REAL ESTATE

The Israeli CRE Market

Highlights from B-BRE reports

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Additional Reports:

The Tel Aviv Office Market

The Israeli Office Market

The Herzliya Office Market

On the B-BRE website: http://b-bre.com/en/market_reports

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Introduction

The Israeli CRE market is relatively young. Modern properties - both in the retail and office sectors - started to become a significant part of the market only about 20 years ago.

The last few years have been good for the market. Israel weathered the 2008-2009 crisis well. Negative price changes were minimal, and prices bounced back quickly. This can be seen in charts 1 and 2 which show that cap rates in Israel remained generally stable, while in the US they peaked in 2009 and declined thereafter.

The current situation also seems good: Occupancy rates are high in all sectors and property prices are stable (in addition, prices are rising moderately in central areas such as Tel Aviv). As it seems, the only clouds in the current picture is the trend of slightly rising vacancies in the office sector (outside Tel Aviv), accompanied by a slight decline in rents.

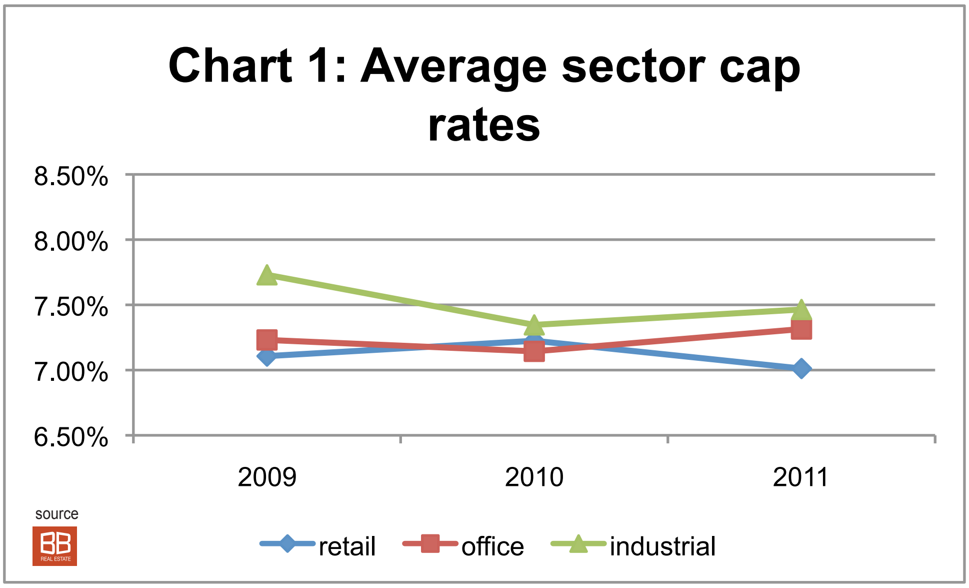
But the future prospects are more complex: Considerable supply is currently in the pipeline, both in the office and in the retail sectors. Its absorption depends primarily on the general macroeconomic situation, and some zones are expected to suffer more than others if the situation gets tougher.

In addition, there are some phenomena that seem anomalies in the market. Thus, for instance, in Tel Aviv, unlike other similar metropolitan centers like New York or London, office cap rates are higher than the country average. Another question mark regards the relatively high prices of retail properties: the price per sqm of retail is double than that of offices, unlike the US or the UK where prices in the two sectors are much closer.

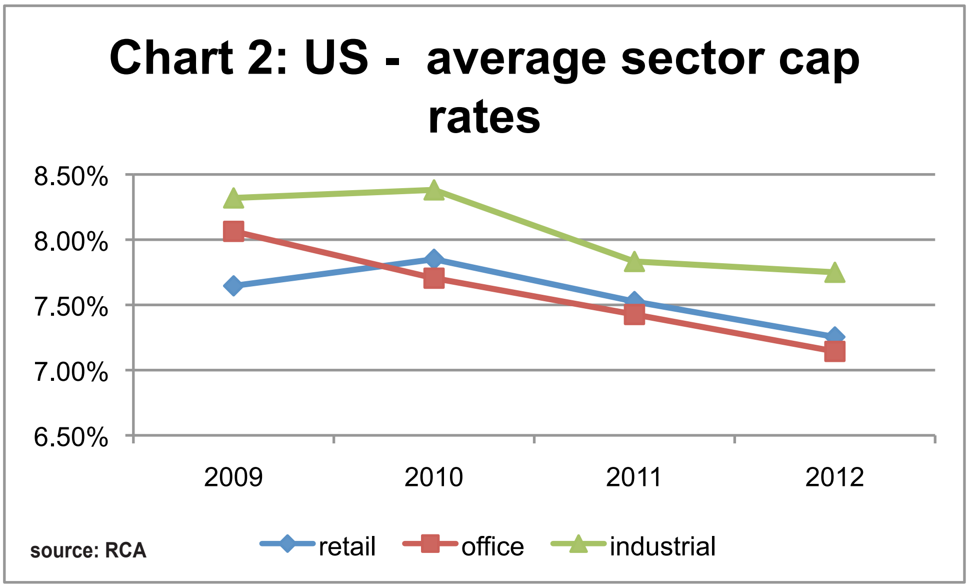
The following document presents a brief overview of the more interesting segments of the market: Tel Aviv offices, Tel Aviv district shopping centers, and the developing industrial and logistics sector.

Overview

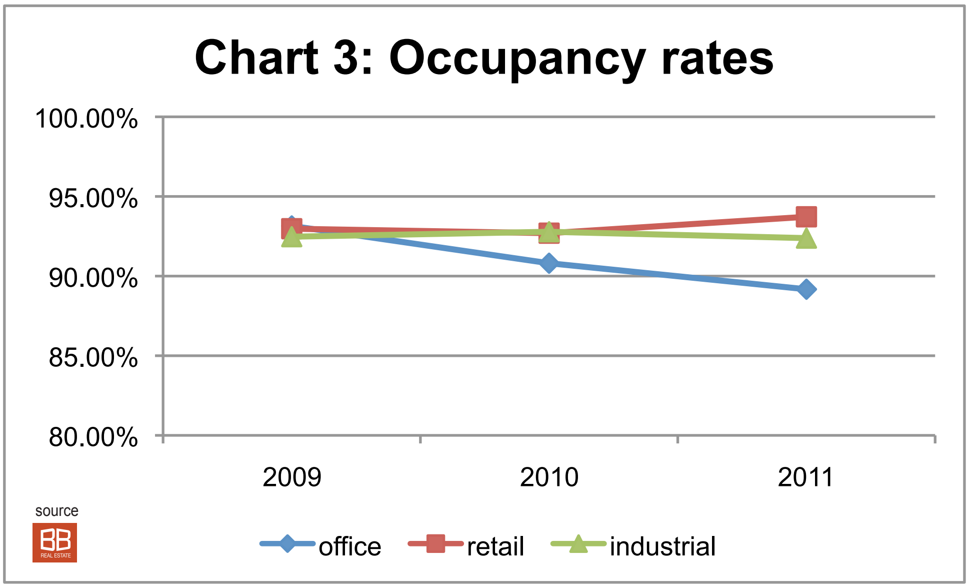
Cap rates: In the last three years cap rates have been relatively stable.



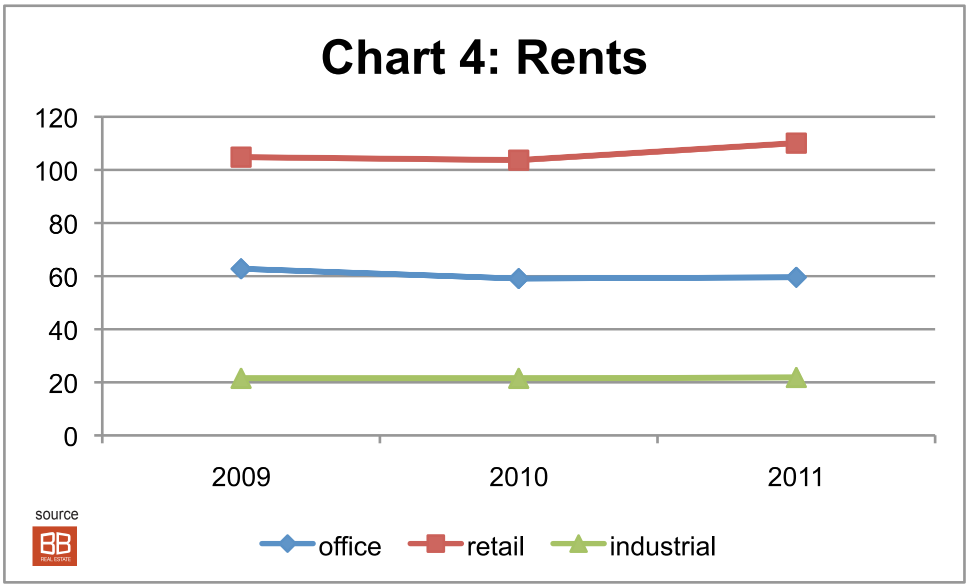
We can see a slight downward trend in retail and industrial properties, and a slight upward trend in office cap rates. The stability of cap rates in Israel stands out when compared to the cap rates in the US during the same three years period.



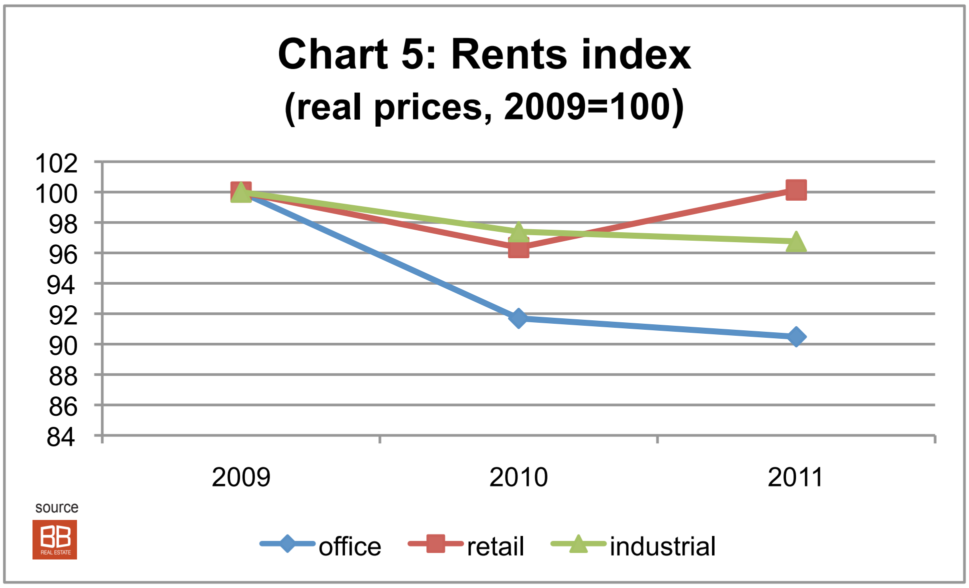
Vacancies: Occupancy rates have been relatively high in all sectors. Nevertheless, we observe a decline in office occupancy rates..



Rents: Rents (in current prices) remained stable in the industrial sector, edged up in the retail sector, and declined slightly in the office sector[1].



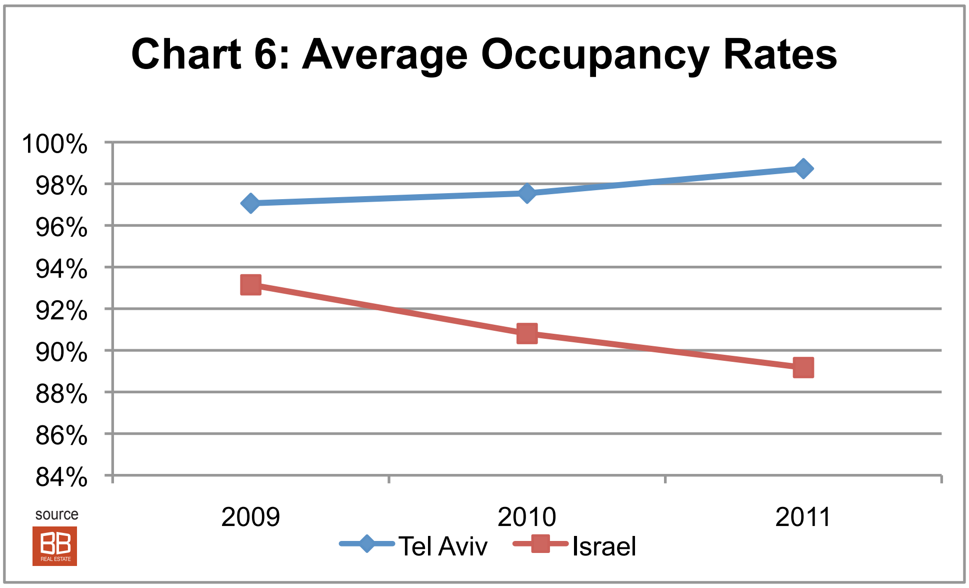
1) Inflation was 4.9% over this period, as reflected in the real price index.



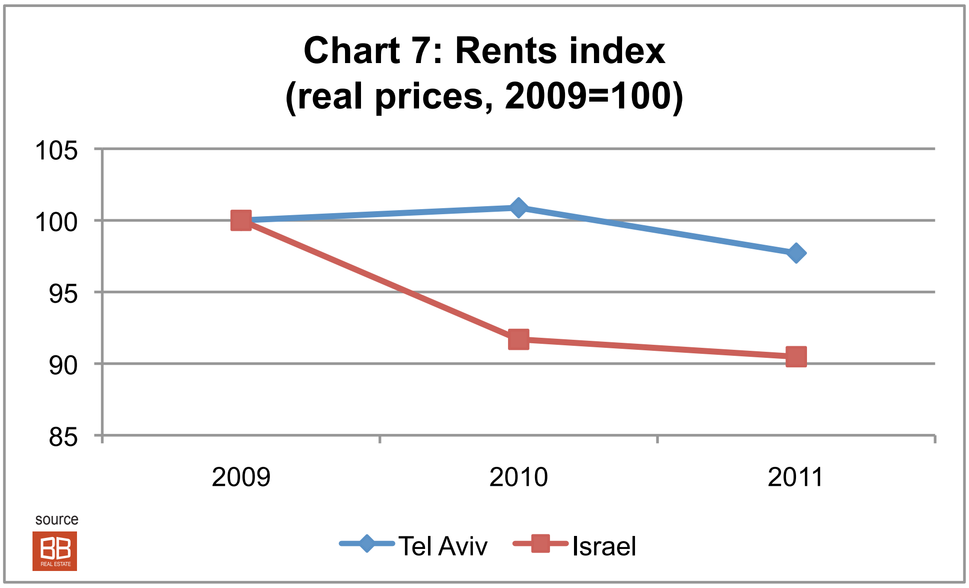
Please note that the changes in the index seem more dramatic than those in chart 4, due to the scale differences between the charts.

Tel Aviv offices

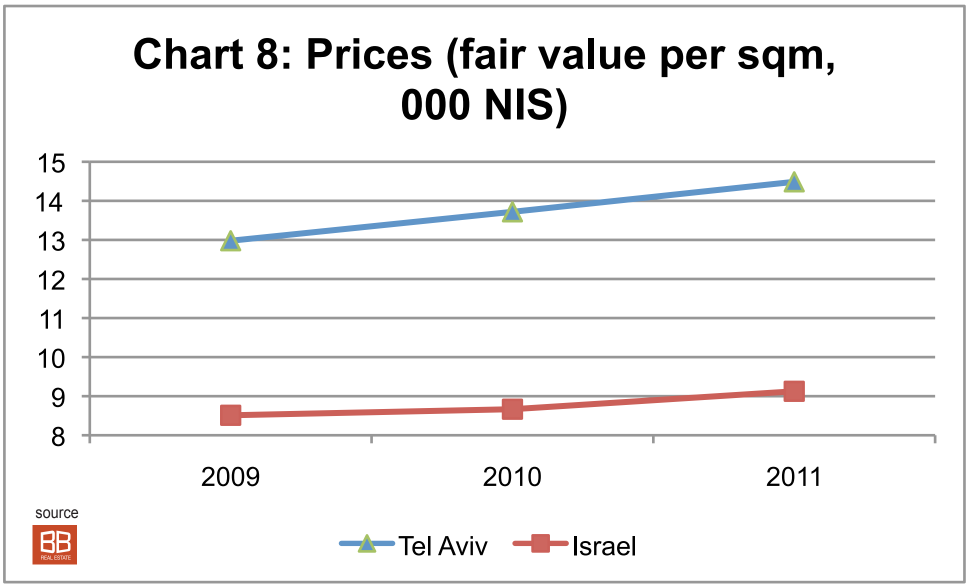
Tel Aviv is the main business center of Israel, and in many respects it is a market on its own. Thus, for instance, although office occupancy rates are declining in Israel, they are on the rise and close to 100% in Tel Aviv.



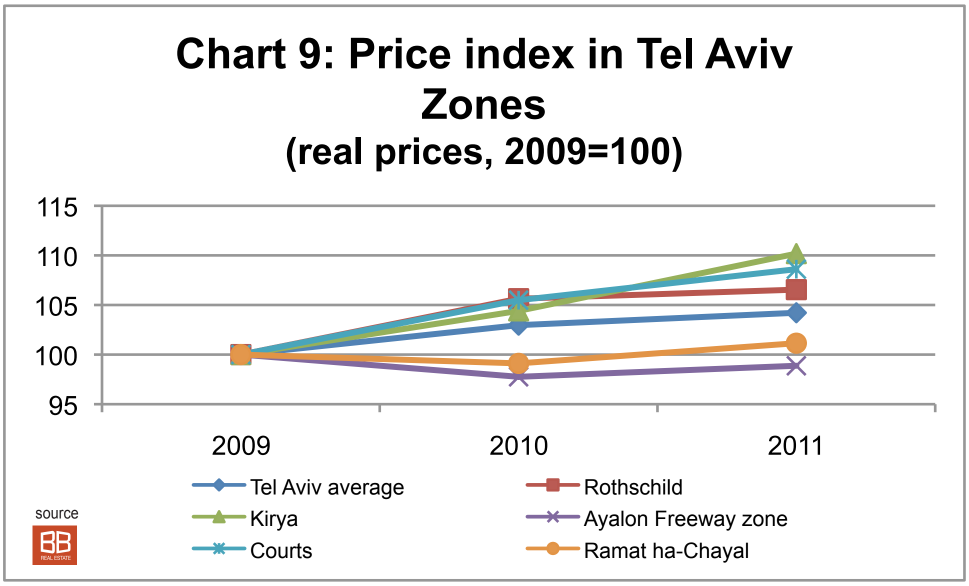
Rents have been stable overall, declining very slightly (in real prices), again in contrast to the sharper decline in Israel.



Property prices (as reflected in fair value per square meter) are about 50% higher than the Israeli average. Over the period real prices appreciated by 4.2%.



Nominal prices, as reflected in IFRS valuations, rose by11% in Tel Aviv and by 7% in Israel between 2009-2011 (6% and 2% in real terms, respectively).

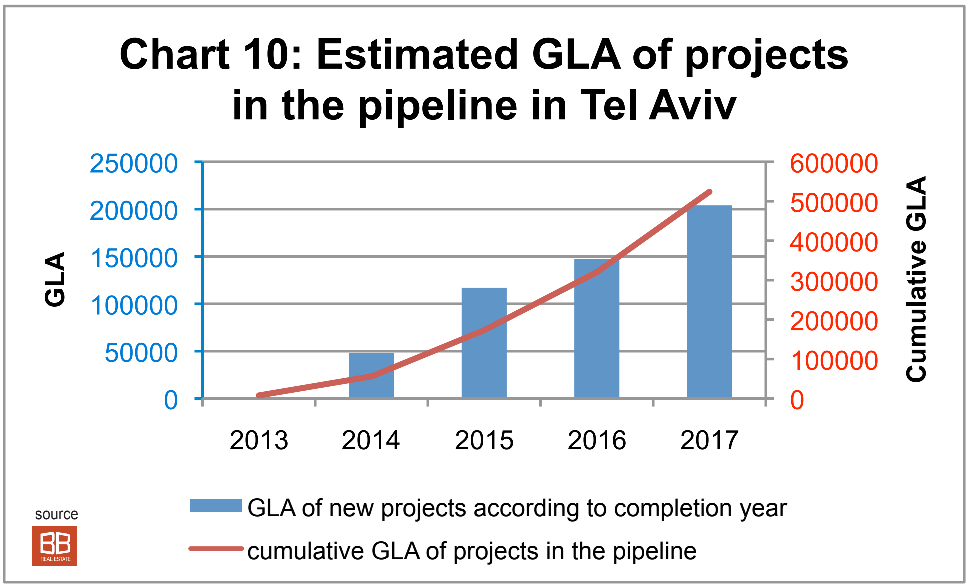


If we examine the real prices in the individual zones, we can see that the steepest rise was in the Kirya zone, Close to the Kirya was the Courts zone. Ramat ha-Chayal and the Ayalon Freeway zones were the only zones with a cumulative decline since 2009. In the Ayalon Freeway zone prices declined in spite of the rise in rents and vacancies as reported by the companies with properties in this zone.

The main issue regarding the Tel Aviv office market is the issue of the effect of projects in the pipeline on the market. In the coming years, according to our estimates, more than 500,000 sqm are supposed to reach this market.

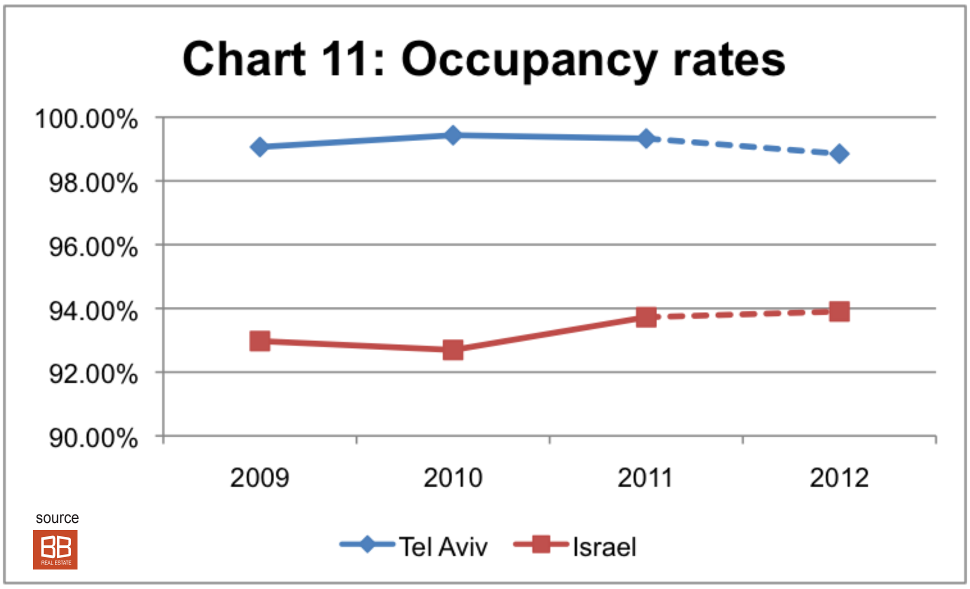
Among the bigger projects is the Azrieli complex which is being built in the Sarona Compound; The BSR building in the Argaz Compound in the Ayalon Freeway zone; the Arba'a project constructed by the Hajjaj Group; and the complex developed jointly by Pangaea, Eurocom, and Electra in the Tnuva compound (in the Northern Business District).

This represents an addition of about 30% to the current supply of similar buildings. Their effect on the market depends on the overall macroeconomic situation in Israel when they come into the market, and on the supply in the areas around Tel Aviv.



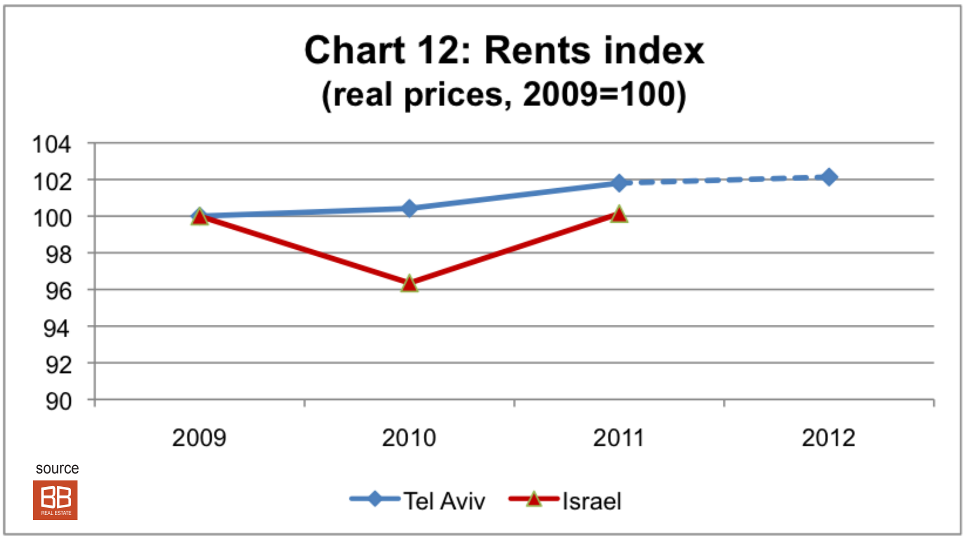
Tel Aviv district retail

The Tel Aviv district includes, besides Tel Aviv itself, eight additional cities around Tel Aviv[2]. The last few years were very positive for the retail sector in Israel in general, and in Tel Aviv in particular. The average occupancy rates in the Tel Aviv district are close to 100%.

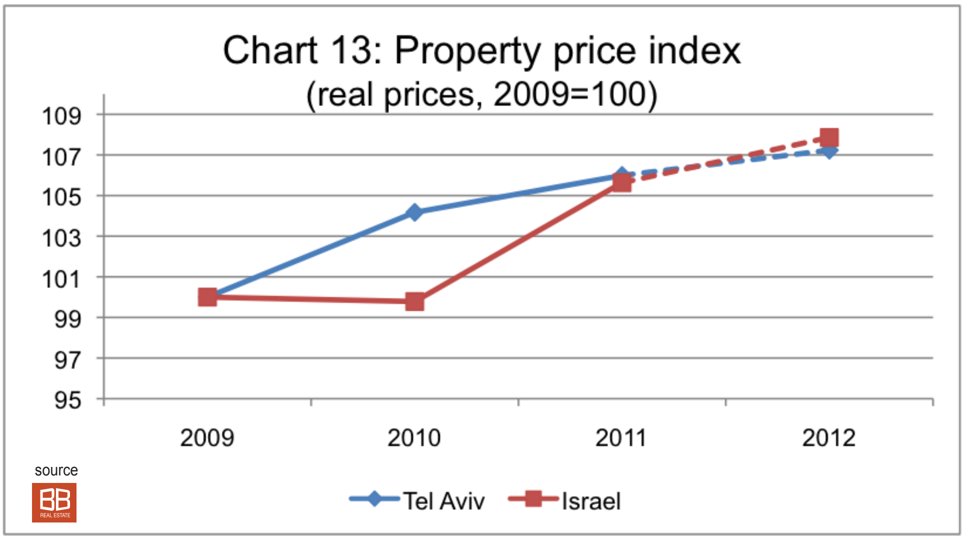


2) Or Yehuda, Bney Brak, Bat Yam, Givatayim, Herzliya, Holon, Kiryat Ono, and Ramat Hasharon.

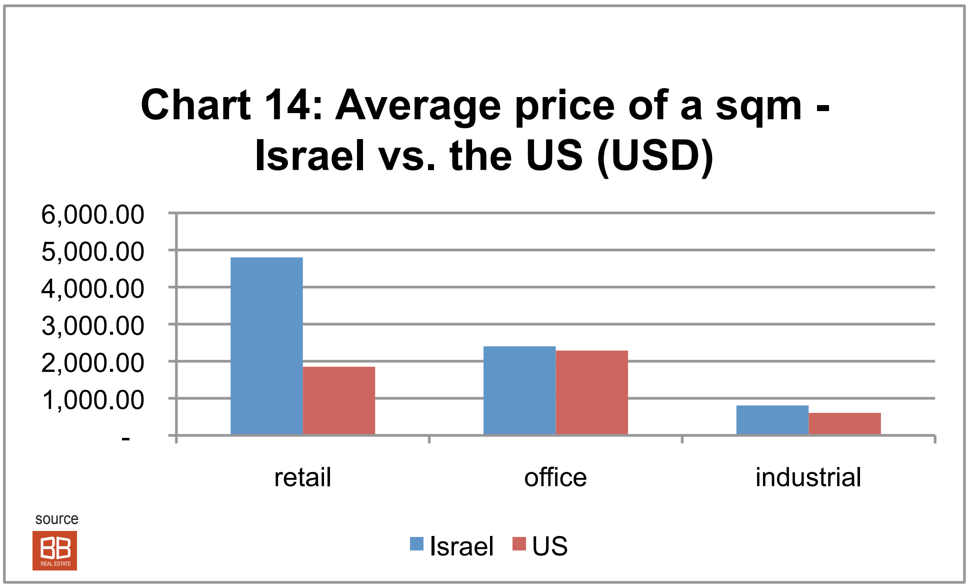
Rents (in real prices) rose slightly but consistently in the Tel Aviv area:



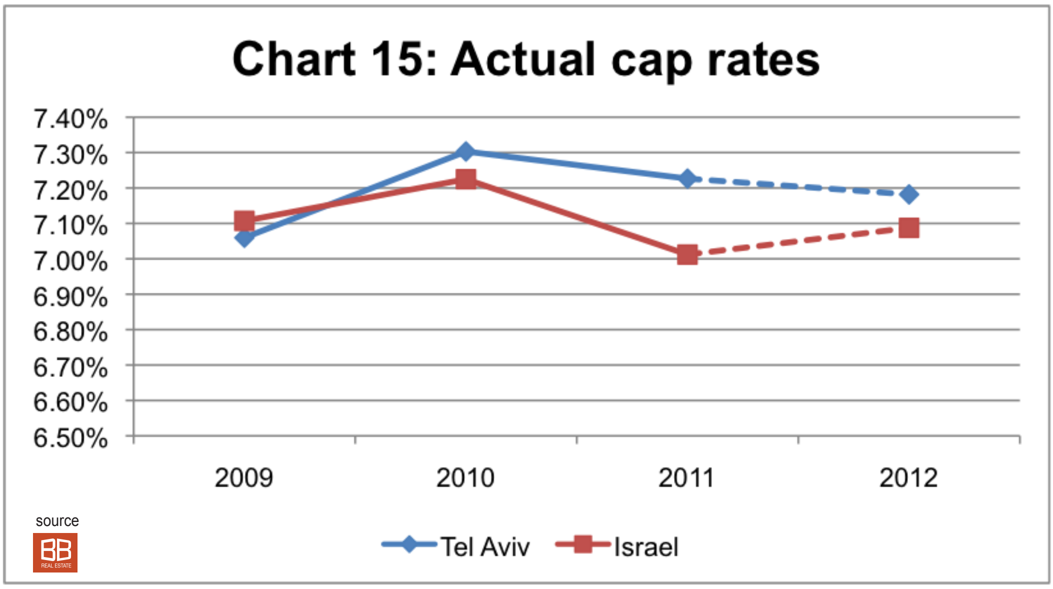
Property prices (as reflected in IFRS valuations) also rose, by about 8% over the period 2009-2012.



Retail prices in Israel also present an anomaly when compared to those of other sectors. As reflected in the following chart, while the ratio between retail and office in the US is close to one, in Israel a sqm of retail costs more than double compared to a sqm of offices. We have no solid explanation for this phenomenon, especially since retail cap rates do not seem abnormally low. A possible explanation might be related to supply and demand issues.



Cap rates declined slightly as property appreciation was higher than the increase in rents and NOI.



Comparing the average cap rate in Israel and in Tel Aviv highlights an interesting phenomenon, or anomaly: There is a positive gap between Tel Aviv and the rest of Israel, i.e. cap rates in Tel Aviv are higher than in the rest of the country.

The data suggest that at present, the retail sector enjoys more favorable conditions than the office sector (both nationally and in Tel Aviv): retail rents are rising as compared to declines in the office sector, and price appreciation has been higher in this sector as well.

In terms of future supply we estimate the addition of more than 40,000 sqm in the city of Tel-Aviv itself (an addition of close to 20% of existing stock), in projects built by public companies. As with the office sector, the absorption of this stock depends primarily on the macroeconomic conditions.

The industrial sector

The industrial properties held by listed companies display a wide variance in terms of types and quality. They range from traditional industrial zones, to light industry (serving also hi-tech companies), to modern logistical centers.

In terms of GLA, industrial properties are about a third of the total GLA held by listed companies. In terms of fair value, industrial properties are only 15% of the total fair value of properties held by listed companies. This reflects the fact, that as in other countries, industrial properties are cheaper in terms of price per square meter.

As seen in chart 1, above, occupancy levels remained stable at a high level of around 93%.

Operational measures reflect that the last years have been good for the sector. NOI rose by 15% (in real prices), and property prices (as reflected in valuations) rose by a similar percentage, leaving actual cap rates without change, between 8.1-8.2%.

In terms of future supply, listed companies have 74,000 sqm in the pipeline. This addition is smaller in absolute terms than the future supply in the pipeline in the retail and office sectors (236,000 and 584,000 respectively). it is even smaller when viewed as percentage of existing stock, the addition representing 2.5% of current GLA. It must be borne in mind, however, that there is a ”parallel” market, in which large industrial companies build their own modern logistic centers, and do not tend to rent these facilities.

B-BRE (Bregman-Baraz Real Estate)

B-BRE was established by Nirit Bregman and Daniel Baraz as a real estate research and consulting firm, with a special focus on the Israeli market. B-BRE is Real Capital Analytics' local data partner, and it strives to increase the transparency of the Israeli CRE market. For additional details, please see http://b-bre.com/en.

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