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TRENDS AND OPPORTUNITIES:

ISRAEL HOTEL MARKET OVERVIEW

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Although the current state of Israel's economy and hotel market is anything but positive, owing to the recent tensions and conflicts in the country and region, hotels have shown good growth in performance during the past year. From 2012 to 2013 RevPAR (Rooms Revenue per Available Room) has grown tremendously which underlines the tourism potential of the country. Tourism arrivals have also shown decent growth in the same period – even the first half of 2014 was positive with higher arrivals than the previous year. However, the current situation is expected to have a severe impact on Israel's economy and tourism sector. It is clear that many tourists will only start returning to the country once the most pressing issues in the region have been resolved and stability and security can be guaranteed (again). Therefore, international hotel investors are likely to avoid Israel until such a time when the country, economy and tourism industry have stabilised which we hope will be very soon.

Highlights

- The outlook for the market is difficult to predict due to the recent events. However, room rates in Tel Aviv, in particular, are high, which illustrates the long-term potential of the hotel industry;
- Our analysis illustrates that hotel values are highest in Tel Aviv, followed by Eilat and Jerusalem, both significantly above those in the Dead Sea and Haifa areas;
- International investment appetite for Israel hotels currently remains weak due to the associated perception of high risk. In addition, historically, hotel transactions have been driven by more local, domestic players with Fattal Hotels and Dan Hotels being the most active companies;
- Opportunities for hotel development do exist generally. Several international hotel brands have already established a presence in Israel but there are still many companies which have not developed hotels in the country. Israel has a lot to offer with regard to culture, nature and leisure, as well as business and conference potential;
- The instability of the country and region remains the main threat for Israel, with the tourism industry being directly impacted (for example, most international airlines temporarily suspended routes to Tel Aviv after a threatened attack on the airport, although, this was swiftly rescinded). The Israel Hotel Association estimates the expected damage of the recent turmoil to Israel's tourism at US$500 million in the third quarter of 2014. Past experience has shown that the country can swiftly recover its tourism business once the military operations have settled back to 'normal'.

Country Overview

Politics, Demographics

Although Israel covers a relatively small area, it contains geographically diverse features. Israel has a population of approximately 8.1 million, the majority of whom are Jewish. It is also home to Arabs, Muslims, Christians, Druze and Samaritans, as well as other religious and ethnic minority groups. Israel's population has shown a growth of 1.9% annually with about 40% living in the centre of the country. The most populous cities are Jerusalem with almost 800,000 and Tel Aviv with about 400,000 people. Israel's government is headed by Prime Minister Benjamin

Netanyahu who leads a coalition that includes his Likud party along with Yisrael Beiteinu, Yesh Atid, the Jewish Home and Hatnuah parties. Israel's political situation is rather complex with various parties involved and often changing coalitions.

Economy

Israel's economy is characterised by its strong service and industrial sectors. The industrial sector mainly focuses on high-tech products, metal products, electronic and biomedical equipment, agricultural products, processed foods, chemicals, transport equipment, military equipment, pharmaceuticals and diamonds (an industry the country is world-famous for). Israel is also well-known for its focus on innovation, research and development. The country is very active in software, telecommunications and high-tech development. Tourism also plays a significant role for Israel's economy as foreign tourist arrivals reached 2.96 million in 2013.

Israel is a small country and relatively poor in natural resources and therefore relies on its trade partners for many goods and services. Recent discoveries of large natural gas reserves off its coast might change the dependence on other countries in the long-term. Its main trading partners for exports are the USA, Hong Kong, the UK, Belgium and China whilst imports mainly come from the China, Germany, Switzerland, Belgium and the USA. As illustrated in the chart below Israel has a strong GDP growth forecast for the coming years with projected growth rates between 4% and 6% whilst inflation is anticipated to remain slightly above 2.5%.

CHART 1: REAL GDP GROWTH, INFLATION, EXCHANGE RATE COMPARISON ISRAEL

	Actual					Forecast				
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP growth (%)	0.8	4.8	4.8	3.4	3.3	3.1	4.1	4.9	5.5	6.0
Consumer price inflation (av %)	3.3	2.7	3.4	1.7	1.5	1.5	2.3	2.5	2.6	2.7
Budget balance (% of GDP)	(5.2)	(3.7)	(3.3)	(3.9)	(3.2)	(2.8)	(2.4)	(1.5)	(0.8)	0.3
Current-account balance (% of GDP)	3.6	2.9	0.1	0.3	2.5	3.0	3.1	3.7	4.4	4.9
Short-term interest rate (av %)	3.7	4.5	5.5	5.6	4.5	3.8	4.3	5.0	5.8	6.0
Exchange rate ILS:US$	3.93	3.73	3.58	3.86	3.61	3.52	3.43	3.35	3.31	3.26
Exchange rate ILS:€	5.51	4.98	4.98	4.94	4.80	4.72	4.36	4.22	4.20	4.11

Source: Economist Intelligence Unit, July 2014

City and Destination Overviews

Jerusalem

This city does not need an introduction. Jerusalem is world famous for its history and culture. Despite a high number of visitor arrivals, demand for hotel accommodation in Jerusalem lags quite significanlty behind Tel Aviv. Average rates and occupancy are both lower in Jerusalem compared to Tel Aviv. Religious travel is an important factor for tourism demand in the city; some travellers might stay with friends or family members. A number of Jewish people from the USA, Canada, France and the UK have purchased apartments in Jerusalem in recent years.

Tel Aviv

Tel Aviv is Israel's second largest city after Jerusalem and benefits from both corporate as well as leisure demand. The city is the financial and economic centre of the country and has the second-largest economy in the Middle East after Dubai. Furthermore, Tel Aviv is a popular tourist destination, particularly famous for its cultural offer, diverse restaurants and nightlife scene. The city is also home to the country's main international airport.

Eilat

Eilat is primarily a leisure destination, located on the shore of the Red Sea. Tourism has become the city's main source of income predominately with leisure tourism but also MICE (meetings, incentives, conferences and exhibitions) demand. Eilat features its own international airport, although it is expected to cease its operation by 2017. It will be replaced by the new Timna Airport, which will feature a longer runway allowing for an increase in the number and landing of larger airplanes.

Dead Sea

The Dead Sea is a well-known tourist area. The sea is world-famous due to its location below sea level and high salt concentration with a variety of spa and other treatments available. The hotel sector is almost entirely leisure driven and demand for hotel accommodation is not as strong as Eilat, Tel Aviv or Jerusalem.

Haifa

Haifa is Israel's third largest city with a strong industrial focus. The city has oil refineries and is also home to Israel's largest port and oldest business park. Hotel demand is predominalty business related but average rates in hotels are rather low compared to Tel Aviv, Jerusalem and Eilat.

Tourism Demand

As the chart below illustrates, domestic bednights in hotels have been gradually increasing over the last few years and enjoying a greater importance than foreign tourism. Bednights from international travellers declined from 2011 to 2012 and remained static during the last year. A significant portion of the travel demand is due to religious travel (one of the main reasons for travelling) as well as those visiting friends and families.

CHART 2: DEVELOPMENT OF BEDNIGHTS IN ISRAEL HOTELS

Year	Total	% Change	International	% Change	Domestic	% Change
1997	16,123,000	—	8,145,100	—	7,977,900	—
1998	16,057,600	(0.4) %	7,079,200	(13.1) %	8,978,400	12.5 %
1999	18,681,600	16.3	9,046,800	27.8	9,634,800	7.3
2000	19,546,600	4.6	9,676,400	7.0	9,870,200	2.4
2001	15,113,300	(22.7)	3,825,800	(60.5)	11,287,500	14.4
2002	14,606,600	(3.4)	2,628,200	(31.3)	11,978,400	6.1
2003	15,095,200	3.3	3,285,000	25.0	11,810,200	(1.4)
2004	16,973,500	12.4	4,771,300	45.2	12,202,200	3.3
2005	19,087,000	12.5	6,783,100	42.2	12,303,900	0.8
2006	19,307,700	1.2	6,854,100	1.0	12,453,600	1.2
2007	20,478,600	6.1	8,405,900	22.6	12,072,700	(3.1)
2008	21,595,500	5.5	10,187,500	21.2	11,408,000	(5.5)
2009	19,904,800	(7.8)	8,108,900	(20.4)	11,795,900	3.4
2010	21,863,800	9.8	9,933,100	22.5	11,930,700	1.1
2011	21,860,000	(0.0)	9,949,100	0.2	11,910,900	(0.2)
2012	22,137,800	1.3	9,750,400	(2.0)	12,387,400	4.0
2013	22,474,000	1.5	9,747,200	(0.0)	12,726,800	2.7
Compound Annual Growth Rate 1997-13		**2.1 %**		**1.1 %**		**3.0 %**
Source: Central Bureau of Statistics						

With regard to the importance of source markets for tourist arrivals, the USA accounts for the highest number of international tourist arrivals, followed by Russia, France, Germany and the UK.

Seasonality

Visitor demand peaks around the Jewish festivals of Passover (which normally takes place in April or occasionally in late March), Sukkot (usually in October or sometimes in late September), preceded by the High Holy Days in September. July and August are particulalry popular months for leisure tourists from France and the UK.

Tourism demand in Israel has been impacted by global events as well as the various conflicts. Historically, the tourism demand has been able to recover relatively quickly once the situation has 'stabilised' again.

CHART 3: MOST IMPORTANT SOURCE COUNTRIES

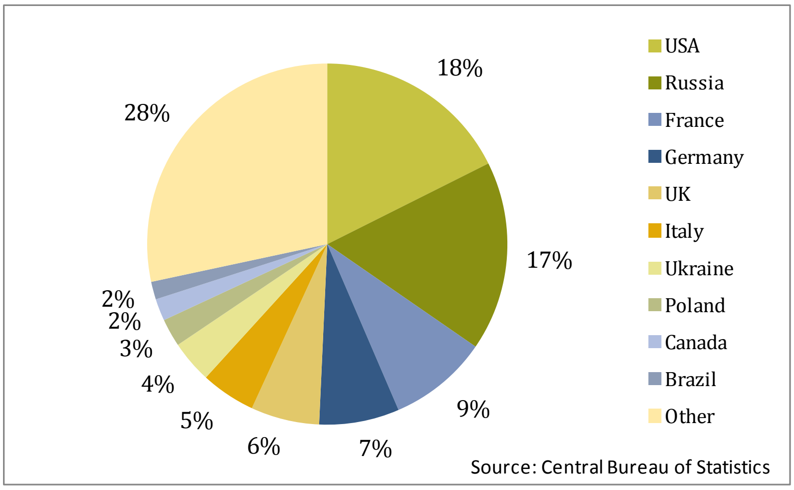


CHART 4: SEASONALITY ISRAEL, TOURIST ARRIVALS 2012 AND 2013

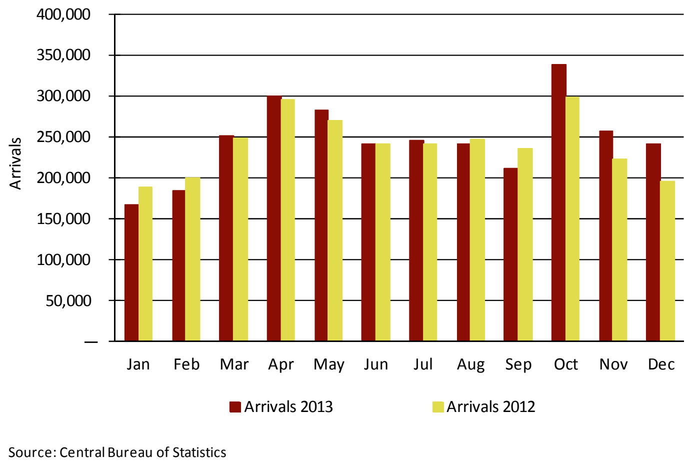
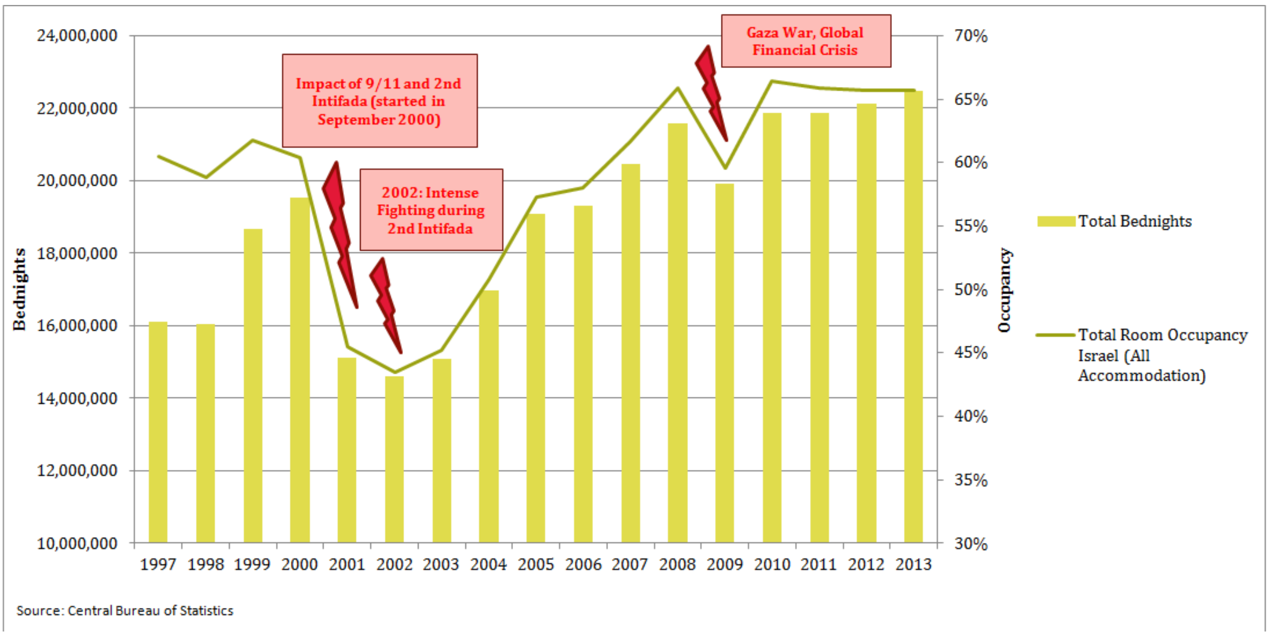


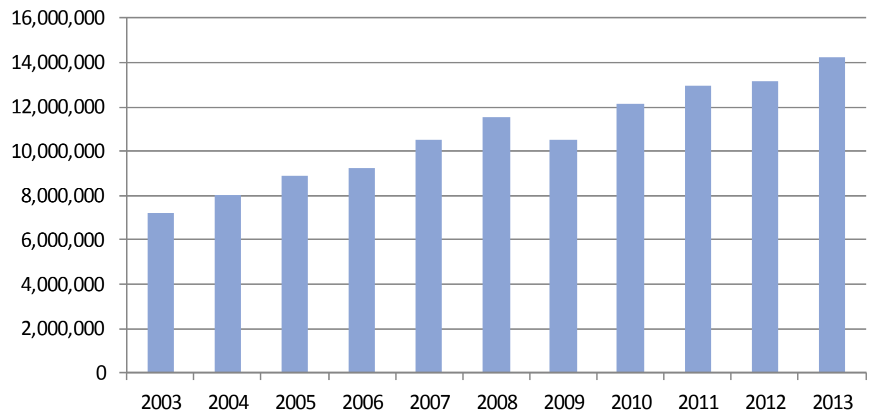
CHART 5: IMPACT OF CONFLICTS AND GLOBAL EVENTS ON TOURISM DEMAND AND OCCUPANCY



Airport Demand

Airport arrivals at Israel's main airport, Ben Gurion International Airport Tel Aviv, have gradually increased over the last ten years and grew at a compound annual rate of 7.1% from 2003 to 2013. In terms of passenger arrivals, Israel's main airport is the seventh busiest airport in the Middle East behind Dubai, Jeddah, Doha, Riyadh, Abu Dhabi and Tehran.

CHART 6: ARRIVALS BEN GURION INTERNATIONAL AIRPORT, 2003 -2013



Source: Israel Airport Authority

Hotel Market

Supply

With regard to new supply, few new developments of international quality, branded hotels have been publicly announced. Developers are experiencing difficulties raising capital for projects due to the currently high risk of the business environment.

CHART 7: OVERVIEW OF EXISTING SUPPLY

Number of Hotels	Tel Aviv	Eilat	Jerusalem	Dead Sea	Haifa
Five-Star	18	14	8	7	4
Four-Star	31	17	30	5	10
Three-Star	15	11	17	4	3
Others	39	15	31	13	10
Total	**103**	**57**	**86**	**29**	**27**

Source: HVS Research

CHART 8: NEW SUPPLY ISRAEL

Proposed Property	Hotel Group	Location	Number of Rooms	Opening Date
Ritz-Carlton Herziliya	Marriott	Herziliya	110	Opened December 2013
Waldorf Astoria Jerusalem	Hilton	Jerusalem	226	Recently Opened
Leonardo Plaza Netanya	Fattal Hotels	Netanya	170	4th Quarter 2014
Herods Herzliya	Fattal Hotels	Herzliya	250	4th Quarter 2014
W Tel Aviv - Jaffa	Starwood	Tel Aviv	125	2015

Source: HVS Research

Demand

Tel Aviv is Israel's largest hotel market. Eilat, interestingly, has a large proportion of five-star hotels which explains to a certain degree the higher average rate than Jerusalem. Overall, average rates grew well between 2012 and 2013 for all destinations.

In Tel Aviv, average rates increased by approximately US$10 from 2012 to 2013 and remain at a high level of more than US$230. Hotels' average rates in Eilat and Jerusalem are at lower levels than in

CHART 9: OCCUPANCY AND AVERAGE RATE COMPARISON, IN US$

	2012			2013			Sample Size
	Occupancy	ADR	RevPAR	Occupancy	ADR	RevPAR	Rooms
Tel Aviv	73%	224	164	71%	234	167	2,941
Eilat	70%	173	122	73%	188	137	3,820
Jerusalem	63%	161	101	63%	167	104	3,935
Dead Sea	77%	106	82	78%	117	91	1,883
Haifa	57%	77	44	58%	87	51	776
Israel (Average)[1]	69%	178	122	70%	190	133	13,355

Source: HVS Research

[1] The average of the samples of hotels in the five destinations

Tel Aviv, but they also experienced good growth during the aforementioned period. The Dead Sea and Haifa's rates are much below the Israel average, mainly due to the absence of high-profile, luxury hotels and clientele.

Hotel Values

The below indications for hotel values in Israel are based on 2012 and 2013 trading results and are based on the assumption that the country, its economy and tourism sector are stable, not taking into account the recent situation of the country. Israel hotel values do not reach the same level as the top European cities, such as the likes of Paris, London, Geneva or Rome. Tel Aviv, however, is well in line with the European average. Israel's best performing hotel market demonstrates strong rates and a more healthy profit margin (EBIDTA levels) albeit there are extra costs for security, Kosher food supervision and higher costs of certain materials.

CHART 10: VALUE PER ROOM (US$) SELECTED CITIES ISRAEL

	2012	2013	% Change
Tel Aviv	281,277	**298,906**	6%
Eilat	179,479	**201,877**	12%
Jerusalem	175,238	**181,630**	4%
Dead Sea	108,507	**120,923**	11%
Haifa	66,644	**77,278**	16%
Israel (Average)	**162,229**	**176,123**	**9%**

Source: HVS Research

CHART 11: VALUE PER ROOM (US$) SELECTED CITIES EUROPE

	2012	2013	% Change
Paris	897,603	**912,600**	2%
London	850,678	**850,518**	0%
Geneva	613,888	**580,665**	-5%
Rome	480,743	**492,017**	2%
Istanbul	466,706	**415,351**	-11%
Amsterdam	382,962	**401,288**	5%
Barcelona	315,195	**330,903**	5%
Berlin	246,594	**245,558**	0%
Prague	235,727	**235,736**	0%
Athens	141,648	**152,353**	8%
Europe Average	**323,677**	**325,480**	**1%**

Source: HVS Research

Hotel Investment

Few publicly available transactions have been recorded in Israel. Buyers and sellers remain primarily domestic. Sale prices are somewhat below our value indications on a per room basis. However, it should be noted that the few transactions are of limited use for the assessment of a hotel's value. Due to the lack of available data, deals would be typically analysed on an estimated future cash-flow basis rather than historic yield or sales price comparison.

CHART 12: TRANSACTIONS (US$)

Date of Sale	Property	Location	Number of Rooms	Price (US$)	Price per Room (US$)	Buyer	Seller
Aug-12	Leonardo Inn Hotel Jerusalem	Jerusalem	185	17,500,000	95,000	Kevin Bermeister and partners	Kedem Hotel Jerusalem Ltd
May-10	Regency Jerusalem Hotel	Jerusalem	505	47,000,000	93,000	Dan Hotels	Promotora Dinamo
Jul-09	Portfolio of 11 Hotels in Israel	Various Locations	2980	247,300,000	83,000	Fattal Hotels	Azorim Investment
Jul-09	Golden Tulip	Beersheba	250	25,500,000	102,000	Fattal Hotels	Eldan Properties Ltd
Mar-08	Golden Tulip Club & Golden Tulip Privilege	Eilat	282 & 247	60,000,000	113,000	Fattal Hotels	Yitzhak Tshuva
Mar-08	Mercure B and P Tel-Aviv	Tel Aviv	103	16,600,000	161,000	Gertler Familly	Avner Levy
Apr-07	Sheraton Moriah Israel (56.5% stake)	Tel Aviv	88	23,800,000	272,000	Azorim Development and Construction	Koor Industries

Source: HVS Research

About HVS

HVS is the world's leading consulting and services organisation focused on the hotel, mixed-use, shared ownership, gaming, and leisure industries. Established in 1980, the company performs 4,500+ assignments each year for hotel and real estate owners, operators, and developers worldwide. HVS principals are regarded as the leading experts in their respective regions of the globe. Through a network of more than 30 offices and 450 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. **www.hvs.com**

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With offices in London since 1990, **HVS London** serves clients with interests in the UK, Europe, the Middle East and Africa (EMEA). We have appraised some 4,000 hotels or projects in 50 countries in all major markets within the EMEA region for leading hotel companies, hotel owners and developers, investment groups and banks. Known as one of the foremost providers of hotel valuation and feasibility studies, and for our ability, experience and relationships throughout Europe, HVS London is on the valuation panels of numerous top international banks, which finance hotels and portfolios.

In Israel, HVS has worked on hotel valuations and feasibility studies throughout the country, in Jerusalem, Tel Aviv, Herzliya, Netanya, Akko, the Dead Sea, Mitzpe Ramon and Eilat. Russell Kett has been a regular speaker at the annual conferences of the Israel Hotel Association and other events.

We are grateful to the many hoteliers in Israel who provided operating data and other information for this report. We would welcome the participation of more hoteliers to enable more representative of the country's hotel sector.

About the Authors

Christof Bertschi is an Associate with HVS London. He joined the company in 2012 after completing his Bachelor of Science in International Hospitality Management at the École hôtelière de Lausanne, Switzerland. Prior to HVS, Christof worked in Switzerland and the UAE. Since joining the London office, he has worked on valuations, feasibility studies and consulting mandates in the UK, France, Germany, Switzerland, the Czech Republic, Poland, Belgium, Croatia and Burundi.

Russell Kett is Chairman of the London office of HVS and also serves on the worldwide Board of HVS. He has 35 years' specialist hotel consultancy, investment and real estate experience, focused on providing valuation, feasibility, shared ownership, property, brokerage, investment, asset management, strategy and related consultancy services, advising hotel companies, banks, developers and investors on all aspects of their hospitality industry related interests, throughout the EMEA region. Russell is a frequent writer, moderator and speaker on the international hotel industry, especially topics relating to hotel valuation, investment, marketing and finance. He lectures at leading international hotel schools including Ecole Hôtelière de Lausanne, IMHI-Essec in Paris, Cornell University, and Oxford Brookes University. Russell received a Lifetime Achievement Award by HOSPA, the hospitality professionals association, in 2011. He is a frequent visitor to Israel and maintains a home there.

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