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Executive Summary

STATE OF THE KSA MARKET

The Saudi government is increasing its efforts to grow KSA tourism from within. The Kingdom’s young population is expected to increasingly participate in travel within the country, and as a result fuel the demand for highway motels and centrally located economy hotels.

The KSA market currently has a total of 1,320 branded economy hotel keys, representing 2.1% brand penetration.

In 2013, the strongest economy hotel market occupancy was achieved by Jeddah, at 70%, while Riyadh had the highest average rate at SAR 357.

INVESTMENT POTENTIAL

A number of joint ventures have taken place in 2013, with GCC-based developers partnering with American and European hotel groups to roll-out their budget and economy brands across the Kingdom.

The number of internationally branded economy/budget hotel keys in KSA is expected to grow from 1,320 in Q1 2014 to 11,626 keys in 2018, based on announced forthcoming supply.

GOVERNMENT INITIATIVES TO DRIVE DEMAND FOR ECONOMY HOTELS

- The Saudi Commission of Tourism and Antiquities (SCTA) is actively stressing the importance of developing tourism infrastructure, upgrading tourism services, products and programs across the Kingdom.

- The SCTA is currently shifting its focus towards the development of domestic tourism, diversifying its tourism offerings in multiple fields such as heritage tourism, archeological tourism, business tourism and even medical tourism. Investment is currently being witnessed with the development of five economic cities and five medical cities throughout the country.

- Investment of SAR 75 million is currently being allocated to the development of domestic airports. A larger number of Saudi youth are expected to participate in domestic travel.

- In December 2013 the Saudi government announced its intention to introduce the Extended Umrah Visa Program, allowing passport holders of 65 countries who visit the country for religious tourism (Umrah), to extend their length of stay to 30 days.

- The move aims to increase inbound expenditure by promoting other non-religious tourism activities within the Kingdom, including shopping activities, heritage tourism and archeological site visits. The visa scheme is set to make its debut in May 2014 based on reports from the SCTA.

- The regions expected to see the largest benefit from the new Umrah visa are the Holy Cities of Makkah and Madinah, along with the gateway city of Jeddah. The secondary cities of Rabigh, Taif, and Yanbu are also expected to benefit from the scheme, as they are located within a short driving distance of the two Holy Cities.

Recent Tourism Trends

KSA HOTEL MARKET INDICATORS FY 2013

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<td>MAKKAH UPSCALE</td>
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* % CHANGE FROM FY 2012
Source: STR Global, 2014

KSA HOTEL MARKET INDICATORS YTD FEB 2014

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* % CHANGE FROM YTD FEB 2013
Source: STR Global, 2014
KSA Economy Hotel Market

MARKET GAP FOR INTERNATIONAL BRANDS

- The lack of international hotel brands may currently be seen as an opportunity for investors. As visa rules are softened and a growth in inbound business visitation is anticipated, mid-income visitors to the Kingdom are most likely to book economy hotels, and a recognizable brand name would provide a clear indication of the quality of the establishment.

- The major advantage of having an economy brand would be international hotel standards for the price-sensitive young domestic travellers and for inbound businessmen typically staying for 2-3 days on assignment.

- Although Saudi’s have generally been reluctant to stay in economy hotels and budget motels, the younger generation will have greater appeal towards an international brand which demonstrates a better understanding of the need for comfort, convenience and connectivity.

- Small introductory steps in the motel and cabin hotels are expected to pay off, with the first movers in these segments being the Motel 6 and Super 8 brands (motels) and the YOTEL brand (cabin hotel).

- Budget and economy hotels located at strategic placements such as major highways and in the city centres will be able to capture this demand for accommodation which is expected to grow from 385 million overnight stays in 2013 to 531.7 million overnight stays in 2018, according to BMI.

- Both hotel operators and the Saudi government are actively addressing the market gap which exists for quality economy hotels in the Kingdom. As the SCTA promotes domestic tourism, the country is expected to see a greater number of young tourists travel and look for affordable, convenient and comfortable accommodation establishments to spend the night.

- According to Business Monitor International (BMI) the number of inbound tourists is expected to see strong growth - from 17.2 million in 2013 to 25.7 million in 2018. As this number increases, so will the need for international hotel brands to penetrate the KSA market.

KEY PERFORMANCE INDICATORS

- In 2013, Riyadh’s economy hotel market demonstrated the strongest average rates amongst the KSA primary cities with SAR 357, due to the fact that it is the business capital of Saudi Arabia. Occupancy stood at 67% in 2013.

- Jeddah had the second strongest average rate in 2013, with SAR 328, but had the highest market occupancy at 70%. Jeddah's diversified guest segmentation – along with its status as the gateway city to Makkah and Madinah – presents itself as a comparatively low-risk investment, especially as the city grows its business and leisure offerings.

- Both Makkah and Madinah have seen slight dips in occupancy from 2012 to 2013, mainly due to lower visits caused by fears of the MERS virus and the limited number of Hajj and Umrah visas distributed due to the construction work around the Masjid Al Haram. Makkah and Madinah achieved occupancies of 62% and 66%, respectively, and achieved ADRs of SAR 260 and SAR 278, respectively. The sheer size of the market in Makkah (around 41,000 2-star and 3-star keys) results in intense competition and low rates.

- Madinah is to provide developers with the largest room to manoeuvre due to the ongoing demolition hotels to allow for the expansion of the Masjid An Nabawi. This drop in supply presents itself as an opportunity for economy hotel developers to enter a market where demand would grow faster than supply.

- Developing economy hotels in Makkah and Madinah will also be beneficial to the price-sensitive pilgrims who are generally paying upwards of SAR 10,000 for the overall pilgrimage package.
KSA Economy Hotel Market – Supply

CURRENT SUPPLY

- As of April 2014, there were a total of 1,258 hotels in the Kingdom, of which 1,100 were categorized in the 3-star, 2-star and 1-star categories.
- As was the case in 2012-2013, a strong opportunity for investment in the hotel industry lies in the branded economy and budget segments.
- The Kingdom currently features 14 internationally branded economy and budget properties, encompassing a total of 2,395 keys. This represents a tiny fraction of the overall supply, accounting for only 3.2% of total keys available in the 2-star and 3-star categories. By comparison, the UAE has an economy/budget brand penetration of 34.5%.
- Although Makkah has no true internationally branded economy hotel (the 3-star Mercure Hatabullah follows the business model of a 4-star hotel), this particular asset class is dominated by local brands, namely Elaf, Mawakeb and Makarim.
- Developers of the upcoming masterplanned 13,500-key Jebel Omar project claim that around 4,050 keys will be in the branded economy segment.
- Madinah currently has no internationally branded hotels – with only local Saudi companies such as Al Ansar Hotels Company and Mubarak Group.

FORTHCOMING SUPPLY

- Multiple development companies are entering Joint Ventures with hotel operators to develop and roll-out multiple economy hotels across Saudi Arabia.
- In December 2013, Kuwait-based IFA Hotels & Resorts entered in a joint venture with Capital Group International to roll-out the YOTEL cabin-concept brand in KSA, with the first property to open in Riyadh, and followed by more hotels in Makkah, Madinah and possibly Jeddah.
- Accor hotel group is making great strides in introducing the Ibis brand into the Kingdom, having opened the Ibis Riyadh in December 2012, and recently signing with the Alesayi group to develop an additional 10 hotels. Accor currently has 1,492 Ibis hotel keys in the announced pipeline for KSA, including properties in Yanbu, Riyadh, Jeddah and Al Khobar. More than thirty new Ibis hotels are planned to enter over the next 5 to 8 years.
- Whitbread PLC is also making a strong entrance in the Saudi market with its economy Premier Inn brand. In February 2014, the company entered into a joint venture agreement with Dubai-based Emirates Group to develop 15 Premier Inns across the Kingdom. A total of 700 Premier Inn keys are expected to be introduced in Jubail, Al Khobar, Hofuf and Jeddah.
- After witnessing the success of the first Days Inn hotel which opened in Riyadh in March 2013, Wyndham Worldwide has announced a countrywide roll-out pipeline of another 9 Days Inn encompassing 800 keys and 20 Super 8 highway hotels adding up to 900 keys.
- Industry reports from 2011 announced the development of over twenty Motel 6 across KSA, but no statement has been made since.
Investment Potential
Areas of Opportunity for the Development of Economy Hotels in KSA

RIYADH

Al Falah / Al Shuhada District is densely occupied with low-end, unbranded serviced apartments. New economy hotels would be able to penetrate a mature market while leveraging the brand name to gain market share. The location in the north of Riyadh City would allow guests to avoid road congestion from the airport.

Olaya District is the growing financial and hospitality heart of Riyadh City. Business hotel developments, old and new, are spread throughout the district and are flanked by towering landmarks such as Kingdom Tower.

Al Malaz District is located to the south of the Military Air Base, and is home to newer properties such as the Four Points by Sheraton and the Corp Executive Deira. The area would be able to accommodate a higher number of guests, particularly those looking for economy hotel rooms, as it benefits from a central location and its ease of access to Riyadh’s city centre and train station.

JEDDAH

Al Hamra District’s central location and high footfall makes it attractive for any hospitality development, and Jeddah is currently lacking in such internationally branded economy hotels. The area offers easy access to the city centre, corporate offices, embassies and the Corniche.

King Abdulaziz International Airport is currently being expanded, and with the expected increase in pilgrims resulting from the expansion of the Haramain, lies the opportunity for economy hotels to cater to a wealth of transient travelers.

Kingdom City is currently under development and will have as its centerpiece the “Kingdom Tower” – which is claimed to exceed one mile in length. This development is expected to attract more leisure and business demand resulting in greater forecasts of guest nights to be captured in the North of Jeddah.

Jeddah Gate is a mixed-use project currently under planning, to be branded as Jeddah’s new downtown city centre and to be the starting line for the Haramain Railway. The masterplanned development is to cover a total land area of 553,000m² and will offer 6,000 residential units, 230,000m² of commercial space and 75,000m² of gross leasable area. New economy brands looking to make an entrance in the city would ideally consider this modern development which is expected to be finalized by 2020.

MAKKAH

The holiest city in all of Islam currently receives around 11 million visitors per year. This number is expected to grow to 17 million in 2025, by which the Masjid Al Haram would have expanded to a holding capacity of 2.5 million worshipers.

Ajyad Municipality is the most ideal location for the development of economy hotels. The 245,000m² Jebel Omar is expected to receive 6 three-star hotels with a total room count of 1,255.

Aziziyah District is a well established hospitality and residential district, located only 1 kilometer from the Al Jamarat Bridge, from which pilgrims perform the stoning of the devil ritual.

Although it is located at a moderate distance of the Ka’abah, Zahra District would compete with existing supply of low-end furnished apartments while also catering to the annual influx of pilgrims.
Investment Potential

MADINAH

Currently around 6 million pilgrims come to Madinah every year to perform Hajj and Umrah rituals. The capacity is currently being expanded to have a holding capacity of 800,000 pilgrims by 2017, with a final holding capacity of 1.6 million by 2040.

The Central Area is currently undergoing redevelopment, with over 25 hotels being demolished, clearing approximately 6,000 rooms. This new void left by the demolition could well be filled with economy hotel rooms around the Haram, especially as the governing entities are lobbying to make the pilgrimage experience more accessible to price-sensitive individuals. Additionally, economy hotels are space-saving, and are ideal for Madinah where developers are looking to maximize space utilization.

The 1.6 million sqm Pilgrim City is currently under development and aims to provide lodging for 200,000 pilgrims, alongside offices for Umrah companies and museums and exhibition venues. Currently no economy hotels have been announced in this development and the opportunity still presents itself. The city will include rail access and a bus station to accommodate large groups of pilgrims in an efficient and organized manner.

Knowledge Economic City will be Madinah’s newest mixed-use development, aiming to diversify the Madinah economy by being the catalyst for growth of the business industry in the city. It will cover 4.8 million sqm and intends to attract over SAR 25 million in investments.

KSA SECONDARY CITIES

There is strong investment potential in the secondary cities of Ha’il, Hofuf, Rabigh, Sakakah, Tabuk, Taif and Yanbu due to growth in urbanization and along with government capital expenditure in the business sector, industrial sector and medical field. Such economic stimulus is expected to enhance the attractiveness of these cities, with the hospitality demand to stem mostly from domestic tourism, as the cities are accessible by land or via domestic air travel.

Conclusion

- In 2012, a gap in the hotel market was made evident. Investors and developers took action in 2013 and began addressing the need for internationally branded establishments, alongside news of increased government expenditure to be focused on developing travel and tourism infrastructure within the Kingdom.

- Although Makkah and Madinah have the highest supply of budget and economy hotels, both cities represent the highest opportunity for internationally branded economy hotels to make an entrance and guarantee high quality service while catering to price-sensitive travelers.

- While the movers and shakers of the economy hotel industry have already laid out expansion plans in the Kingdom, it has become more apparent that these types of operations, with their inherent profitability and limited capital expenditure, have seen increased interest from investors.

- An economy hotel’s true advantage lies in the low volatility of its revenues and low operation costs, as these properties largely depend on volume rather than price.

- Saudi Arabia is currently in the process of seeing an increase in brand penetration, with additional quality supply expected to bring the total number of branded economy keys to 11,626 by 2018, based on announced forthcoming supply.
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The team can advise throughout the key phases and lifecycle of project:

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- Market and Financial Feasibility Study
- Development Consultancy & Highest and Best Use Analysis
- Operator Search, Selection and Contract Negotiation
- Pre-Opening Budget Analysis and Operational Business Plan
- Owner Representative/Asset Management/Lenders Asset Monitoring
- Site and Asset Investment Sale and Acquisition/Due Diligence
- RICS Valuations for Finance Purposes and IPOs

OUR REGIONAL EXPERIENCE

- Strategic Advisory and Hospitality Capital Valuation for more than 32,400 keys with a total asset value in excess of AED29.4 Billion
- Hotel Operator Search, Selection and Contract Negotiation in excess of 7,200 keys with client savings averaging AED10.4 million
- In excess of 17,258 keys proposed within Highest & Best Use, Market & Financial Feasibility Studies for Hotels, Resorts & Serviced Apartments
- Highest & Best Use, Market & Financial Feasibility Studies for Hotels & Serviced Apartments with a total estimated net asset value in excess of AED 36.2 Billion
- In excess of 4,635 Hotel Keys under Asset Management as Owner’s Representative
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• AIRPORTS
• MIXED USE

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