Kingdom of Saudi Arabia white land tax

Opportunities, implications and challenges for the real estate sector
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Executive summary

EY’s view of industry publications on the macroeconomic climate of the Kingdom of Saudi Arabia (KSA) indicates that the Kingdom’s economic position globally has not been as strong in 2015 compared to previous years.

Total revenues declined significantly in 2015 over 2014 by around SAR140 billion¹, and the estimated expenditures are higher in 2016 due to the government’s continued spending on infrastructure projects.

This report examines the concept of “the white land tax (WLT),” which aims at enhancing the supply of land, which is expected to contribute to the Kingdom’s recently announced National Vision 2030 focused on accelerating economic growth through diversification of revenue and offsets the impact of falling oil prices. The report looks at the purpose of its introduction and assesses its impact and sentiment on the real estate sector. It raises pertinent questions on various scenarios where WLT could apply. It also incorporates feedback from market participants on the proposed tax and the inferences that can be made. The report concludes with EY’s point of view on the WLT. It should be noted that the research was conducted during January 2016.

¹ KSA real estate market overview 2015 (Century21)
The economic performance of KSA for 2015 came with a deficit of SAR367 billion due to falling oil prices (US$37 per barrel for Brent in December 2015) and oil exports (year-to-December 9.94 million barrel per day). This is the second fiscal deficit since 2009, and was mainly due to both falling revenues and large expenditures.

Total revenues in 2015 slipped by almost 42% compared to the previous year, and slipped below the SAR1 trillion mark for the first time in three years. Total expenditures in 2015 declined over 11%. Inflation in KSA has been stabilized at a moderate level during the last few years. In January 2015, inflation was recorded at an average of 2.2%, which increased slightly to 2.3% by December 2015.

Expenditure for 2016 is budgeted at SAR840 billion while revenue is at SAR514 billion. The current budget accounts for 73% of oil export/revenue, which still shows it is a dominating sector in spite of government efforts to diversify hydrocarbon based economy.

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue Projected (SAR in billions)</th>
<th>Revenue Actual (SAR in billions)</th>
<th>Expenditure Projected (SAR in billions)</th>
<th>Expenditure Actual (SAR in billions)</th>
<th>Surplus or Deficit Projected (SAR in billions)</th>
<th>Surplus or Deficit Actual (SAR in billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>702</td>
<td>1,240</td>
<td>690</td>
<td>853</td>
<td>12</td>
<td>387</td>
</tr>
<tr>
<td>2013</td>
<td>829</td>
<td>1,131</td>
<td>820</td>
<td>925</td>
<td>9</td>
<td>206</td>
</tr>
<tr>
<td>2014</td>
<td>855</td>
<td>1,046</td>
<td>855</td>
<td>1,100</td>
<td>0</td>
<td>-54</td>
</tr>
<tr>
<td>2015</td>
<td>715</td>
<td>608</td>
<td>860</td>
<td>975</td>
<td>-145</td>
<td>-367</td>
</tr>
<tr>
<td>2016f</td>
<td>514</td>
<td>-</td>
<td>840</td>
<td>-</td>
<td>-326</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: Jadwa Investment

<table>
<thead>
<tr>
<th>KSA economic profile</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nominal GDP (%)change</td>
<td>5.25</td>
<td>1.9</td>
<td>-2.3</td>
</tr>
<tr>
<td>Real GDP (%)change</td>
<td>10.13</td>
<td>13.5</td>
<td>13.5</td>
</tr>
<tr>
<td>Inflation (CPI, % y-o-y)</td>
<td>13.13</td>
<td>13.5</td>
<td>8.25</td>
</tr>
<tr>
<td>GDP per capita (SAR)</td>
<td>92,546</td>
<td>90,941</td>
<td>86,771</td>
</tr>
</tbody>
</table>

Source: Oxford Economics

<table>
<thead>
<tr>
<th>KSA demographic profile</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population (million)</td>
<td>30.2</td>
<td>30.9</td>
<td>31.5</td>
</tr>
<tr>
<td>Population growth rate</td>
<td>2.30%</td>
<td>2.30%</td>
<td>2.20%</td>
</tr>
<tr>
<td>Labor supply (million)</td>
<td>11.3</td>
<td>11.7</td>
<td>12.2</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>5.60%</td>
<td>5.50%</td>
<td>6.00%</td>
</tr>
</tbody>
</table>

Source: Oxford Economics

Government revenues and expenditures (2011-2016f)

Source: Jadwa Investment
White land tax introduction

Introduction

- Saudi Arabia indicated it would impose fees on undeveloped plots of land in urban areas as the Kingdom tackles a housing shortage problem for its young and growing population.
- The existence of “white lands” – large plots of idle urban land – is seen as a major contributor to a growing housing shortage in Saudi Arabia, as owners choose to hold property for long periods to maximize value instead of developing it for housing.
- According to national statistics, a large number of local citizens are residing in rented accommodations.
- With the introduction of the white land tax, the supply of land available for affordable housing is expected to increase (estimated at 400k units), which should help to discourage land hoarding, and to encourage real estate developments.

Residential units supply matrix (Riyadh)

![Riyadh residential supply matrix](chart)

Source: GCC real estate sector (Al Masah Capital, December 2015)

Residential units supply matrix (Jeddah)

![Jeddah residential supply matrix](chart)
White land tax overview

1. What is white land tax?
   - The KSA’s Council of Ministers approved a proposal to apply a 2.5% WLT in November 2015. Under the new law, owners of empty plots of urban land designated for residential or commercial use in towns and cities will have to pay a tax of 2.5% of the value of the land each year. However, the bylaws on the regulation are yet to be announced.
   - Each plot will need to be valued based on its size, location, use, building regulations and availability of public services, and accessibility of public services.

2. Why was it introduced?
   - The Ministry of Housing (MoH) has recently announced the main objectives to the introduction of this initiative are the following:
     - To promote real estate development in the Kingdom by incentivizing developers to develop land, thereby addressing the rigorous supply shortage in the region.
     - To offer land for housing purposes at feasible prices.
     - To safeguard fair competition and combat monopolistic practices.

3. When will it be introduced?
   - The regulations will be released to the public in early June 2016.
   - The regulations made available to the public state that the fees will be introduced over phases, however, the timeframe is not fixed.

4. What should the regulations cover?
   - In EY’s point of view the regulations should cover the following:
     - Time frame for the application of fees.
     - Criteria that need to be met to discontinue the application of fees.
     - Controls necessary to ensure the fair application of fees and compliance.
     - Mechanism for determining availability and accessibility of public services.
     - Criteria for identifying obstacles to the issuance of permits and approvals necessary for the development or construction of land, resulting in restricting the capability to charge fee thereon.
     - Rules and procedures for the collection of fees and assignment of the authority to collect the fees.
     - Mechanism for notification of decisions rendered against the land owner.
Important questions to ask

- How will the land valuations be carried out? Are there prescribed methods, valuers, etc.?
- How often should a land valuation be carried out?
- What is the stage of development after which the land will not be subject to WLT?
- What does commercial land include?
- What are the urban area boundaries and when will these be made available to the public?
- What is the minimum size of parcel lots for the WLT to be imposed?
- What are the appropriate mechanisms to identify factors that secure public utilities and infrastructure to the plots as part of the valuation process?
- Will the taxpayer be granted some grace period to develop his/her land?
- Will the plots be classified and then the tax applied gradually per class?
- Will the tax be applied on the “instant sale value” which is predominantly less than the market value?
- Is an empty plot with basic infrastructure over a limited area considered “taxable”?
- What are the challenges that prevent the issuance of licenses, required approvals and plot development that a developer faces in case no tax is applied?
- What are the penalties involved if no tax is paid?

Administration of the tax

- The owner of the land shall be notified of the decision to subject its land to fees and the fees due in accordance with the bylaws.
- MoH, along with the Ministries of Justice, Finance, Municipal and Rural Affairs, Economy and Planning and Commerce and Industry, will be responsible for developing the bylaws and will be issued within a short period from the issuance of the regulations date.
- The tax collected will be spent on housing projects, expanding public utilities as to cover such projects and provide public services.
- The MoH in coordination with other governmental bodies will maintain a database that will include issues related to the implementation of the tax and will be accessible to concerned parties to view the database of implementation and collection of funds related to the tax.
- The MoH will assign a certain party to undertake and submit a yearly review of the results of the time schedule related to the implementation of the tax.
- Use of funds will need to be monitored in a transparent manner.
White land tax impact and sentiment

• Promote real estate development and the construction sector in the region as developers would not want to pay tax on land that does not generate cash flow.

• Address the severe supply shortage of residential units across income levels in the region, especially affordable and middle income housing.

• Generate additional revenue for the exchequer as a mean to diversify income streams from oil and gas.

• Expected reduction in land prices consequently development costs as trading of empty land plots would increase.

• Help develop a more active real estate market in KSA as key property developers will actively get involved in starting new projects and hence increase the overall real estate transactions by value and numbers.

• Certain developers believe that bare minimum construction would be completed to avoid the land tax without monetizing the asset in the long run.

• May lead to inefficient use of land as developers may respond with a knee-jerk reaction without regard to supply-demand and development economics.

• Additional government services and infrastructure will be required to adequately monitor and levy the WLT.

• Lack of clarity on the bylaws has led to industry-wide confusion and is currently compounding the problem of land not being developed as industry participants are adopting a “wait-and-see” approach.

• Landowners may maintain or increase the selling price of their lands to offset the imposed tax on the buyers.
EY point of view

• We consider the WLT to be an initiative that should help activate the land development industry. Bylaws need to be developed to add clarity and help ensure success. This should facilitate real development. Otherwise, the affordability crisis will not be addressed sufficiently.

• We anticipate the WLT will enhance the supply of land and encourage real estate development. This is expected to contribute to the recently announced KSA National Vision 2030 focused on accelerating economic growth through diversification of revenue and offsets the impact of falling oil prices.

• We anticipate it would have a widely positive impact on the market by reducing the gap between the two-tiered land market in KSA, the ‘land-banking’ and ‘land development’ markets. These are often priced differently with large variance in pricing expectations (i.e., land is usually traded for a much higher price than a feasible development would yield).
Market participants’ feedback on the new law

Introduction
In order to understand the market sentiment on the new law, a survey was conducted based on the following questions throughout the Kingdom with real estate developers, investors, government bodies and other real estate professionals.

1. Expected impact of the land tax on housing developments

Our survey participants responded that they expect an immediate uptick in the development and construction activity as investors are likely to hedge against paying charges on raw land. However, the majority anticipate a more gentle push into development as many factors come into play, including but not limited to the rate and mechanism applied in the land tax, grace period given to land owners, appetite to develop, availability of development financing and customary supply-demand forces.

Sixty-five percent of our survey participants anticipate an incremental increase in housing development over the next 2-3 years, further surpressed by the current economic and political situations as investors favor “store of wealth” strategies and postulate a “wait-and-see” approach. The true effect of the new law may not be felt before mid-2017.

Q: What in your opinion will be the expected impact of the land tax on housing developments in the next two to three years?

2. Expected impact on other related issues

The majority of the feedback from our survey participants pointed towards some confusion in the market regarding building materials and construction prices with an anticipated drop in land prices due to an increase in demand and availability of land. Dropping commodity prices at the global level are expected to counter the level of the temporary increase in demand. A long-term increase in sales, labor and material prices is seen taking hold as the private sector kicks in and margins would have to be preserved. This should be offset by expected improvements in the financing channels.

Q: Do you agree or disagree with the anticipated impact of the following related issues upon the implementation of the new law?

<table>
<thead>
<tr>
<th>Change Category</th>
<th>Agree</th>
<th>Disagree</th>
<th>Unsure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Changes in project delivery strategy</td>
<td>70</td>
<td>25</td>
<td>5</td>
</tr>
<tr>
<td>Increase in sales prices</td>
<td>50</td>
<td>45</td>
<td>5</td>
</tr>
<tr>
<td>Increase in land transactions</td>
<td>65</td>
<td>25</td>
<td>10</td>
</tr>
<tr>
<td>Decrease in land value</td>
<td>80</td>
<td>15</td>
<td>5</td>
</tr>
<tr>
<td>Increase in labor costs</td>
<td>65</td>
<td>25</td>
<td>10</td>
</tr>
<tr>
<td>Increase in building material and construction prices</td>
<td>70</td>
<td>20</td>
<td>10</td>
</tr>
</tbody>
</table>
Market participants’ feedback on the new law (continued)

3. Role of the Government and authorities

Our survey participants felt that the Government and the relevant authorities should have more than one goal that should be tended to in parallel with the execution of the tax. One of the significant objectives is to stamp out land trading monopolies that cannot be curtailed with a solitary law; rather, it requires lot of administrative changes and activities that target and tackle distinctive perspectives of the real estate industry.

Other useful input included compelling execution of the mortgage law and offering attractive financing choices for developers, providing infrastructure in new undeveloped zones, presentation of new measures that foster the formation of compelling and effective public-private partnerships (PPP), furnishing developers with enhanced incentives in forthcoming contracts with the Ministry of Housing (MoH), resolving plot ownership conflicts and speeding up the process of issuing plot “blueprints.”

Q: In anticipation of an upswing in real estate developments, what do you suggest the Government or authorities need to do to streamline the process of developments?

<table>
<thead>
<tr>
<th>Action</th>
<th>Response %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase loan to value (LTV) ratio</td>
<td>90</td>
</tr>
<tr>
<td>Attractive financing alternatives for developers</td>
<td>85</td>
</tr>
<tr>
<td>PPP integration</td>
<td>66</td>
</tr>
<tr>
<td>Regulatory reforms and initiatives, including labor market and land trading</td>
<td>82</td>
</tr>
<tr>
<td>Streamline planning and approval processes</td>
<td>97</td>
</tr>
<tr>
<td>Improve infrastructure</td>
<td>97</td>
</tr>
</tbody>
</table>

4. Why now?

One of the major obstacles the country is facing is the demand for housing units from its local citizens, which is estimated to be short by 1.5 million homes. This move is expected to allow the government to avoid construction in areas outside the urban boundaries through larger availability of plots to develop within the urban boundaries and provide stable revenue for the government estimated at SAR40 to SAR50 billion a year, at a time when the country’s oil revenues are dwindling.

Q: What in your opinion is the main driver behind this new law?

<table>
<thead>
<tr>
<th>Driver</th>
<th>Response %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduce gap between &quot;land banking&quot; and &quot;land developments&quot;</td>
<td>80</td>
</tr>
<tr>
<td>Reduce land values and development costs</td>
<td>63</td>
</tr>
<tr>
<td>Generate additional government revenue to help offset declining oil revenues</td>
<td>97</td>
</tr>
<tr>
<td>Affordable and design conscious housing</td>
<td>84</td>
</tr>
<tr>
<td>Spur housing developments</td>
<td>84</td>
</tr>
</tbody>
</table>
Market participants’ feedback on the new law (continued)

5. Effect of lowering oil prices

The slowdown in economic growth, mainly due to lowering oil prices, is likely to see government spending restructured, with more focus on top priority projects, such as infrastructure and affordable housing, and reduced spending on less urgent projects.

Although government spending on infrastructure projects currently under development is expected to continue, the Ministry of Finance has instructed that the government will fund no new projects.

Q: What in your opinion will be the expected impact of low foreseeable oil prices on housing developments?

History demonstrates that land has dependably been one of the great safe segments for speculators who look past the petrochemical and money-related markets. The majority of the feedback highlighted that the Saudi Real Estate market is going through a “maturing” process that is expected to support the development of businesses and opportunities in the market. It is expected to shift the model from land trading to construction, especially through the introduction of this new law and the unprecedented demand for housing. This would cement the first step in a lengthy process, whereby the real estate sector advances and players turn out to be more sophisticated.
Understanding the issues and opportunities

We understand the key opportunities, challenges, and critical questions you have as a result of the proposed white land tax.

### 1. Developing the right project
- What is the best development strategy?
- What is the optimum use of land?
- Where are the market opportunities and gaps? How best to tap into opportunities and mitigate threats?
- Where are the niche opportunities, if any?
- How will you manage this development process?
- Who are the right partners you need to unlock your land bank and unblock the value?
- What is your land worth?
- Are you targeting the right audience?
- What is the current state of the plot in terms of development progress?

### 2. Financial and strategic advice
- What is the optimum use and sourcing of funds?
- How best to invigorate private sector investment and involvement into the projects?
- What are the incentive mechanisms and exit option strategies that should be adopted to achieve this?
- What are the financial returns for your project and what do they need to be to achieve overall success?
- What will be the impact of this tax on your financials?
- What advice do you need before you decide to sell? What support do you need during the buy-side/sell-side transaction?

### 3. Balance sheets
- How should you incorporate this new “tax” on your balance sheet?

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- Highest and best use studies
- Project management
- Repositioning analysis
- Valuation
- Financial and commercial due diligence
- International tax planning and compliance
- Business and operating strategy
- Strategic acquisition and disposition alternatives
- Financial modeling and analysis
- Financial advisory and restructuring
- Infrastructure and PPP advisory
- Business process improvement
Outlook:

The issue that needs to be addressed is to increase the supply of housing in Saudi Arabia. The WLT initiative is not a complete measure. Other solutions may be announced in the near future while the Government continues to address the housing shortage for local citizens.
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