



Market Snapshot – Jerusalem, Israel

Alexandre Smertnik, Associate
Russell Kett, Managing Director

HVS - LONDON OFFICE

7-10 Chandos Street
Cavendish Square
London W1G 9DQ
+44 20 7878 7700
+44 20 7878 7799 (Fax)

3 November 2008

Market Snapshot – Jerusalem

This article has been published by HVS – London Office

As the spiritual and political capital of Israel, Jerusalem is host to the prominent hotel market of the country and includes landmarks such as the King David Hotel opposite the old city walls. The following article, which we initially released on 14 November 2008, regularly refers to the ‘political instability’ of the region. The current military action taking place in the Gaza Strip is an unfortunate, yet clear illustration of this instability. It is very difficult to assess the negative effect of such an action on the hotel industry and market interpretations/forecasts should be viewed in context.

National Economic Overview - Israel

Israel’s economic growth over the last five years has shown strong signs of recovery after the cooling effect of the Second Intifada as GDP grew by 4.8% in 2004, 5.6% in 2005, 5.2% in 2006 and 5.3% in 2007. However Real GDP growth is now expected to slow in 2008 and 2009 to 4.0% and 3.5% but remain robust, as forecasts predict that it will top 4% after 2009. A relatively strong currency supported by export growth and inflows of foreign direct investment and portfolio investment will help keep inflation in check even though domestic demand should remain strong and wage and domestic price pressures will probably increase in 2008-09.

City Overview

Jerusalem is the capital of Israel and its largest city in terms of both population and area: 730,000 residents in an area of 125 km². Located in the Judean mountains, between the Mediterranean and the northern tip of the Dead Sea, modern Jerusalem has grown up outside the Old City.

The city’s gateway by air, and the airport at which the majority of foreign tourists arrive, is Ben-Gurion International, which is 50 km away, roughly 30-45 minutes by car. Most domestic visitors travel around the country by car.

Jerusalem is primarily a tourist destination, though it does attract some commercial business on account of its commercial centres as well as its standing as the capital of Israel. The city thus benefits from many different types of demand for hotel accommodation. Depending on the security situation, the accommodation business mix can change significantly.

Throughout the year, leisure FITs (frequent individual travellers) account for approximately 40% of the demand for accommodation in Jerusalem. Guests coming in groups to attend a religious celebration (weddings, bar mitzvahs/bat mitzvahs), family events or congresses account for approximately 20% of the demand. Larger tour and pilgrimage groups account for 40% of the demand for accommodation.

Significant drivers of commercial (that is, business) visitation to Jerusalem include the following.

- The Knesset, associated government ministries, the Bank of Israel, the Supreme Court, and so forth are all in the city;
- The Hebrew University is located in Jerusalem's Givat Ram and Mount Scopus campuses;
- The city is also a centre for numerous archaeological excavations taking place throughout the country. Archaeologists and volunteers from all over the world visit the region, often to conduct research or work on digs for extended periods;
- Numerous embassies and consulates as well as several NGOs are located in the eastern and western parts of the city;
- Owing to continuing instability in the region, many news agencies, including the BBC, ABC, CNN, Al Jazeera, and Reuters, have offices in the city;
- Major science and industrial parks are scattered throughout the Jerusalem area: in Atarot, Givat Sha'ul, Malha, Pigat Ze'ev, Ram and Har Hotzvim. These parks attract researchers, scientists and other visitors from an international sphere.

Jerusalem is the only city in the world to serve as a centre for the three main monotheistic religions of Judaism, Christianity and Islam. Some of the major tourist attractions in and around Jerusalem are as follows.

- The old city of Jerusalem including the Western Wall and the Western Wall Tunnels, the Temple Mount, the El-Aqsa Mosque and the Dome of the Rock, Via Dolorosa and the Church of the Holy Sepulchre, the Cardo, the Davidson Centre, the Tower of David, Ophel Archaeological Park, and the Armenian Quarter;
- The Church of St Mary Magdalene, The Church of the Paternoster, The Tombs of the Prophets, and King David's Tomb;
- The Yad Vashem Holocaust Museum;
- The Mount of Olives and Mount Zion;
- The Israel Museum, the Bible Lands Museum, the Bloomfield Science Museum and the City of David complex;

- Numerous other museums, parks, cemeteries, war memorials, churches, and so forth;
- A number of bars, restaurants and nightclubs, many of which are centred around Ben Yehuda Street, Shlomzion Street and Rivlin Street.

Infrastructure Improvements Projects

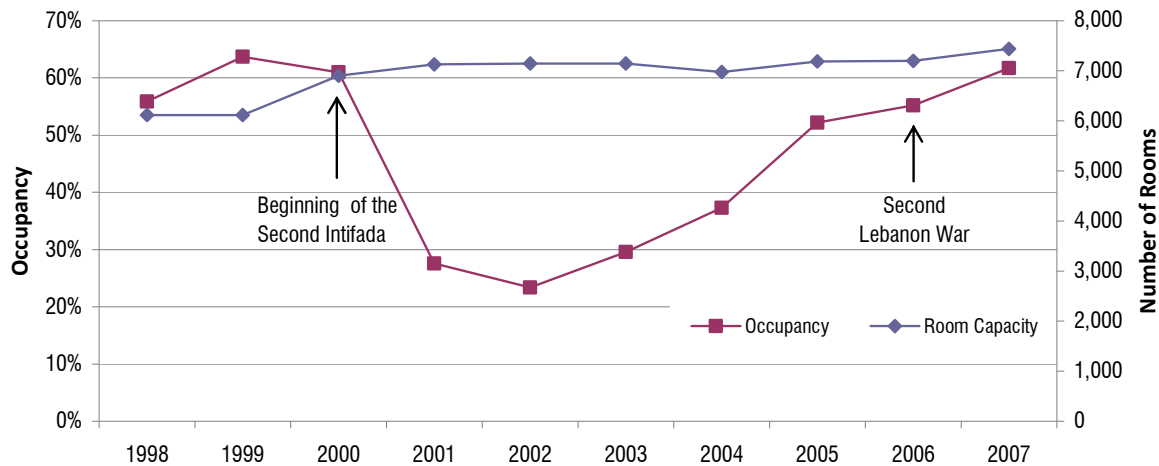
The Jerusalem Light Rail project consists of one and, at a later stage, multiple light-rail lines that will provide rapid public transport in Jerusalem. The first line is currently under construction and is now scheduled for completion around 2010 and is expected to considerably improve the city's transport infrastructure and relieve some of the disruption due to ongoing traffic jams.

A **new high-speed rail line running from Tel Aviv to Jerusalem** is scheduled to be completed in 2011. Its terminus will be an 80-metre-deep underground station serving the International Convention Centre and the central bus station.

We note that the Jerusalem municipality is currently rezoning the city grid in order to improve the city's attractiveness and logistics. As a result, several areas are currently undergoing revitalisation work and street signage is being improved. While demonstrating the efforts the city's municipality is making to develop the city, this process is long and its full impact might not be felt for several years.

Historical Supply and Demand Analysis

Given the city's various attributes and history, 'the holiest city in the world' has significant potential to attract visitors from various regions of the world. However, on account of local political instability, this potential has been affected over the last few decades by repeated conflicts and various forms of random attack. Chart 1 illustrates the effects of this instability.

Chart 1 Supply of and Demand for Hotel Accommodation – Jerusalem

Source: Jerusalem Hotel Association

Chart 1 shows the significant volatility of demand in the market, which is correlated to the political situation in the country. After the Second Intifada broke out in September 2000 occupancy in hotels in Jerusalem fell from 61% in 2000 to 23% in 2002. We can see that before this, room capacity from 1999 to 2000 had increased by 13% in response to rising occupancy, thus creating an even greater disparity between supply and demand from 2001 to 2003. As the effects of the Second Intifada softened, so occupancy gradually recovered, despite a slowdown in 2006 caused by the Second Lebanon War. In 2006 supply remained stable (no new rooms entered the market) and demand growth fell from 44% in 2005 to 6% in 2006, before recovering to 16% in 2007.

The increase in demand for accommodation since 2004 has bolstered average room rates. This has led the Jerusalem hotel market to demonstrate its underlying potential with marketwide RevPAR having experienced double-digit growth in the last three years.

Existing Hotels

We can classify the existing main international quality hotel supply as follows.

- The 'top tier' hotels include the King David Hotel (237 rooms) and the David Citadel Hotel (385 rooms), which benefit from exclusive locations opposite the Old City's walls as well as from world class facilities. Close behind is the Inbal Hotel (294 rooms), which has similar standards of service and facilities but a less prestigious location. The boutique-like American Colony Hotel (84 rooms), a member of Leading Hotels of the World, can be included in this classification, given its standard of service and product; however, less

comparison can be made with the other three properties in terms of the range of facilities and location as well as the nature of the guests they attract. The American Colony has traditionally attracted a broader range of guests drawn from largely non-Jewish sources and it has often been used as a location for informal meetings between Arab and Jewish representatives; the other three luxury hotels serve a largely Jewish clientele;

- Second-tier hotels include four-star and five-star hotels that benefit from similar standards of service and location. The quality of the product and the facilities might differ from property to property, but for the purposes of classification we have ranked them in the same category. These hotels include the Sheraton Plaza Hotel (275 rooms), the Dan Panorama Hotel (292 rooms), the King Solomon Hotel (148 rooms), the Prima Kings Hotel (210 rooms), the Olive Tree Hotel (304 rooms) and the Grand Court Hotel (442 rooms);
- Other hotels are those with a lower standard of product and service or those penalised by a more remote location. Therefore, they possess neither the attributes nor the attractiveness of the aforementioned properties. The Crowne Plaza Hotel (397 rooms), the Ramada Hotel (620 rooms) and the Regency Hotel (505 rooms) are considered to be more suburban hotels, located as they are on the outskirts of the city while the Moriah Classic Hotel (394 rooms), formerly known as the Novotel, is of lower standard.

Future Hotel Developments

Two additional de luxe five-star hotels are expected to enter the market in the coming years: the 192-room Mamila Hotel, which is due to open along the recently developed upscale Mamila shopping mall in early 2009, and the 220-room Waldorf Astoria hotel, which is expected to open in early 2012, opposite the David Citadel hotel, on King David Street. These hotels are expected to increase the city's supply of luxury hotels by approximately 40%. Additionally, there is a Four Seasons project which has been stalled for many years. Dan Hotels recently launched its boutique brand following its acquisition and refurbishment of the former Ariel Hotel.

Conclusion

On the back of improved economic conditions, its history and cultural attributes and the softening of regional tensions, Jerusalem's tourism has experienced strong and even double-digit annual growth over the last few years, revealing the country's significant potential to become a world-leading destination.

However, we consider that the economic slowdown in the main source countries might deter developments in the short term. In the medium to long term we consider that the region's political instability remains a potentially serious threat; however, recent history has shown the country's tourism industry to be remarkably resilient. Given the country's own economic stability and the traditional support shown to the country

by visitors from the USA, France and the UK in particular, it is likely that the Jerusalem hotel market will continue to exhibit strong signs of growth in the years to come.

*No investment decision should be made based on the information in this survey.
For further advice please contact the authors.*

About the Authors

Russell Kett is Managing Director of the London Office of HVS, the leading global specialist hotel valuation, consulting and brokerage firm which was founded more than 25 years ago. HVS has more than 400 hotel specialists around the world and is renowned for (literally) having ‘written the book’ on how to value hotels. Russell has some 30 years’ specialist hotel consultancy, investment and real estate experience and generally focuses on the provision of valuation, feasibility, shared ownership, property brokerage, investment, asset management, strategy and related consultancy services, advising hotel companies, financial institutions, developers and investors on all aspects of their hospitality industry related interests, throughout Europe, the Middle East, Africa and Asia. He is a frequent speaker and writer on international hotel industry and on topics relating especially to the valuation of and investment in hotels, resorts and shared ownership developments, as well as on the hospitality sector generally.

Alexandre Smertnik is an Associate with HVS’s London office, specialising in hotel valuation and consultancy. He joined HVS in 2007, from the Sales and Product Development team of Natixis Asset Management in Paris. Since then he has conducted a number of valuations, feasibility studies, strategic advisories and other consultancy assignments in Europe, Russia and the Middle East. Alexandre holds both French and Canadian nationalities and is a graduate from Ecole Hôtelière de Lausanne, Switzerland where he obtained a BSc in International Hospitality Management.

For further information, please contact one of the authors.

Alexandre Smertnik – Associate, London

Email: asmertnik@hvs.com

Direct Line: +44 (0) 20 7878 7728

Russell Kett – Managing Director, London

Email: rkett@hvs.com

Direct Line: +44 (0) 20 7878 7712