

INTER news

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WAKEFIELD**

June 2013 Edition

National Priority Areas

Carmiel

Beit She'an

Yokneam

Be'er Sheva

Arad

Kiryat Gat

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Dear Readers,

The assignment of National Priority Areas, while providing attractive incentives for businesses, are important tools for drawing added value companies to the Galilee and the Negev, with the goal of

developing significant employment opportunities for these areas. The Government of Israel will shortly reevaluate its zoning of National Priority Areas, which will influence decisions of Corporates as to whether to move to the periphery or to stay in the center of the Country.

In anticipation of changes in both the designation of National Priority Areas and also in the incentives offered, we have interviewed Nadav Gil, CPA, Head of International Grants & Incentives at Deloitte, concerning incentives currently offered to investors and entrepreneurs and where there remains room for improvement. Also on this topic, we have interviewed MK Naftali Bennett, the Economics Minister, who outlines his plans for his Ministry and how to make the Negev increasingly attractive for development. Is Israel taking the right steps to compete successfully with similar countries in attracting international corporations to its periphery? All will be revealed in this newsletter.

Also in this newsletter, we have provided an analysis of the supply and demand in the office rental market for the quarter under review, in Israel's central coastal areas. As per usual, we have provided rental prices for the leading 11 commercial districts in Central Israel, from Netanya in the North to Ness Tziona and Rehovot in the South. Our data shows continued stability in this market both in comparison to the previous quarter as well as when balancing supply and demand.

Have a pleasant read!

Yoram Blumenthal
Partner, Inter-Israel

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The Negev Beckons



Israel's population is concentrated largely in its center, resulting in a sizable countrywide disparity between land available for development and the location of the population. This is particularly noticeable in the Negev, which comprises 60% of Israel's territory yet only 9% of its population.

Israel's periphery, in particular the Negev, is in need of development and funding in order to maximize the country's available land resources. Israel's future growth lies in the Negev and Galilee, yet this is dependent to a large extent on a government strategy to designate these areas as National Priority Areas. Such areas are allocated various benefits and

“Keep in mind, government incentives and benefits are received only by the first plants to be established in a National Priority Area.”

incentives in order to attract investors and entrepreneurs to the country's periphery and to other designated National Priority Areas, in order to be more attractive to industry. For example, Israel has attempted to sway Intel with a substantial incentive package, valued at \$300 million, to build a new plant in Kiryat Gat, though the company has decided to build its next plant in Ireland, due to other considerations. To date, Intel has received about \$1.5 billion in incentives from the Israeli government, out of the \$9.4 billion that Intel has invested in its plants in Israel.

Government incentives and benefits are received only by the first plants to be established in a National Priority Area. The policy's goal is to attract large companies to set up significant activities in these areas. Zoning of areas is updated by the Israeli government periodically and is based on development preferences established by the government. Likewise, those areas designated as “periphery” are updated per national prerequisites and are used as a means to improve opportunities for these areas and their residents. If the economy of a National Priority Area significantly improves, the government may change or even discontinue any incentives for the area.

Where has this policy succeeded and where has it not?

Success stories of National Priority Areas include, in the south, Be'er Sheva (promoting the city as a regional metropolis and providing benefits and incentives for companies and entrepreneurs), Omer and Ofakim; in the sNorth, the Tefen Industrial Park, Migdal HaEmek and Yokneam. In contrast, there are areas where establishment of a National Priority Area has not succeeded in improving the local economy, such as Dimona and Arad in the Southsouth and Bet Shean in the Northnorth. This may be due to adverse conditions such as geographical distance and the lack of sufficient public transportation. The road to success is apparently supported by a combination of factors including proximity to a university or academic center, good public transportation, reasonable accessibility for the local population and an attractive economic package.

Which large companies currently operate in National Priority Areas?

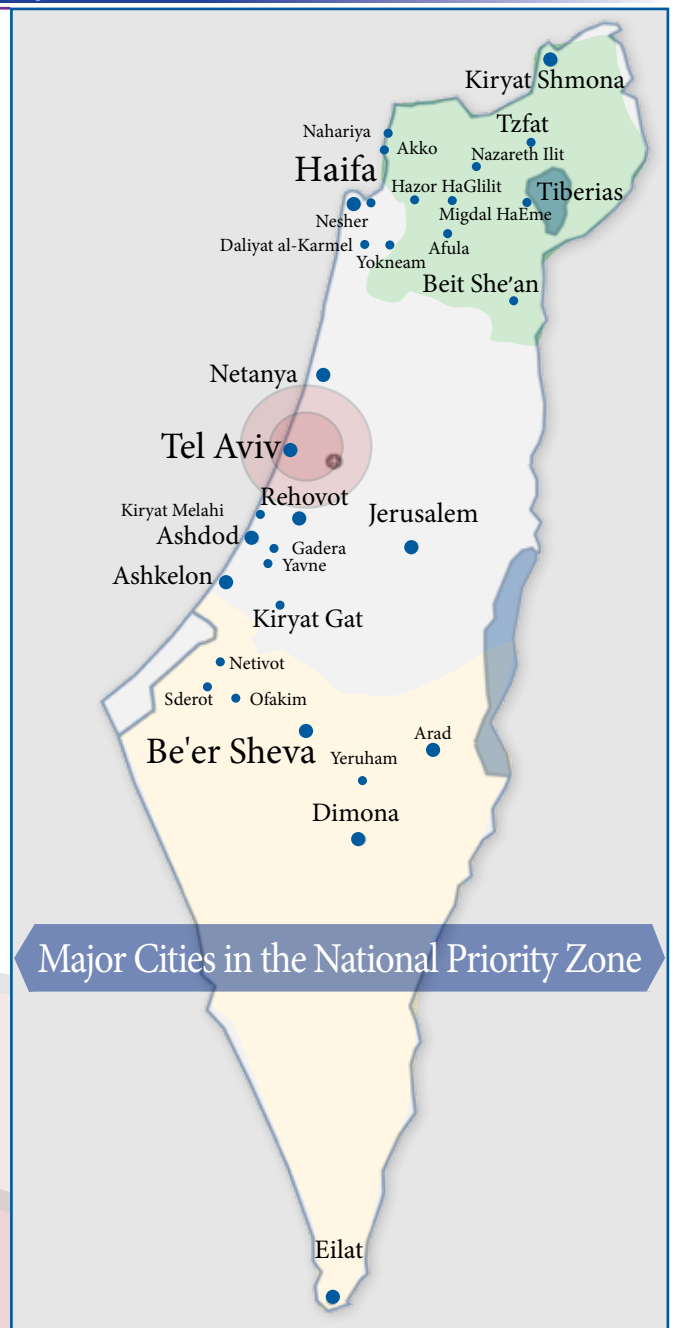
Recipients of benefits include large companies such as SanDisk, with a long-standing presence in Tefen and Omer, Intel, which has established operations in both Kiryat Gat and Jerusalem, Tower Semiconductors in Migdal Haemek, and EMC, Ness Technologies, Deutsche Telecom, dbMotion (recently acquired by Allscripts), Gefen-Dekel Technologies, Oracle, Elbit and many others that have established additional technology development centers in the Be'er Sheva area.

Likewise, there remain many sizable companies, such as Check Point, Nice, Converse and others, who have not expanded operations to National Priority Areas, preferring to remain in the greater Tel Aviv area. These companies speculate that they will have difficulties in hiring suitably qualified manpower in undeveloped regions. In addition, there has recently been seen a significant strategic shift; companies who are establishing a presence in the periphery usually also have a significant presence in Israel's central regions.

For most companies, the economic rationale for establishing additional activities in National Priority Areas can be similar to that of operating "off shore". While the activities of large internationals in Israel are already by definition "off shore", the establishment of local satellite operations can further improve conditions for these companies. A more appropriate term, perhaps, is "near shore" with "off shore" conditions. The actual key driver for expansion of company operations to either the north or the south is the availability of quality manpower. Additional factors may be reduced competition for hiring quality workers while employees can also benefit from improving their quality of life at a reduced cost.

EMC, after recently establishing a development center in Be'er Sheva, has managed to hire qualified workers, despite fears of there being a limited pool of engineers for hire in the south. This was enabled due to the presence of a nearby academic center in Be'er Sheva: Ben-Gurion University of the Negev has excellent, world-renowned departments

"Be'er Sheva, in its expansion as a regional metropolis, provides excellent benefits and incentives for companies and entrepreneurs."



for both Engineering Sciences and Computer Science. Therefore, EMC was pleasantly surprised with the ease with which it achieved the corporate milestone of hiring suitable personnel, and has even led to the expansion of its R&D center in the technology park adjacent to Ben-Gurion University, with the imminent launching of operations.

In sum, there remain many significant potential growth opportunities for large companies in our small Israel, whether located in National Priority Areas or more developed regions. These opportunities are even more significant when taking into account the economic incentives and benefits that are provided by the Israeli government for employment, technology and academic centers. We believe Israel can further improve conditions for attracting additional companies and lead to greater economic growth in designated National Priority Areas, so that cases such as Intel choosing an alternative country as a development site will not repeat.

National Priority Areas

Is Israel Doing Enough and What More Can Be Done?

The map of National Priority Areas is expected to be updated shortly; the market expects a revival in activity and to attract additional large multinationals

The Gav Yam Park Negev technology park, in cooperation with Ben-Gurion University of the Negev and the city of Beer Sheva

to Israel's peripheral areas. We present Nadav Gil, CPA, Head of International Grants & Incentives and the Director of Cleantech at accounting and consulting firm Deloitte Brightman Almagor Zohar, who explains what benefits are currently offered to investors and entrepreneurs and what is required to improve Israel's situation in the global marketplace

If and when changes are made in the zoning of National Priority Areas, some currently designated areas may be rezoned and subsequently cease to offer benefits and incentives to investors and corporations. Other areas may be newly zoned as National Priority Areas, based on priorities set by the government for renewal, development and improving conditions for economically depressed populations. Obviously, before any such action is carried out, the government must sustain heavy political pressures from various interested parties as each decision can have far-reaching

consequences on companies and local employment due to any changes in taxes, benefits and grants. In the long-term, companies who move to these areas will benefit from the new conditions for these industrial zones.

“Yokneam is an excellent example of a successful decision by the government. There is practically no available commercial or industrial space and in parallel we see continuous construction of new buildings. As Yokneam today is a National Priority Area A as well as a world class technology development center and only a 45 minute drive from Tel Aviv, it remains to be seen whether



Nadav Gil

it should still be zoned as a National Priority Area,” stated Nadav Gil, continuing “an additional subject is how to relate to industrial and hi-tech zones that are included in the municipalities of Arab villages. In 2006, these areas were all designated as National Priority Areas A by the government, in order to increase employment opportunities for the local Arab populations. For example, The

“The corporate tax differential between Kiyat Shmona and Tel Aviv is only 6% and not sufficient to motivate companies to expand activities to National Priority Areas.”

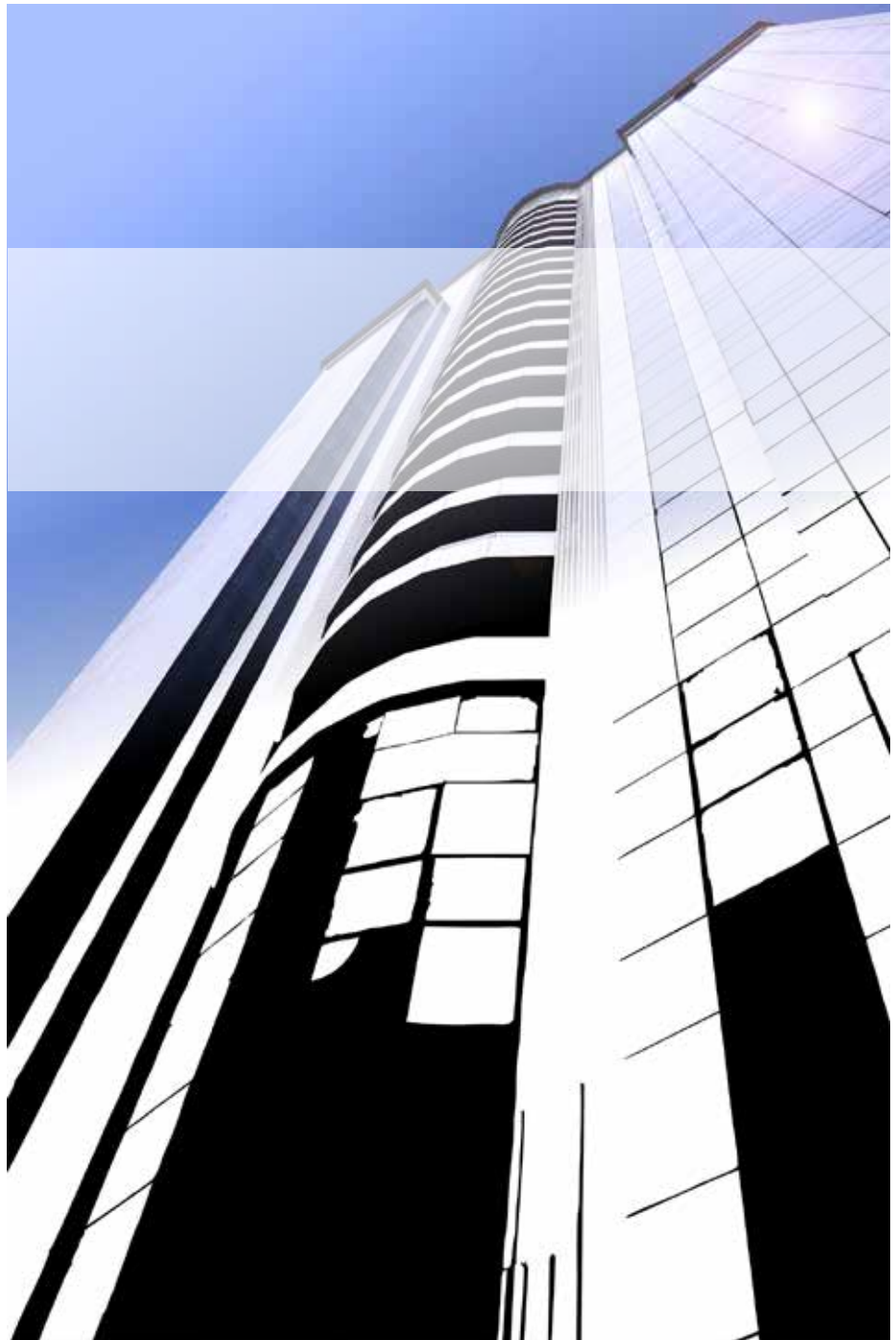
Lev Ha'aretz industrial park, established north of Rosh HaAyin, is considered a National Priority Area A due to its establishment in the municipality of Kafr Qasim, while the adjacent Park Afek Technology Park is only zoned as a National Priority Area C.”

Are there errors or problems with how areas have been zoned?

“The Ministry of Industry, Trade and Labor has established a series of benefits for specific populations designated as “weak” – Arabs and the Ultra-Orthodox. These benefits have been assigned despite the lack of any economic rationale. Superior conditions are provided to companies near the Green Line or that are adjacent to Jerusalem, which lacks employment. Benefits and preferred conditions such as grants for employment and investments, as well as tax benefits and more are therefore given to companies within a very short distance from Tel Aviv.”

In hindsight, can you say that areas were correctly zoned with successful outcomes?

“I’m positive they were. We must remember that following the 2011 update of the Law for the Encouragement of Capital Investments



the corporate tax rate was reduced to 12% for Tel Aviv based companies while those in National Priority Areas such as Kiryat Shmona, were reduced to 6%. This 6% tax differential is not sufficient to motivate companies to expand activities to National Priority Areas. Previous to this, companies who moved to a preferred development area Class A, received a 10 year tax exemption while in Tel Aviv they received only a 2 year tax exemption – a sizable difference. Similarly, available grants to companies today cover only 20% of set-up costs in

“Israel must continue to provide competitive investment conditions to other countries. If we cannot remain attractive – we will see the rapid desertion of these companies.”

a National Priority Area A, which is not enough to make a real difference for companies.”

What therefore needs to be done to improve the success of the program?

“Currently the government is in a process of fiscal reduction, leaving little opportunity for these projects. But if the investment budget could be increased, and investors could receive greater than 20% of their start-up costs, additional facilities would then be established in the periphery, of great benefit to the economy. In short, the government is not applying its resources correctly. It provides employment grants to the periphery, but this isn't enough to attract companies to these areas. Therefore these resources are not properly leveraged due to pressures from other interests, improper decision making and a lack of government budget available today.”

Where are there similar successes elsewhere?

“In India, for instance, there are special economic zones, where anyone who moves there will receive extensive assistance from the state. In Israel, companies need to stand up and actively pursue any benefits offered by the government.”

Are there still obstacles from government bureaucracy?

“We assisted an investor who was interested in investing \$700 million in alternative energy and we have as yet to receive any clear assurances from the government. It is not simple to bring large international projects to Israel, though this has improved with the years. The main problem is budgetary in nature.”

So what does the Country need to do?

“Israel needs to find ways to attract a reliable workforce to the periphery. Incentives provided today are only to the employers, at 40% salary grants for four years for 2.5 times the average salary, and it is not clear that this benefit is passed on in its entirety to the employee. For example, in the Be'er Sheva area, incentives should be given directly to the employees, and not only employees who live in Be'er Sheva or who commute by train to Be'er Sheva but also to all those who live within a 40 km radius of the city.”

Do benefits require the transfer of the entire company to the periphery?

“No, companies are not required to move fully to National Priority Areas. They can maintain their corporate headquarters in the Tel Aviv area and transfer only their R&D activities to the National Priority Areas, while the entire company is then designated

“Israel must continue to provide competitive investment conditions in relation to other countries. If we cannot remain attractive – we will see the rapid departure of these companies.”

as a preferred development are Class A. If only a portion of the R&D is moved to a National Priority Area, the company will receive a mixed basket of benefits, depending on their activities in the different zones. In this manner a company can significantly reduce their

tax rate. For companies with net profits in the hundreds of millions of dollars, each percent interest in taxation can be significant and improve profits dramatically.”

To summarize, which companies would most benefit from relocation to a National Priority Area?

Such a move is recommended for a profitable company that is both operational, pays taxes and can reduce its tax burden or for a company that can benefit from a new workforce. For example, entries to the new technology park in Be'er Sheva can recruit graduates from the Ben-Gurion university. I would also recommend relocation to companies who are considering the establishment of new facilities and are eligible for funding for this purpose. Israel must continue to provide competitive investment conditions in comparison to other countries. If we cannot remain attractive – we will see the rapid departure of these companies. They need to offset risk both in their set-up and operations and subsequently in their profitability. We can find far more attractive investment conditions today in Eastern Europe and other regions. Israel's advantage currently lies solely in its superior human resources.

There are National Priority Areas That Have Failed

Daliyat al-Karmel - “This area received a lot of press and support from the government to attract investment, yet in practice, the challenge was not taken on, due primarily to the difficulty to find suitable employees in the region due to the nature of the population.”

The Park Tzvaim Industrial, Beit She'an – “There are many enterprises that failed here. The cause – poor accessibility, no train or easy connection with Highway 6. A solution is being sought in order to attract new industry.”

Arad – “Be'er Sheva is considered an easier and more attractive option for investment and therefore, despite reductions in city taxes and rentals, there is not enough of a reason for companies to relocate to there. All benefits are temporary and subject to change with time, and so have no real significance.”

Continued Stability

The Commercial Real Estate Sector Remains Strong with a High Occupancy Rate

In this report for the first quarter of 2013, we have analyzed supply and demand for office space in different geographic areas and expectations for the coming year. We have collected data on rental pricing and occupancy rates among offices in 11 submarkets, from Netanya in the north- Central Coastal Region to Nes Tziona and Rehovot in the south - Central Coastal Region. Our data indicates an overall stability in this market with the available supply balancing demand for these geographic areas.

Occupancy Analysis by Area:

Ramat HaHayal – Unoccupied space has declined to 2% in the first quarter of 2013 from 12% in the last quarter of 2012. The “10% empty space” effect,

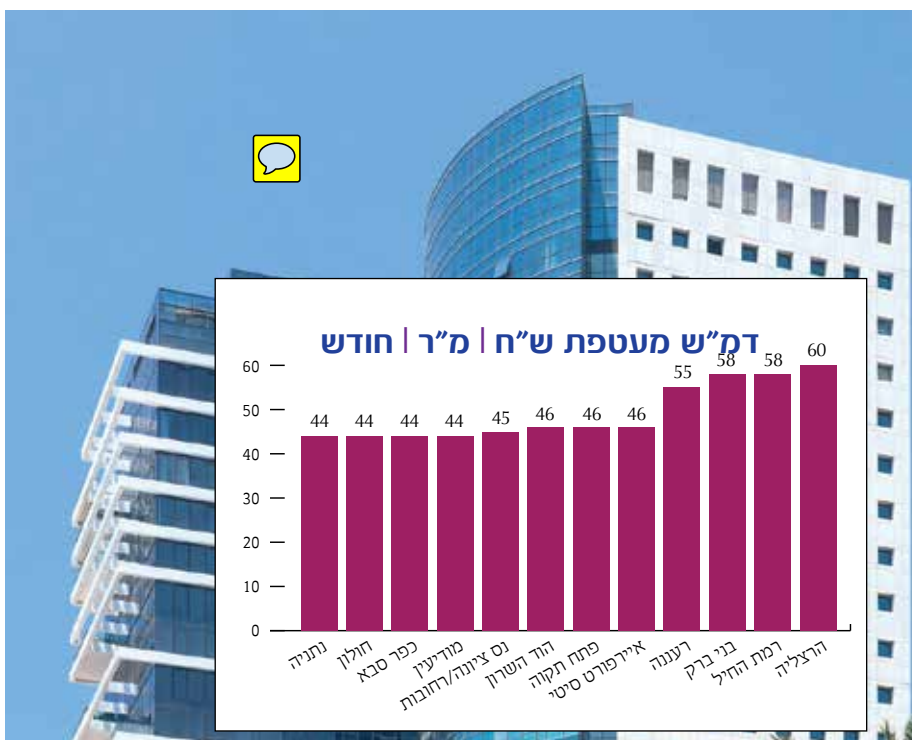
comprising a psychological barrier that has led to price reduction, has been broken in the quarter under review. The drastic reduction in available spaces is a result of the 42,000 sqm Clal Insurance transaction in the new Atidim Towers sqm This lease at what was until recently a white elephant, will neutralize the heretofore negative pricing trend in the area and stabilize pricing Clal Insurance’s occupancy will strengthen the area and is indicative of the area’s metamorphosis from a tech dominated submarket to a diverse submarket, one of the largest in greater Tel Aviv.

Petah Tikva – Two important transactions were closed. The Ministry of Defense leased space in Darban Investment’s (Fishman Group) City

Plaza. In addition, fund manager Excellence Nessuah will relocate its offices from Ramat Gan to Amot’s new Platinum Building. Together, these two deals total 30,000 sqm and significantly reduce the availability of Class A officespace, yet there are still a significant quantity of available office space in Petah Tikva. Tikva

Rosh HaAyin – Occupancy rates at Park Afek continue to decline, further pushing it down the list of areas in demand in the center of the country. This decline stems from a gradual shift of Park Afek in recent years to an area for service providers. The recent large scale workforce reduction among service providers has led to a sharp drop in occupancy rates. Examples that stand out include Orange, due to layoffs, Netvision, which has closed activities at Park Afek due to its merger with Cellcom, Better Place, which has declared bankruptcy, etc.

Ness Tziona / Rehovot – This submarket continues to enjoy stability and very high occupancy rates with the most expensive rents in the southern Tel Aviv suburbs This is the epicenter of the life sciences industry in Israel due to the world renowned Weizmann Institute of Science which borders on the Rehovot side of the submarket Both Africa Israel’s Weizmann Science Park and the neighboring buildings in Rehovot’s Rabin science park have single digit vacancies. Africa Israel has leased the majority of its new Building 11 which will begin occupancy in summer 2013 and Gav Yam’s new Rehovot is currently in the early phases of construction and will not deliver until early 2015.





The Ben-Gurion Airport Area:

Airport City – maintains near 100% occupancy rates. This should have a positive effect on demand in nearby submarkets such as Yehud and Or Yehuda to the west and Modi'in to the east.

Or Yehuda – benefits from its accessibility and low traffic congestion. The first building of Vitania's 45,000 sqm Terminal Park is nearly 100% leased while the second building is currently under construction and expected to deliver in 2014. The Israel National Roads Company and Tahal Engineering have leased 13,000 sqm this quarter.

Yehud – Leading developer Amot's acquisition of the 20,000 sqm three-building HP campus for ILS 240 million (~\$65 M) is indicative of the increased attractiveness of this region. The planned infrastructure improvements and new zoning are expected to spur future development in Yehud.

Lod – Poor infrastructure and the city's negative image continue to weaken office demand, most of which is large self-enclosed campuses by banks and freight forwarding companies.

The Sharon Region:

Herzliya continues to be strong with high occupancy rates and high levels of demand. Two large transactions (~ 6,000 sqm) were carried out in the quarter under review, Regus in the Ackerstein Towers complex and Akamai at Gav Yam's recently renovated Herzliya North complex, a reflection of the continued demand.

Netanya – the Poleg Industrial Zone in south Netanya continues to show stability in rents and overall has a positive outlook.

Kfar Saba – As a result of significantly improved highway access, the Atir Yeda Street corridor in the city's southeast is seeing significant activity. The mixed use Globus City project, currently under construction, and the Oshira office complex in the advanced planning phase, are expected to significantly contribute to the area's attraction for both commerce and entertainment, with all the makings of a highly desirable office submarket. Recently several large office tenants such as Alcatel Lucent, Advise and Elbe have relocated to the area and the solid demand is expected to continue.

Ranaana – The market is expected to remain tight with low vacancy and high rents due to the continued demand, including organic growth from current large users such as HP, NICE, SAP and others. As a result, this will likely increase demand in nearby submarkets such as Kfar Saba and Hod Hasharon.

Hod Hasharon – Demand continues to remain strong because of good highway accessibility and tight supply limited. Abbott Laboratories and Qualcomm are relocating to approximately 5,000 sqm in summer 2013. Developer Ashtrom is expected to break ground in summer 2013 on a 20,000 sqm office building within its Hod Hasharon Towers complex. Prices are expected to continue to remain stable.

Leading Business Centers in the Tel Aviv Area

In addition to our above analysis of supply and demand for office space in cities in Central Israel, we have also summarized our methods of analysis for the lead Tel Aviv business districts for the quarter under review.

Our survey encompasses office space totaling more than 2,000,000 sqm in 78 buildings in the greater Tel Aviv area. Of this, 1.43 million sqm was located in the six submarkets that comprise Tel Aviv's CBD, including the adjacent Diamond Exchange district in Ramat Gan. An additional 625,000 sqm was covered in outlying areas of Tel Aviv, including Ramat HaHayal, with its large tech and media concentration, and Bnei Brak's rapidly developing BBC district adjacent to Ramat Gan's Ayalon Mall. For analytical purposes, we have divided the market into two areas: (1) CBD and Greater Tel Aviv. Among the 78 buildings surveyed, 27 were single tenant buildings.

Main Conclusions

In contrast to the large blocks of available space in the outlying business submarkets, there is very limited space in Tel Aviv's CBD submarkets. The oversupply in outlying districts declined in the quarter under review, specifically due to the Clal Insurance transaction in the Atidim Tower in Ramat HaHayal.

The office rental market maintains its strength with high occupancy rates. In the quarter under review, there were a number of large transactions including Clal Insurance, DS Meitav, Israel's Department of Defense, Excellence Nessuah and others, with a common denominator being that all transactions occurred outside the central business districts of Tel Aviv. As described in the previous quarter's review, the outlying Tel Aviv districts (Ramat HaHayal and BBC) continue to offer a worthy alternative to the CBDs and attract companies with large office

requirements which had previously spurned areas such as Petah Tikva, Ramat HaHayal or Bnei Brak.

Average Monthly Rental Prices in the CBD increased to ILS 97/sqm from ILS 96/sqm in the previous quarter and from ILS 93/sqm in Q3f 2012. The Financial District / Rothschild Boulevard submarket maintains the highest rents at ILS 114/sqm, followed by the Courthouse / Shaul Hamelech submarket at ILS 110/sqm, principally due to very limited supply. The Manshiya submarket on the Tel Aviv's southern shore continues to have the lowest rent at ILS 78/sqm on average, mostly due to accessibility and transportation issues.

Growth in Occupancy

In the quarter under review, occupancy rates jumped by 21,000 sqm in the CBD submarkets (not including Ramat HaHayal and BBC) following a decline in the previous quarter to 13,500 sqm from 17,500 sqm in the third quarter of 2012. The market high was recorded in the first quarter of 2011 with a rise in occupancy of 66,000 sqm. Total occupancy rates for the outlying Tel Aviv markets remain at 97%.

Office Rental Price Levels remain stable, or rather, with a very slight average rise of ILS 97/sqm/month from ILS 96/sqm/month in the previous quarter (not including Ramat HaHayal and BBC).



Interview with the Minister of Economy, Nafatli Bennett

The Ministry of Economy Advances Plans to Establish Nine Large Industrial Areas in the Northern and Southern Periphery



MK Naftali Bennett

The new minister, Naftali Bennett, has recently been given responsibility over the Ministry of Economy, better known by its previous name of the Ministry of Industry, Trade and Labor. Amongst other things, the Ministry is responsible for development, finance and support of industry, businesses, investors and of course, National Priority Areas. We have asked the Minister about his ministerial duties and the plans of his Ministry in regard to anticipated zoning changes for National Priority Areas.

Minister Bennett, the map of National Priority Areas was scheduled to be updated in May 2013, which has not yet happened. Should we expect to soon see changes in benefits being offered for companies and entrepreneurs to relocate to a National Priority Area?

“Eligibility criteria for each

Minister of Economy, MK Naftali Bennett:

”Factories that relocate from Israel’s center to these areas will be eligible for benefits for relocation, construction and equipment purchases as well as support for manpower absorption”

locality is based on a combination of geographical location and socio-economic standing, except for the Arab sector, where every township has been classified as eligible. Support is given to export-oriented industries and there is no map of National Priority Areas. In May, the finance committee approved extension of current eligibility criteria until 2014. The Economics Ministry is promoting a plan for the establishment of nine general industrial areas to serve a number of regions in the periphery. In the North: Shfaram, Bet Shean, Nahariya, and Rosh Pina; in the South:

“In remote townships such as Dimona, Arad and Yeruham, we expect to see significant economic and community growth following the relocation of the IDF’s Training Campus to the Negev in 2014”

Dimona, Be’er Sheva and Netivot. Companies that relocate from the center to these areas will be eligible for benefits for relocation, construction and purchase of equipment as well as support for manpower absorption.”

Be’er Sheva, as a National Priority Area A, is considered an excellent option for companies and entrepreneurs and therefore, despite benefits given to adjacent cities, few companies choose

to move to satellite towns of Be’er Sheva. Why is that?

“Be’er Sheva has ways to grow and to really establish itself as a leading metropolitan area in Israel’s South. In order to develop the South, we must first develop a significant regional center established on education, employment and community. Be’er Sheva is certainly growing and this is the best way to also advance its satellite towns. Establishment of a new hi-tech area next to Ben-Gurion University, transfer of various army facilities to the area, and the relocation of technology companies, is making Be’er Sheva and its vicinity attractive to international investment.

In remote townships such as Dimona, Arad and Yeruham, we expect to see significant economic and community growth following the relocation of the IDF’s Training Campus to the Negev in 2014 and the Intelligence and C4 bases in 2019. This will led by an inter-ministerial effort that will allocate significant tools and resources to leverage the relocation of IDF operations to the Negev. The program will be brought for approval in the coming weeks. Part of the program includes an industrial zone near Dimona that will also serve Arad and Yeruham and contribute greatly towards development of the Eastern Negev.”

In Israel 2013, it remains difficult for many companies to receive government grants and aid. The feeling is that these incentives cannot

be relied upon for cash flow as it is not apparent if and when this assistance will be received – what is your opinion on this and how do you plan to improve the situation?

“There are indeed limits on the budget and resources available and our professional department processes applications according to instructions from the general comptroller. The bureaucratic load is certainly a fundamental problem for government assistance in National Priority Areas and this can certainly be improved. The Economics Ministry will prioritize steps to manage the bureaucracy. While there is a need for the existence of appropriate bureaucratic management of public funds, these funds can be relied upon once the proper approvals are given. Of course, this also relies upon availability of the budget.”

What are the plans of your Ministry for the next few years to make the Negev an even more attractive place?

“From an employment perspective, our Ministry provides various employment programs for the Negev, such as a program for advancing regional employment, with a holistic influence on employment centers, advancing opportunities to job seekers in Dimona and Yeruham. Additionally, there are certain preferences in criteria for the establishment of daycare centers in the Negev.”

“From an industry and business perspective, there are various programs attracting international corporations to the technology parks in Be’er Sheva and Omer, plans to establish extensive industrial areas in Dimona and Be’er Sheva, and special resources applied to strengthen small and medium size businesses in the Negev, in order to increase their chances of being awarded government tenders and increase their portion of the budget assigned for relocation of IDF bases to the South.”

“Be’er Sheva is certainly growing and this is the best way to also advance its satellite towns. Establishment of a new hi-tech area and the relocation of technology companies, is making Be’er Sheva and its environs attractive to international investment.”