BB REAL ESTATE

The Herzliya Office Market

Nirit Bregman, C.P.A. (Isr.), LL.M.
Daniel Baraz, Ph.D.

July 2012

REAL ESTATE

Additional Reports:
The Israel Office Market

Forthcoming Reports:
The Tel Aviv Office Market
The Tel Aviv Retail Market

This report is based on a database compiled primarily from the public information of more than 40 real estate companies traded on the Tel Aviv Stock Exchange, and reflects the listed commercial property market in Israel.

Contents

Overview

According to our database the size of the listed office sector in Israel at the end of 2011 was 2.5 million square meters in terms of GLA and NIS 23 B (USD 6 B)[1] in terms of fair value (for further details please see our Israel Office Report)[2]. The geographical distribution of properties reveals that most of the properties (both in terms of GLA and of fair value) are concentrated in the Aviv district[3]: 51% of the GLA of the listed sector, and 72% of its total fair value. Within the district, most properties are concentrated in two cities: Tel Aviv (50% of the GLA in the district, 74% of fair value) and Herzliya (32% of the GLA in the district, and 20% of fair value).

The Herzliya Industrial Zone started off as a traditional industrial zone and evolved into the most significant office submarket outside of Tel Aviv. Tenants in the area are primarily hi-tech companies (both local and global), law firms, financial firms, etc. A small number of traditional industrial compounds are still operational, but they are in the process of liquidation and replacement by office buildings, as reflected in the plans of real estate companies like Gav Yam (Bayside Land) and Vitania to develop office buildings in the oxygen plant and Fedco compounds.

Our sample of properties includes seven buildings out of ca. 40 office buildings in the Herzliya Industrial Zone, which add up to 150,000 square meters and to a fair value of NIS 2 B (USD 525 M), out of a total GLA of more than 500,000 square meters in the area. Hence the sample coverage is around 30% of the GLA and even more in terms of fair value.

1) Prices in USD were calculated according to an exchange rate of 1 USD = 3.80 NIS.

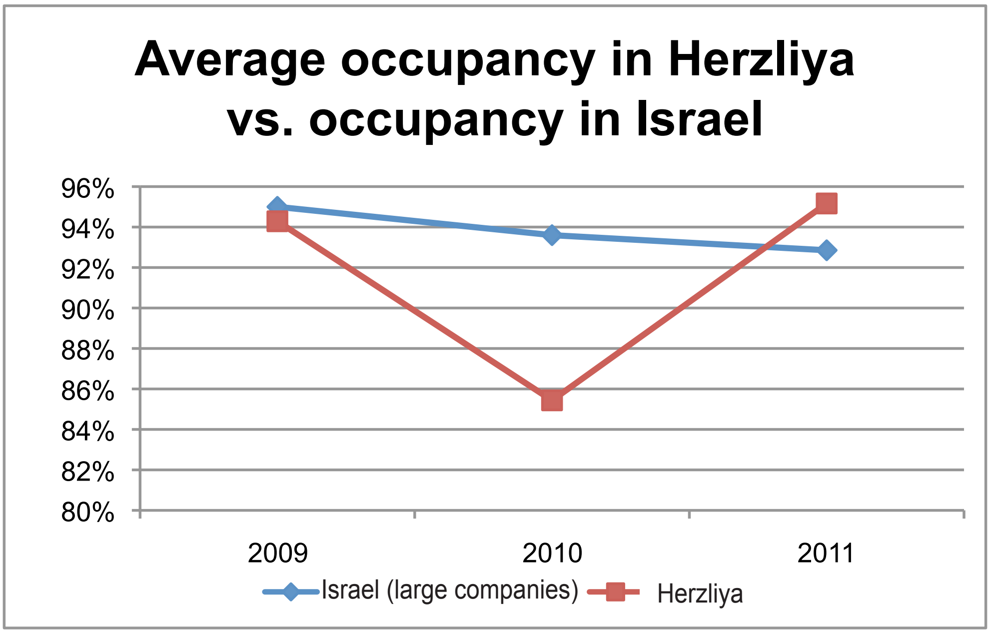
2) www.b-bre.com/market_reports.

3) The Tel Aviv district, as defined by the ministry of interior, includes Tel Aviv, Herzliya, Givatayim, Ramat Gan, Bat Yam, Bnei Brak, Or Yehuda, Kiryat Ono, and Ramat Hasharon.

The Herzliya industrial zone underwent rapid development in the last few years, and a significant amount of office space was added. Between 2009-2011 45,000 square meters were added to the stock of office space held by listed companies. The additional space influenced a number of parameters like vacancies and rents, as can be seen in the charts below. It seems to us that the influence of this additional stock was mitigated by the favorable macroeconomic conditions which enabled the absorption of this supply relatively quickly. By the end of 2011 the new space was almost fully occupied.

Vacancies

As we indicated above, during the period reviewed (2009-2011) considerable amount of 45,000 square meters of new office stock entered the Herzliya market. The following chart reflects the resulting decline in occupancy rates, and the absorption of most of the new stock in 2011.[4]

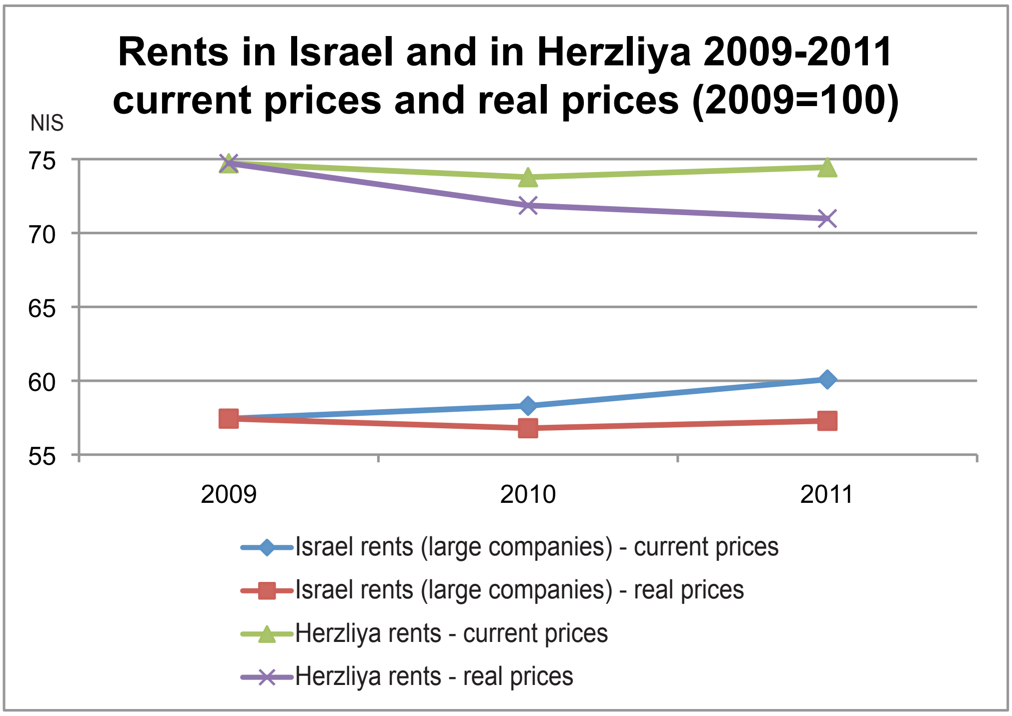


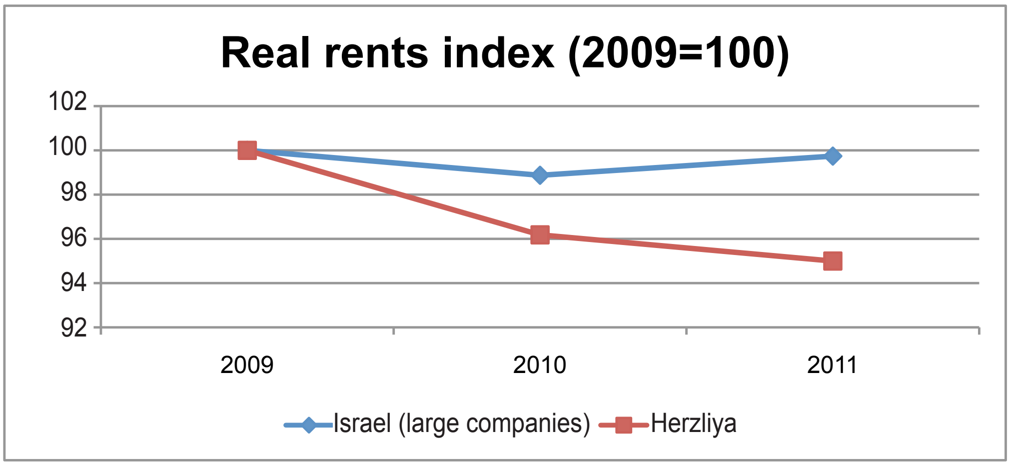
* Large companies for the purpose of this report are companies that held more than NIS 1 B in office properties, and reported consistently for the last 3 years.

4) The chart reflects the decline in occupancy only in the properties owned by listed companies. The effect of the new stock on the whole market was more moderate.

Rents

Rents reflect the decline in occupancy rates in 2010, and the rise in 2011. Overall, we see a cumulative decline of 5% in rents when measured in real prices.

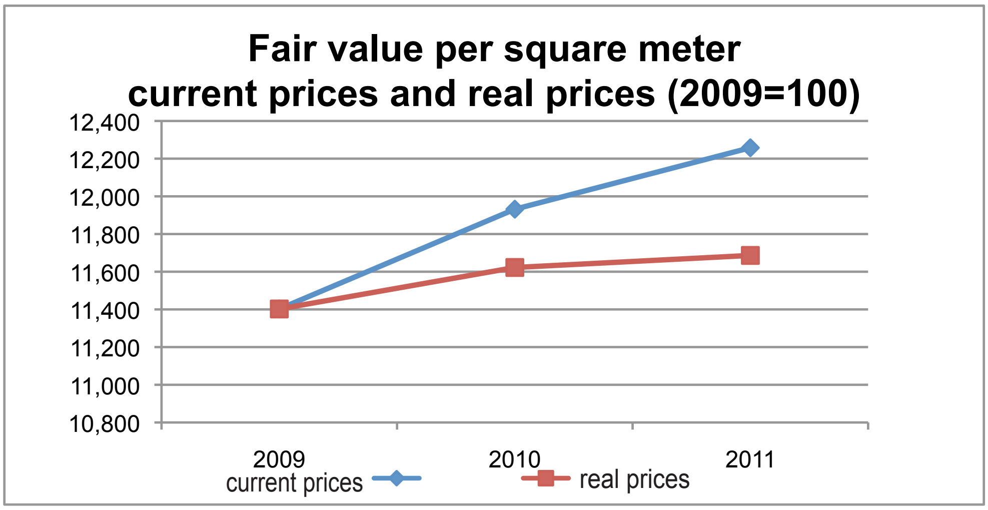




Prices (fair value per square meter)

The chart below presents the change in fair value per square meter is the Herzliya Industrial Zone, measured both in current and real prices. It can be seen that real prices rose by ca. 2.5% between 2009-2011.

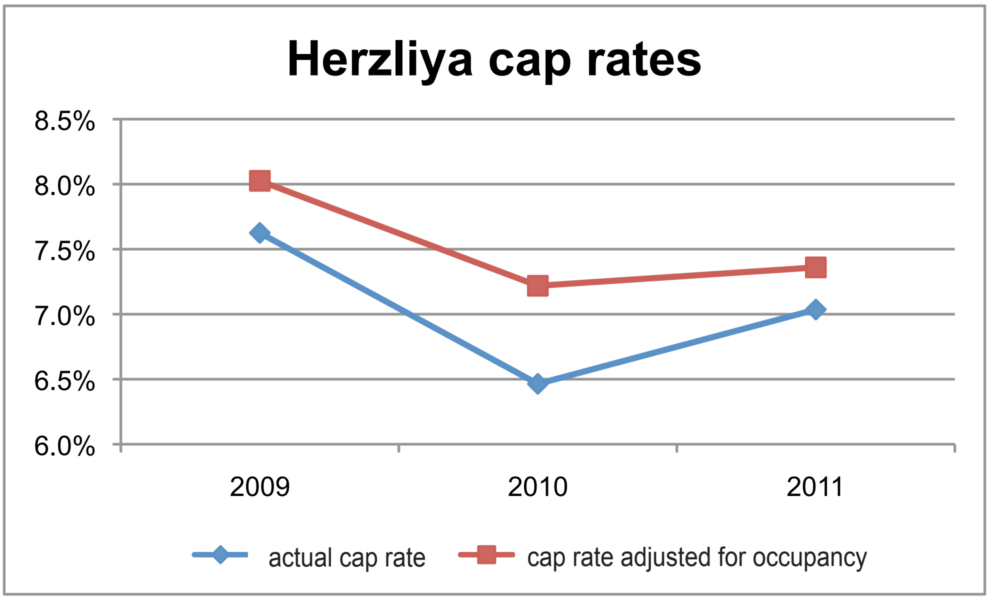
This data seems to provide local support to the general claim that income-producing property can serve as a hedge against inflation. Nevertheless, it must be born in mind that there were no significant actual deals in 2011, and the prices are based primarily on valuations.

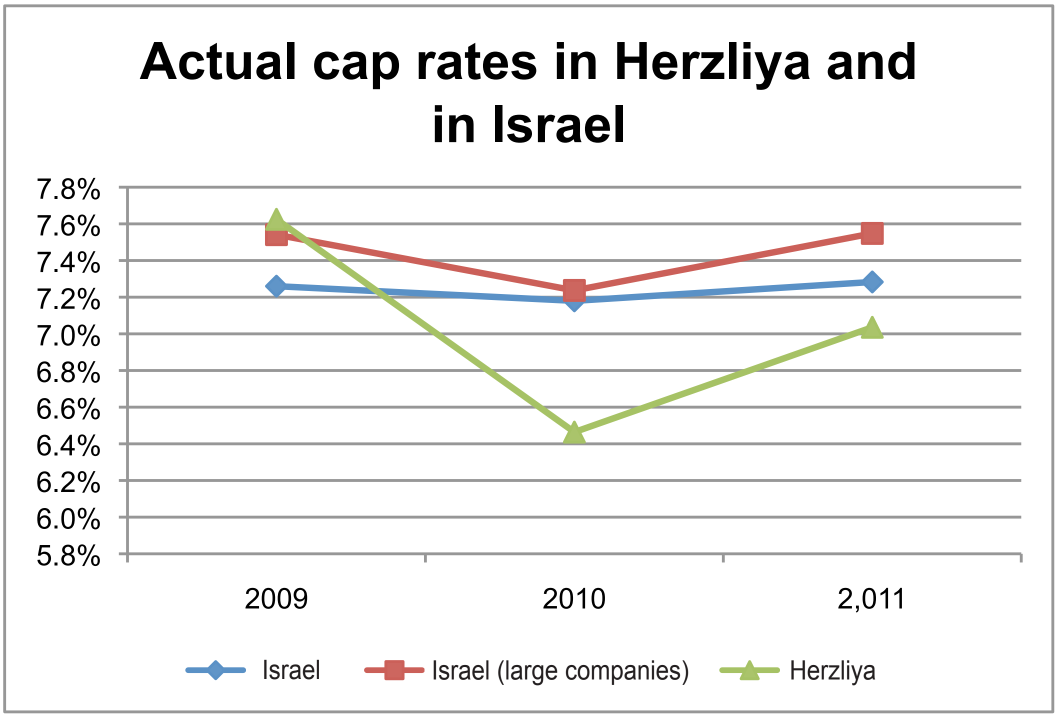


In our opinion, property valuations went up, in spite of the decline in rents, due to the rise in occupancy rates and the absorption of new supply.

Cap Rates

The following chart presents the actual yields, and the yields adjusted to full occupancy in Herzliya between 2009 and 2011. We can see that yields decline in 2010 due to new supply which was not yet absorbed, and rise again in 2011 following the absorption of the new supply.





The cumulative decline since 2009 can be accounted for by the decline in real rent prices which occurred parallel to the slight rise in the fair value of the properties.

Future supply

An estimated total of 80,000 square meters are in the planning and execution stage by listed companies in the Herzliya Industrial Zone, in four buildings: Two buildings are built by Pangaea Real Estate, 17,000 square meters each (the Sea View and Ha-Hoshlim projects). Gav Yam is building another building in the oxygen plant compound, which will consist of an additional 28,000 square meters in two stages. The fourth building, of 20,000 square meters, is planned by Vitania on the Fedco compound.

This additional supply constitutes of ca. 15% of the existing stock. We estimate that 50,000 square meters (out of the planned 80,000) will be actually completed in the next 2-3 years. This new supply is around 10% of the existing stock, which renders the proportion of the new supply to the existing stock considerably lower than the country average which is 25%.[5] The absorption of the new supply depends, to a considerable extent, on the macroeconomic conditions which will prevail when the supply comes into the market, and - in spite of the very local nature of real estate - on the competition from similar hi-tech and industrial employment zones in region.

5) Please see our Israel Offices report: www.b-bre.com/market_reports.

Summary

Herzliya is the most significant office submarket in Israel outside of Tel Aviv. It is an interesting market also on account of the significant new supply and its influence on the market during the period reviewed here. Examined in the long run (the 3-year period 2009-2011), Herzliya coped well with the new supply. The oversupply reflected in a sharp decline in occupancy rates in 2010 was corrected with the absorption of this supply in 2011, and the bounce in occupancy rates back to their 2009 level. Property prices did not decline, and even rose marginally. It must be noted that occupancy rates in Herzliya are significantly higher than the country average, and that the proportion of future supply to existing stock is lower than the country average. Nevertheless, the effect of the completion of the projects in the pipeline depends, to a large extent, on the macroeconomic conditions and on competition from adjacent submarkets.

REAL ESTATE