beyond the Headlines

Opportunities Rising in the Kingdom's Logistics Sector

December 2024

Overview

The world's longest linear park, futuristic designs, 11 new football stadiums for the 2034 World Cup, and luxury resorts surrounded by coral reefs and dormant volcanoes.

It's no surprise Saudi Arabia's ambitious development plans have captured the attention, and the imaginations, of commercial real estate (CRE) investors worldwide. The Saudi Arabian CRE market is forecast to exceed US$31 billion by 2028, up from just over US$20 billion last year,[1] lifted by government spending, favourable demographics and policies set to boost tourism and retail.

As impressive as the Kingdom's 'giga-projects' are, they often divert attention from what we believe will prove the true engine of long-term value in real estate in Saudi Arabia and throughout the Middle East: the logistics sector. Warehouses and distribution facilities may be less glamourous than luxury resorts and state-of-the-art shopping centres, but the logistics asset class is at the heart of a generational, government-driven transformation, supported by strong fundamentals and macroeconomic tailwinds that make it a particularly compelling investment.

In this report we explore why logistics is poised to play a central role in the country's unfolding growth story, outline where zones of opportunity are concentrated and offer strategic advice on approaching and accessing a high-potential, but at times highly complex, market.

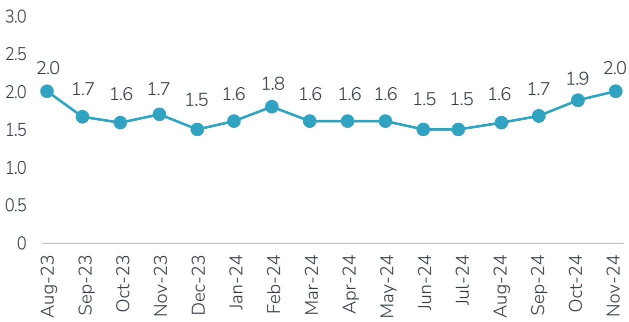
What we're watching

Inflation

Saudi Arabia's inflation rate has held steady in recent months after retreating from a peak above 3 percent in early 2023. Annual inflation ticked up slightly to 1.9% in October 2024 from 1.7% the prior month, remaining below the 2 percent target adopted by multiple global central banks, and the rates seen in many G20 peers. [2,3,4]

Overall inflation is expected to remain contained by the riyal's peg to the US dollar, supportive government policies and subsidies, and a flexible labour market. This should help contribute to a generally positive environment for real estate investment.

CPI:
Year-on-Year, %



Source: Saudi Arabia General Authority for Statistics

What this means for real estate investors

- With inflation and hence interest rates settling into a 'new normal' activity is likely to pick up, especially in the residential sector.[5]
- Prices in sectors outside residential remain stable overall.[6] Tamer inflation should help drive growth and commercial real estate as a whole, with over US$1 trillion worth of projects currently planned or under construction.[7]

By 2030 oil is expected to account for only a quarter of economic activity

Interest rates and financing costs

Saudi Arabia's central bank has aligned with the US Federal Reserve for the second time this year by implementing a 25-basis-point reduction in its main policy rate, lowering it to 5.25%.[8]

Interest rates are expected to move in line with US Fed rates, given the local currency peg, with forecasts anticipating they will reach around 4 percent by the end of next year.[9 10]

We expect that this gradual easing and the predictability of the country's monetary policy will inject energy into non-oil sectors. Capital-intensive industries like construction and real estate will likely be among the main beneficiaries of cheaper credit, which should support the ambitious investment and expansion plans linked to the country's Vision 2030 plan for economic revival.

The monetary policy trajectory means real estate financing costs will continue to be stable and are poised to improve over the medium term, with lending and capital broadly available.

What this means for real estate investors

- Capital market conditions are likely to stay benign over the coming months, and could see steady improvement in 2025 as rates retreat further. The central bank's generally conservative stance, Saudi Arabia's dollar peg and consistent government policy all foster an environment of stability.
- Real estate has been a key driver of the double-digit growth in lending by Saudi Arabian banks this year, with property loans exceeding US$200 billion in the second quarter.[11] Lending to the sector has climbed steadily in recent years and this is expected to continue or even accelerate, as demands for property and development rise, inflation moderates and policy grows more accommodative.
- We continue to favour higher cap rate sectors where demand and occupancy dynamics are likely to fuel rental performance.

Economic overview

The government recently tapered down its growth forecasts and hiked estimates of the budget deficit for 2024 to 2026, based on expectations for higher government spending and softer oil prices. The finance ministry expects real GDP to grow just 0.8% in 2024, a reduction from the previous 4.4% estimate, while the growth rate for 2025 was cut from 5.7% to 4.6%.[12]

However in the same announcement the authorities reiterated their commitment to "transformative" spending to foster growth and diversify the economy, which is increasingly less anchored to oil price fluctuations.

The futuristic cities, theme parks, 2034 World Cup infrastructure and next-generation transportation networks under construction in Saudi Arabia are just the most visible results of the government's Vision 2030 strategy to reduce dependency on hydrocarbons and stimulate growth across multiple segments of the economy, from tourism to technology and financial services. In 2023 the country hit a historic milestone with non-oil activities reaching a 50% share of real GDP, fueled by a 57% jump in private sector investment over the previous two years.[13] By 2030 oil is expected to account for only a quarter of economic activity, according to S&P Global.[14]

Growth will also be powered over the mid to long term by Saudi Arabia's favourable demographics. The country boasts a fast-expanding and youthful population, with over 60% of its people under the age of 30.[15] Along with a rise in female participation in the workforce[16] this points to robust consumer spending, which is already defying a downturn in much of the rest of the world.[17]

Labour market conditions have fluctuated in recent quarters but remain broadly consistent, with the overall unemployment rate decreasing slightly to 3.3% in the government's most recent quarterly report.[18] The rate for Saudi nationals also retreated 0.5 percentage points from the prior quarter, to 7.1% - a historic low and a heartbeat away from the 7% target outlined in Vision 2030.[19] Comprehensive recent reforms to make workplaces more attractive to employees, including extending maternity leave and requiring employers to provide appropriate accommodation and transport for workers, should encourage further participation in the job market.[20]

What this means for real estate investors

- With the impact of any economic slowdown likely to be blunted by proactive government policy and spending, investors can expect rising employment and a more diversified economy to continue to drive residential and commercial real estate demand.
- The projected budget deficit and continued uncertainty around external conditions argue for a focus on assets that are tied closely to high-priority development initiatives and, in residential and hospitality, on the more affordable end of the valuation and rent scales, which should be more resilient if growth or consumer spending lose momentum.

Projects, infrastructure and regulation

Vision 2030 is driving a wave of project and infrastructure development that will have long-lasting implications for investment and growth. These include 'giga-projects' of unprecedented scale, such as the new city of NEOM; the Qiddiya sports and entertainment capital near Riyadh; 11 new football stadium's ahead of the Kingdom's hosting of the 2034 World Cup; and the Red Sea Global tourism project on the country's west coast. Overall Vision 2030 projects have topped US$1 trillion in value, with some US$164 billion in real estate contracts awarded to date.[21]

With these developments comes a major infrastructure push designed to facilitate the flow of commerce and tourism. This will encompass new road and transport networks in and around the capital; new and improved ports and airports;[22] [23] renewable energy projects[24] and the expansion of residential and hospitality assets.[25]

Local regulation has also seen major changes as the government works to reduce barriers to development and investment. This includes the relaxation of restrictions on foreign property ownership;[26] the creation of a 'one stop shop' for government services; simplified construction permitting and property registration processes; and steps to improve access to credit. The government has also established five major Special Economic Zones (SEZs) throughout the country with special incentives to draw foreign direct investment, and unveiled additional plans to jointly develop with China another special economic zone at King Salman International Airport. Three SEZs, including King Abdullah Economic City and the Riyadh Special Integrated Logistics Zone, are logistics-focused, and there are plans to classify another four logistics hubs as SEZs to further facilitate trade[27] [28]

What this means for real estate investors

- Vision 2030 projects and the associated infrastructure improvements will create a steady pipeline of opportunities across sectors for real estate investors.
- Strong policy support and ongoing reforms should ensure conditions for investors remain favourable and barriers to investment are further reduced over the next few years.

In Focus

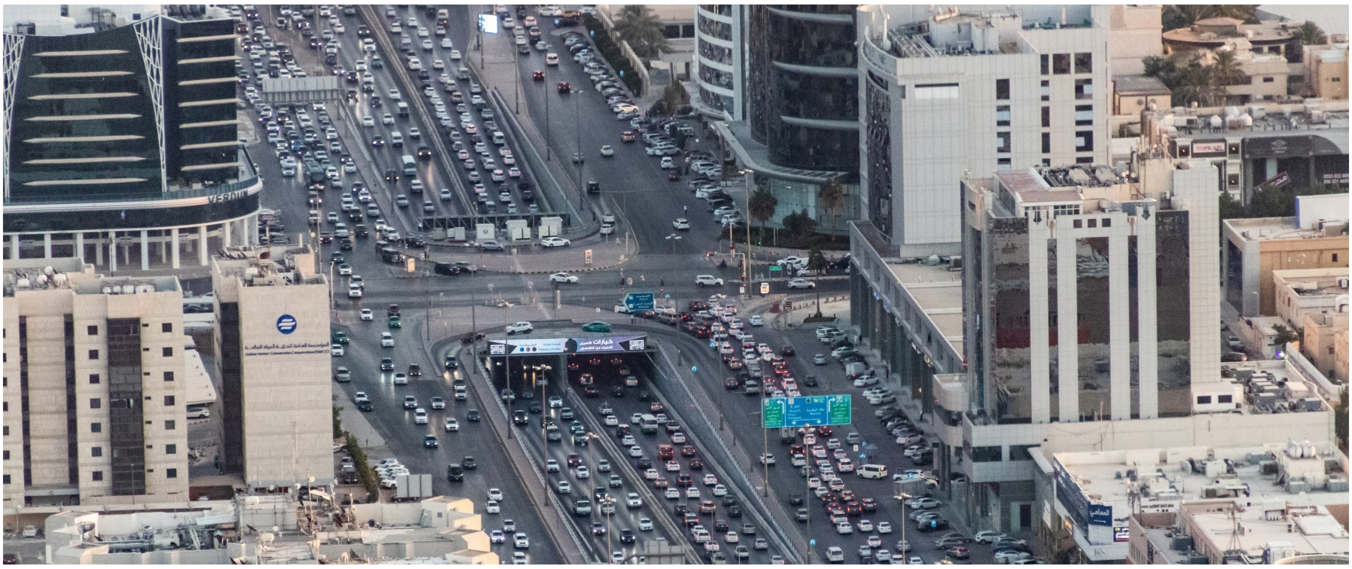
The industrial & logistics market

The industrial and logistics sector is both underpinning and benefiting from Saudi Arabia's investment boom. A raft of infrastructure improvements are underway to meet the national goal of lifting the country into the top 25 nations in the World Bank's Logistics Performance Index by the end of the decade.[29] [30]

Progress is already evident, with new investments in the industrial and logistics space rising 63% in 2023, and nearly doubling in the first quarter of 2024. Growth has been spearheaded by the Saudi Authority for Industrial Cities and Technology Zones (Modon), which now oversees almost 8,000 industrial, logistical, and investment facilities; and the Saudi Industrial Development Fund (SIDF) which aims to increase the value of industrial exports to SAR 557 billion (US$148 billion) by 2030. Financial incentives, proactive policies and support for small and medium-sized enterprises (SMEs) and priority industries are all being leveraged in service of this goal.[31]

Unlike other segments of the property industry, where investment is concentrating around high-profile megaprojects in the hopes demand will be stimulated and eventually catch up, the industrial and logistics is firmly supported by fundamentals that are only set to strengthen. These include Saudi Arabia's strategic position as the largest economy in the Gulf region, and proximity to a key corridor for international trade, with some 12% of global container traffic passing through annually.[32] The government is determined to leverage this position through its Global Supply Chain Resilience Initiative,[33] part of the National Investment Strategy focused on attracting strategic supply chains to Saudi Arabia and boosting the Kingdom's market share in critical sectors.

The strength of the local manufacturing sector, one of the fastest-growing in the world,[34] and the acceleration of the local e-commerce market (see boxout) is placing pressure on Saudi Arabia's existing industrial infrastructure. There is a clear impetus to develop it further, including warehouses, distribution and storage centers; and road, rail and transport networks that will give rise to new logistics hubs.



Saudi Arabia's e-commerce surge

With just under two thirds of its population under the age of 30, near-ubiquitous smartphone and high-speed internet penetration, and accelerating adoption of digital payment systems,[35] Saudi Arabia is witnessing a surge in online retail. The local e-commerce market topped US$10 billion in 2023 and is expected to grow faster than the global average, to reach US$44 billion by 2030.[36]

The expansion of e-commerce is one of the main factors driving logistics investment. The government is facilitating the industry's growth by simplifying licensing for delivery firms; and taking steps to expand warehousing, fulfillment and trucking capacity.[37] Such moves have not gone unnoticed by major international players, with US tech giant Amazon doubling its local storage capacity by launching a new fulfillment centre in Riyadh last year.[38]

The outlook for investors

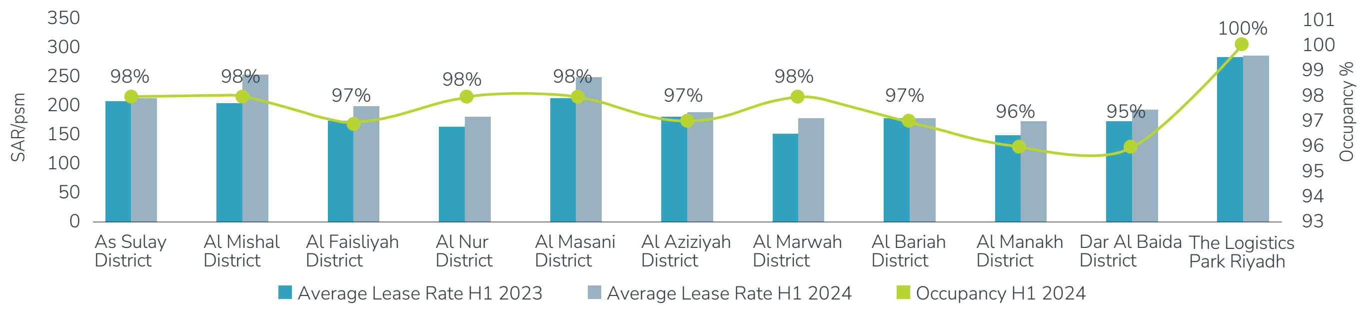
The Saudi Arabia industrial and logistics market continues to demonstrate positive supply-demand dynamics that are likely to support rents, and consequently yields, for the foreseeable future. In the main markets of Riyadh and Jeddah, occupancy stands at around 97%, and some high-demand sub-markets – such as The Logistics Park Riyadh and Asfan, Jeddah – are running at full capacity.[39]

This is translating into increasing lease rates in most areas, with average rates for light industrial and Grade B facilities in Riyadh rising over 10% from the first half of 2023 to mid-2024.[40]

From what we see on the ground, demand is outstripping supply particularly when it comes to higher-quality assets. More current and potential users of logistics and warehousing space are on a 'flight to quality,' looking past older stock to modern spaces with higher ceilings, better electricity loads, more parking or truck loading facilities. Yet the availability of such assets remains limited, with Grade A warehousing assets accounting for only 8-10% of the market, according to JLL.

This trend will only gain strength as more international tenants seek a local presence. In the first quarter of 2024, international investment in the industrial sector only accounted for 8.3% of the total.[41] This figure is likely to rise as more global firms look to tap into the country's growth trajectory, as demonstrated by leading Denmark shipping company A.P. Moller – Maersk recently inaugurating its largest global logistics park investment, a US$250 million facility, at Jeddah Islamic Port.[42]

Lease Rates and Occupancy



Source: Knight Frank

Other factors contributing to a sustained positive outlook for industrial and logistics real estate include:

- **A broadly supportive macro backdrop:** Private investment and consumption have continued to show strength,[43] and policy is likely to remain accommodative. This could lead to softer cap rates – which currently average 7-8% for industrial real estate – but will also support valuations by encouraging borrowing and private investment.[44]
- **Supply staying limited:** Development activity has picked up and more supply is coming to the market. Over 800,000 square metres of industrial and logistics space are under construction in Riyadh, primarily in sought-after districts like South and North / East Riyadh; while in Jeddah plans have been unveiled for the 415,000 square metre Jeddah Logistics Park.[45] However the development pipeline is still not sufficient to meet the rapid growth in demand, especially for prime assets in key locations, with robust utilities and infrastructure connections. The limited availability of this kind of stock and of land zoned for industrial use will keep supply constrained for at least the medium-term.

Arcapita Focus

We believe Saudi Arabia's industrial and logistics sector stands out in terms of the opportunity it offers and its ability to generate future value, given its position as a pillar of national development strategies. Bearing in mind the distinct structure and characteristics of the local real estate market, in accessing this opportunity we prioritise planning and execution, and emphasise several key principles:

- **A development mindset**
  The demand for international-grade product in newly emerging, built-for-purpose logistics hubs makes greenfield development, a preferred route into the market. In addition to strong partnerships with local builders and developers, development projects typically require familiarity with the features and restrictions governing various locations, as well as a sense of where growth zones are likely to be concentrated in future.

- **Knowledge of the tenant base**
  The mix of companies active in the Saudi industrial and logistics market is changing rapidly, as are their demands and expectations. A sound investment strategy will focus on assets aligned with shifting tenant requirements around space, amenities and sustainability, based on knowledge of the zones or locations that will best meet the needs of occupiers.

- **A dedicated local presence and network**
  The extraordinary pace of development in Saudi Arabia in recent years, and the fact that industrial zones, the commercial real estate sector and the rules and restrictions that govern both continue to evolve,[46] mean investment strategies must be informed by perspectives that are up to the minute, and derived from observations on the ground. An extensive local network is also vital to identifying promising local projects, and maintaining the capacity to act when windows of investment open.

Arcapita has been a presence in Saudi Arabia for over a decade, investing nearly SAR 1.5 billion over that period. We recently closed our SAR 1.8 billion KSA Logistics Fund III, focused on the development of a pipeline of manufacturing and warehousing assets in strategic locations, and have plans to launch more such funds in future. Our focus on Saudi Arabia and the logistics sector in particular reflects our fundamentals-driven approach to investment, which emphasises the proactive management of risk and the ability to deliver meaningful results over the long term.

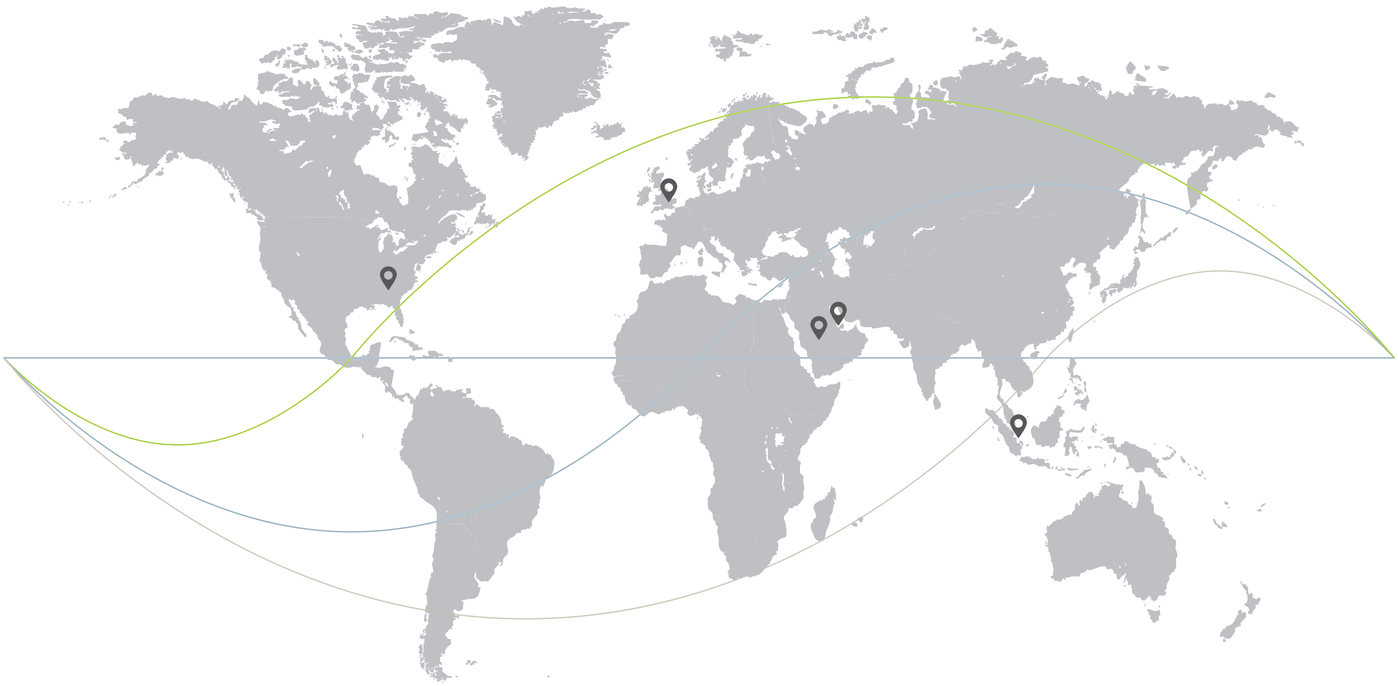
At the same time Saudi Arabia is part of our broader global logistics strategy, which spans North America, Europe and Asia as well as the Middle East and under which we've overseen investments of over SAR 17.7 billion in transaction value since 2006. This enables us to deploy both local knowledge and broad global expertise in industrial real estate when investing in Saudi Arabia, and to be a leading and active participant in the improvement of the Kingdom's industrial and supply chain infrastructure, and ongoing transformation into a fully diversified international logistics hub.

ARCAPITA

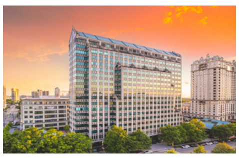
Overview

Arcapita is a premier asset manager offering diverse investment opportunities, focusing on private equity and real estate. At the center of one of the fastest growing wealth markets in the world, Arcapita's management has been serving an exclusive group of investors in the GCC region over the past two decades. With offices in Bahrain, US, UK, Saudi Arabia, and Singapore, Arcapita's management team has completed transactions worth a total value of approximately $30 billion and possesses a footprint to invest on a global scale. Arcapita focuses on defensive and counter-cyclical sectors supported by long-term macroeconomic and demographic trends.

With two decades of experience, Arcapita's management has built a global investment platform to access the opportunities that exist in our core markets of the US, Europe, Middle East and Asia.



United States



Arcapita Investment Management US Inc.

One Buckhead Plaza
3060 Peachtree Street NW,
Suite 1650, Atlanta, GA
30305 – United States

Tel: +1 404 920 9000

United Kingdom

Arcapita Investment Advisors UK Limited

The Shard, 32 London
Bridge Street, London SE1
9SG – United Kingdom

Tel: +44 207 824 5600

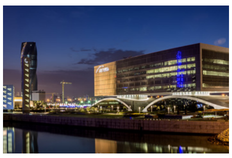
Saudi Arabia

Arcapita Capital Company

Office 2502, Kingdom
Centre, Riyadh – Kingdom
of Saudi Arabia

Tel: +966 114667610

Bahrain



Arcapita Investment Management B.S.C. (c)

Arcapita Building, P.O. Box
1357, Manama – Kingdom
of Bahrain

Tel: +973 1721 8333

Singapore

Arcapita Investment Management Singapore Pte. Ltd.
1 Robinson Road
#17-00 AIA Tower
Singapore 048542
Republic of Singapore

Tel: +65 6513 0395

Disclaimer:

While every effort has been made to ensure that the data quoted and used for the research behind this document is reliable, there is no guarantee that it is correct, and Arcapita Group Holdings Limited and its subsidiaries accept no liability whatsoever in respect of any errors or omissions. This document reflects our considered opinion and is not intended to constitute investment advice, nor to solicit any investment.

[1]https://www.imf.org/en/News/Articles/2024/06/13/mission-concluding-statement-saudi-arabia-concluding-statement-of-the-2024-article-iv-mission
[2]https://www.stats.gov.sa/sites/default/files/CPI%20Aug%202024-EN_.pdf
[3]https://www.theguardian.com/commentisfree/2024/feb/01/the-damning-truth-about-the-uks-2-inflation-target-its-completely-made-up
[4]https://www.agbi.com/analysis/economy/2024/06/saudi-new-mortgage-approvals-rebound/
[5]https://www.arabnews.com/node/2560476/business-economy
[6]https://property.constructionweekonline.com/gcc-real-estate-sector-rapid-growth-expected-amid-lower-inflation-and-rising-gdp/
[7]https://www.arabnews.com/node/2571984/business-economy
[8]https://www.fitchratings.com/research/banks/saudi-bank-performance-growth-prospects-underpinned-by-favourable-operating-environment-05-08-2024
[9]https://tradingeconomics.com/saudi-arabia/interest-rate
[10]https://www.arabnews.com/node/2570312/business-economy
[11]https://www.cnbc.com/2024/10/01/saudi-arabia-slashes-growth-forecasts-sees-wider-budget-deficits.html
[12]https://www.spa.gov.sa/en/N2065314
[13]https://www.arabnews.com/node/2571094/business-economy
[14]https://en.majalla.com/node/295336/business-economy/saudi-arabia%E2%80%99s-state-art-census-reveals-young-population
[15]https://www.pwc.com/m1/en/publications/saudi-arabia-economy-watch/documant/saudi-economy-watch.pdf
[16]https://www.consultancy-me.com/news/7941/saudi-consumer-spending-to-defy-regional-trend-says-alixpartners
[17]https://www.stats.gov.sa/sites/default/files/LMS%20Q2_2024_PR_EN_0.pdf
[18]https://english.aawsat.com/business/5066492-saudi-unemployment-rate-approaches-2030-target
[19]https://www.wtwco.com/en-gb/insights/2024/08/saudi-arabia-labor-reforms-for-both-foreign-and-local-workers
[20]https://www.bloomberg.com/news/articles/2024-09-10/saudi-arabia-s-vision-2030-projects-reach-1-3-trillion-in-value
[21]https://www.agbi.com/infrastructure/2024/08/riyadhs-road-network-gets-a-3-5bn-upgrade/
[22]https://www.diligenciagroup.com/blogs/infrastructure-boom-is-driving-development-in-saudi-arabia
[23]https://www.eiu.com/n/saudi-arabias-ports-are-on-the-rise/
[24]https://www.arabnews.com/node/2411686
[25]https://www.constructionweekonline.com/business/saudi-arabias-real-estate-market-continues-its-upward-trajectory-in-h1-2024-jll
[26]https://www.legal500.com/developments/thought-leadership/foreign-ownership-of-real-estate-in-saudi-arabia
[27]https://www.chinadaily.com.cn/a/202410/15/WS670dcb73a310f1265a1c7a32.html
[28]Saudi Arabia Ministry of Transport & Logistics Services, General Plan for Logistics Centers
[29]https://www.vision2030.gov.sa/en/overview/pillars/a-thriving-economy
[30]https://lpi.worldbank.org/sites/default/files/2023-04/LPI_2023_report_with_layout.pdf
[31]Knight Frank, Saudi Arabia Industrial & Logistics Market Review, H1 2024
[32]https://www.mot.gov.sa/en/AboutUs/Pages/Logisticsplatform.aspx
[33]https://gscri.investsaudi.sa/
[34]https://fastcompanyme.com/impact/the-middle-east-is-quietly-strengthening-its-manufacturing-capabilities-how-and-why/
[35]https://www.agbi.com/opinion/logistics/2024/01/the-saudi-e-commerce-surge-is-transforming-logistics/
[36]https://www.digitalcommerce360.com/2024/05/20/saudi-arabia-makes-ambitious-plans-to-expand-ecommerce
[37]https://www.digitalcommerce360.com/2024/05/20/saudi-arabia-makes-ambitious-plans-to-expand-ecommerce/
[38]https://www.tahawultech.com/news/amazon-saudi-launches-new-facility-designed-to-support-entrepreneurs/
[39]Knight Frank, Saudi Arabia Industrial & Logistics Market Review, H1 2024
[40]Knight Frank, Saudi Arabia Industrial & Logistics Market Review, H1 2024
[41]Knight Frank, Saudi Arabia Industrial & Logistics Market Review, H1 2024
[42]https://www.maersk.com/news/articles/2024/08/21/maersk-largest-logistics-park-at-jeddah-islamic-port-in-saudi-arabia
[43]https://agsiw.org/saudi-economy-contracted-in-2023-but-growth-projections-unchanged-for-2024/
[44]Arcapita KSA market update (PPT)
[45]Knight Frank, Saudi Arabia Industrial & Logistics Market Review, H1 2024
[46]e.g.https://www.tamimilawfirm.com/blog/saudi-new-law-to-set-off-real-estate-boom-for-investment/;https://www.ey.com/en_gl/tax-alerts/saudi-arabia-announces-amendments-to-real-estate-transaction-tax-implementing-regulations