Kingdom of Saudi Arabia

The Power of Retailers

KSA Retail Mall Market Overview
Introduction

The Kingdom of Saudi Arabia retail markets offers developers and investors a unique proposition. Driven by strong fundamentals including population growth and in particular high percentage of generation Y&Z, coupled with rising disposable income, limited entertainment options and harsh climates, developers and retailers are posting relatively strong retail performance.

A number of key challenges exist which have hindered the pace of development within the sector. An opportunity exists to develop retail formats (specifically malls) in the Kingdom that will be in line with regional counterpart such as The Avenues (Kuwait City), Bahrain City Centre (Manama), Mall of Dubai (Dubai) and Mall of Emirates (Dubai). Colliers’ research indicates that the one of the biggest challenge developers and owners face is the uncertainty in dealing with major retailers an aspect that is also arguably unique to KSA.

In this paper, Colliers studies this uncertainty to provide clarity on non-parity between developer and retailers and what may be considered in engaging more mutual benefit. In finding such parity, Colliers believes this will allow developers and their tenants (retailers) to formulate a better working relationship that can translate into better utilisation of retail in KSA.
Key Drivers of Retail Demand

An analysis of the key factors driving demand for retail space, specifically malls, helps to anticipate future growth trends. It is evident that KSA’s strong fundamentals are contributing to the positive outlook for the retail sector while also providing opportunities to further develop the sector:

Population & Demographic Structure

A steadily expanding population base and urbanization make Saudi Arabia’s demographics highly attractive for retailers. It is expected that KSA’s population will increase from c. 32.3 million in 2016 to c. 34.3 million by 2019.

Macroeconomics

Despite slightly lower projected growth rates than historical levels, the annual rate of population growth in KSA should stay above 2% for the foreseeable future. This is expected to be a boom for the retail sector as population has a direct effect on potential market size.
Approximately 65% of the population is composed of generations Y and Z. This digitally sophisticated younger generation of up to 35 years old, make up a significant proportion of the consumer base owing to their purchasing power.

Various studies have demonstrated the high propensity and sophisticated level of consumption for generations Y and Z. The country’s young demographic structure indicates that the retail market should evolve faster than other countries that have an ageing population.

Rising GDP per Capita and Disposable Income

According to Economist Intelligence Unit, the disposable income of KSA’s residents has increased from c. SAR 674 bn in 2011 to c. SAR 1,062 bn in 2015 (58% increase). Growth in disposable income is projected to slow down with an increase from c. SAR 1,147 bn in 2016 to c. SAR 1,485 bn in 2019 (30% increase).

Historic Increase in Disposable Income

The growth in personal disposable income level should drive expenditure on consumer retail products such as electronics, grocery and apparel, which in turn can increase demand for retail and retail mall GLA.

Lack of Entertainment Options

Due to the lack of globally recognized entertainment options such as cinemas or Intellectual Property type entertainment concepts (such as Sega World), retail malls are considered the only acceptable and widely accessible family entertainment option within the Kingdom.

Weather Conditions

Arguably, Saudi’s climate also plays a major role in populating retail malls. For example, the hot and dry weather in Riyadh, or hot and humid weather in Jeddah make indoor facilities (such as malls) popular leisure destinations.

Both operators and customers confirmed the effect of climate on retail patterns, and this trend has been further confirmed by various consumer surveys. Thus, malls become entertainment/socializing centres in addition to shopping locations. This further increases retail malls’ significance in the local economy and requires developers to offer more than just “shopping space”.

Projected Increase in Disposable Income

Source: EIU, Colliers Analysis

The growth in personal disposable income level should drive expenditure on consumer retail products such as electronics, grocery and apparel, which in turn can increase demand for retail and retail mall GLA.
Retail Spending Trends

Food retail sales are defined as expenditure on food related items that are consumed off premises. These include sales from convenience stores to large scale hypermarkets. Sale from non-food retail is defined as expenditure on all other items except for food retail.

Consumer spending is almost equally divided between food and non-food retail and is expected to continue on this path in the foreseeable future.

**Historic Retail Spending Trends**

![Historic Retail Spending Trends Graph]

**Projected Retail Spending Trends**

![Projected Retail Spending Trends Graph]

Source: EIU, Colliers Analysis
Key Demographics

Colliers has conducted an in-depth analysis of retail malls in KSA with a major focus on the cities of Riyadh, Jeddah, Dammam and Al Khobar. In order to better understand the retail market in these cities, it is necessary to know the key demographic factors that shape the retail landscape.

Key Demographics – 2015 Year End

Disposable income is an important indicator that signifies the amount of money available for retail spending. Jeddah’s households income is less, in absolute amounts than other major cities, however, the lower household size (4.9 as opposed to 6.1 in Riyadh) has a positive effect on overall disposable income. Tourism spending is an important factor which increases the overall spending in retail malls, and drives demand for retail space. According to Colliers’ analysis and data from MAS it is estimated that tourist spending comprises 10-20% of the total spending in retail malls for cities like Jeddah, Dammam and Al Khobar. This can partly account for higher GLA per capita in these cities when compared with Riyadh’s.

Supply Analysis

Supply Characteristics – 2015 Year End

Although Riyadh has a fair amount of malls under construction, GLA per capita is the lowest. This is expected to increase in the coming years due to strong forthcoming supply, planned to be c. 2.4 mn sqm out of which c. 412,000 sqm is currently under construction.
It is worth noting that the planned supply of malls in Riyadh equates to c. 2.4 million sqm of GLA as multiple developers and investors are attempting to capitalize on the market opportunity. Much of this supply is in the form of super regional malls (average size of mall is c. 130,000 sqm), however only 17% of this is under construction, while the rest remains under planning. This can be attributed to the challenges of developing a super-regional mall, some of which are listed below:

1. capital intensive development which increases payback period for the developers

2. difficulty in identifying suitable location with easy accessibility, which is considered vital for the success of these developments. Many location factors play a role in making it more attractive, such as:
   - catchment area characteristics (demographics, income profile, and residential density)
   - competitive developments in the surrounding area
   - visibility of the development

3. the need for differentiation from existing supply (which also includes design elements) and the ability of the development to respond to the changing needs of consumers in the short, medium and long term

In terms of competitiveness of supply, Colliers has created a grading criteria to assess malls in the form of primary, secondary and unclassified supply. Some of the factors used to classify supply include location, accessibility, parking, specifications and amenities, and retail product offering. Since malls are of various sizes and offering, this grading helps quantify the market variances in a more granular manner to identify true demand supply gap in each city.

Retail centres and malls have been under development within Jeddah for a relatively longer period of time; hence its share of unclassified supply is the largest (as most tend to be older properties). Furthermore, it is the only city where primary supply has the highest concentration, followed by secondary and then unclassified supply. This partly accounts for the competitive retail environment in Jeddah, which can be seen in the below graph:
Based on the line shop lease rate comparison of primary and secondary grade malls in the three cities, the following should be noted:

› The variation in rents among mall types illustrates the growing rental premium of primary grade malls over secondary malls, as primary malls generally feature a better tenant mix and location that are capable of attracting higher footfall.

› In comparison to Riyadh and Dammam / AlKhobar, Jeddah’s primary grade malls have much lower premium rates over the city’s secondary grade malls. This could be due to many factors such as the competitive structure of the city and residents’ preference towards community centres (evident by their strong performance) etc.

› Many of the community centres (most of which are classified as secondary due to lack of entertainment facilities) within Jeddah are themed plazas with consistent brand representation along central locations. Hence, they are able to charge high lease rates which are slightly lower than primary grade malls.

› For Dammam & Al Khobar, the much higher premium of primary grade malls over secondary grade malls is primarily due to the much lower quality of secondary grade malls.

› Within the local market of Dammam Al Khobar, Al Khobar commands higher lease rates than Dammam, as supply of primary grade malls is limited in Dammam, while secondary is dispersed throughout both cities. The higher lease rates in Al Khobar therefore are mainly due to the inferior quality and tenant mix in Dammam.

› Dammam is more focused on local tenants in its product offering, while primary grade malls in Al Khobar are in line with Riyadh and Jeddah in terms of tenant mix, offering and quality.
A Note on Forthcoming Supply

In order to better engage visitors and meet the requirements of mall tenants, developers of malls, that are currently under construction or planning, are focusing on “Differentiation”.

Much of this strategy is focused around the aspect of “size” as a differentiation factor. Emphasis of this approach is to provide super regional malls (with GLA greater than 150,000 Sqm) or smaller retail centers (with GLA less than 20,000 Sqm), with a sustainable product mix, which allocates higher GLA for entertainment and/or F&B. Additionally, parking ratios are being improved with easier access to the property. The result is a product centered mall/center with a focused target market and corresponding product mix.

Although the strategy is commendable, it lacks other elements to provide the essence for long term distinction. As mentioned previously (in demand drivers), recent retail trends have shifted the primary objective of a mall from “shopping” to “socializing”. In our opinion, a successful approach to dominate the sector would be a retail mall that is a “Product Centered Attractive Destination for Socializing”.

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**Diagram:**

- **Objective:**
  - Differentiation

- **Strategy Focus:**
  - Sustainable Product Mix with Higher Areas for:
    - Entertainment
    - F&B
    - Parking

  - Concentration on:
    - Design
    - Quality
    - Supporting Components (Hospitality, Office, Residential)

  - Offering of:
    - Theme
    - Strong Brand Selection and First to Market Brands
    - IP type Entertainment

- **Result:**
  - Product Centered
  - Attraction
  - Destination for Socializing
Summary

Riyadh

Riyadh’s retail sector has witnessed strong performance in recent years, despite the considerable increase in available retail GLA. The volume of retail that remains under construction is much lower than those in the planning process. However, Riyadh has been able to absorb high amounts of retail GLA historically in 2008-2010 when a number of super regional malls (Riyadh Gallery, Hayat Mall, Panorama Mall, and Othaim Mall Rabwa’s Renovation) were delivered with a combined GLA of c. 370,000 sqm. This is driven by retail being one of the few available recreational activities in Saudi Arabia, suggesting that the market may support a higher GLA per capita and higher average spend. However, it is important to note that many factors such as location, competition, catchment area specifics, and mall management must be considered before initiating the development of retail malls. For existing malls, the current market dynamics should push rentals upward while keeping occupancies at similar levels.

Jeddah

Overall, the retail sector in Jeddah is performing well. However, it might not be able to fully cater to the increase in demand for retail space. Growing demand and limited availability of land might restrict forthcoming supply and shift supply dynamics towards smaller centers (which is already evident). This might make the operating environment of the current supply more positive in terms of potential increases in rents with sustained occupancies.

Dammam Al Khobar

With the introduction of forthcoming supply, competitiveness within the market will likely increase and the Dammam/Al Khobar market dynamics may potentially change. This may set new trends in the retail mall sector within Dammam/Al Khobar and the extra supply will likely put pressure on existing stock that may require them to revisit their operating strategy by restricting rental growth to sustain current occupancy levels.
Sample Details

In order to better engage major retailers, it would be prudent to understand their presence in the market. For this purpose, Colliers has assessed a sample of malls in ten major cities throughout KSA.

Malls assessed are located across Riyadh, Jeddah, Dammam, Al Khobar and Other Cities with a total GLA of more than 1.5 million sqm. Other cities include:

- Al Ahsaa
- Madinah
- Qaseem and others

Sample Distribution by City (%)

The total sample comprises community centres, regional malls and super regional malls. The average mall size by category is:

- Super Regional Malls: 100,000 Sqm
- Regional Malls: 51,000 Sqm
- Community Centres: 26,000 Sqm

Sample Distribution by Type

The sample of malls is well distributed across the cities and with a good representation over various categories. This ensures that data is not biased and hence makes it possible to understand the presence of these retailers and their ability to negotiate somewhat more favorable lease terms.
Space Occupied

Mall tenants, in general, are locally franchised in KSA and arguably have an accepted position of strength when negotiating lease terms with developers. Colliers has collated and analyzed the majority of recognized retail outlets within targeted areas of Saudi Arabia and their franchise partners. Retail franchises are ranked according to the area they lease within line shops (categorised as shops with area less than 500 sqm). Colliers has considered only line shops in this analysis as this segment is the most important indicator of overall rental rates a mall is able to command.

Generally, other categories (such as junior anchors and anchors) are normally priced in comparison to line shops (and lower due to much larger sizes), while other types of products, such as food courts and hypermarkets, have a different set of retailers that occupy them. The top five retailers of line shops (Top 5) within each mall is established to understand their overall presence within a mall.

According to the graph on the left, the top 5 retailers occupy c. 39% of line shops within malls. The remaining space is occupied by different retailers that have relatively lower number of brands in their portfolio.

Riyadh has a strikingly large concentration of top 5 retailers within its malls (c. 53%) which shows that their activity is concentrated in the capital. This could be due to limited supply of malls (measured by GLA per capita) in Riyadh compared with Jeddah and Dammam & Al Khobar.

Variance from Rent

In addition to the space they occupy, the top 5 retailers have also been assessed on their overall average rent paid per sqm. This is then compared to the average of that particular mall to gain further understanding of ability such retailers have in any negotiation process.

The top 5 retailers within malls pay approximately 19% less than the average of the overall line shop lease rate of the mall. Compared to the area that they lease (39%), and the value they bring to the property (i.e. a portfolio of recognized brand names), the discount attributed towards the top five seems reasonable and much lower than what is typically thought by many developers.

Riyadh’s top 5 tenants pay a rent which is much closer to the average, partly due to the fact that the top 5 tenants comprising such a large portion of the tenants (53%), therefore their rent has a bigger impact on the variance from average lease rates. This could also be due to the relatively limited supply of malls in Riyadh which may suggest that both tenant and landlord have a closer appreciation of lease values.
Closer Look at Super Regional Malls

Line Shop Space Occupied and Variance from Rent Comparison (Top 5)

<table>
<thead>
<tr>
<th></th>
<th>Super Regional Malls</th>
<th>Overall Sample (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Space Occupied</td>
<td>53</td>
<td></td>
</tr>
<tr>
<td>Variance from Average Rent</td>
<td>-13</td>
<td>-19</td>
</tr>
</tbody>
</table>

Source: Colliers Research

Colliers also compared the specifics of super regional malls with the overall sample. It is interesting to note that while the line shop space occupied in super regional malls by the top 5 retailers is less than the overall sample, the variance from average rent is similar. At first this might seem in contrast to the overall relationship between size and lease rate, however, it can be explained by:

➢ Super regional malls typically have a lower share (in terms of percentage) of line shops when compared to regional malls. One of their major strengths lies in their ability to offer more financially viable spaces for junior anchors and anchors, which are more preferred by top 5 retailers in a super regional setting.

➢ Even though the top 5 occupy a lower percentage of line shops, they occupy a considerably larger share of junior anchors and anchors within these malls. This allows them to have the same bargaining power as if they occupy a larger percentage of line shops.
Closer Look at the Sample

Colliers examined the data more closely to understand the various possible relationships that exist between different variables.

**Mall Size vs. % of Line Shop Space Occupied by Top 5**

The GLA of malls under assessment has been indexed, with the largest mall in the sample equating to 10 on the index. Mall size comparison with space occupied by top 5 roughly indicates that as mall's size increases, space occupied by top 5 decreases, as revealed in our analysis of super-regional malls.

**Line Shop Space Occupied vs. Top 5 Lease Rate Variance**

While the area occupied by the top 5 retailers has a broad range from near 0% to 90%+, the lease rate variance seems to have a cap at c. -40%. Some interesting insights from the above graph can be concluded as (numbering refers to the numbers on the prior chart):

1. This particular mall (labelled as 1) appears to have limited the rent discount for top 5 tenants. However, a closer look at the property reveals that while it is one of the prominent malls, its overall lease rate is lower than its comparable sample which indicates that the mall itself trades with a rent discount compared with its competitors.

2. The sample circled as number 2 is interesting as it shows malls have varying power to negotiate lease rates for the top 5 tenants. This is evident due to the area occupied being roughly similar, while the lease rate variance is between 10% and 35%.

3. For the mall labelled as 3, the rent variance is high, while at the same time area occupied by the top 5 tenants is also higher. This means that other tenants in this mall pay substantially higher than the top 5. A closer look at the property shows that due to its location in other cities and its small size, the developer may have availed more favorable terms for the top 5 retailers to increase the overall appeal of the mall. This likely enabled the development to pass the majority of rental premiums to the remaining occupants.

A comparison of average mall rent compared with the top 5 lease rate variance indicates that the best performing malls in terms of lease rate (highlighted) have top 5 variance ranging from c. -8% to -22%.

This indicates that mall operators still have the ability to command high lease rates despite providing discounts to the top 5.
Summary

In summary, it can be seen that much of the perceived discussion around strong tenant conditions to taking up space within malls (with higher discounts), may arguably be slightly overstated. Their negotiating power is related to the size they occupy (on average, c. 39% in line shops) and the overall value they bring to a mall.

The top 5 are typically the first to occupy space in a mall, while it is still under development, and which bears them no assurance of success. Their presence in the early phases reduces the risk of development and eases the complex process of leasing for the developer, as it further attracts other retailers.

This exercise highlighted some important aspects of mall operator’s relationship with its top 5 tenants, which we hope will provide a more favourable outcome for new mall developments.
Colliers International Middle East

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