



# The Split Housing Market:

Market Forces, the Housing Crisis,  
and the Forgotten Vision

Shlomo Swirski | Yaron Hoffmann-Dishon

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Adva Center

P.O. Box 6136401

Telephone: 972-3-5608871

Fax: 972-3-5602205

[www.adva.org](http://www.adva.org)

[contact@adva.org](mailto:contact@adva.org)

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# Executive Summary

For over three decades, and increasingly since 2000, housing policy in Israel has been in the thrall of a "free market" ideology, as the responsibility for constructing homes for Israelis shifted from the government to the private sector. No longer does the Israeli government reach deep into its pocket to plan and erect housing projects; now both the financing and construction are in the hands of the "free market," while the state benefits from housing activity as a significant source of income.

"Free market" policies have deepened gaps that were already formidable, while an ever-growing stratum of the population struggles to attain "suitable and affordable housing" – once the vision of the Ministry of Construction and Housing. The "free market" policies, however, have created a relatively narrow, affluent stratum that has only enhanced its resources. With the outbreak of the financial crisis in 2008, individuals in this stratum diverted significant funds to real estate, contributing to the rise in housing prices and ultimately leading to the so-called "real estate bubble."

The "free" housing market today thus reflects clear class divisions, and can be viewed – to borrow a concept from sociologist Edna Bonacich<sup>1</sup> – as a **split housing market**.

Ever since the social protest in the summer of

2011, housing has topped the list of public priorities. But housing prices have continued to rise since then, with a concomitant drop in homeownership, particularly among young people. The high price of housing has undermined the ability of young adults in Israel to own their own home.

The social protest and public debate have prompted government pronouncements about its desire to resolve the housing crisis. These, however, have not yielded real policy change, nor have they ended the downward trend of homeownership, the spiraling cost of housing, or the increasingly heavy financial burden experienced by most Israelis who purchase a home, particularly young couples. The problem that brought thousands of Israelis into the streets and elicited promises by two successive finance ministers, Yair Lapid and Moshe Kahlon, remains unresolved.

Why, despite all the promises and declarations, have successive Israeli governments failed to find a comprehensive solution to the housing crisis?

We argue here that one key factor explaining this is the clear class division in Israeli society and the ability of a relatively small group of affluent Israelis to dictate policies that will line their own pockets. These are policies made by a range of government institutions involved in the housing issue – the

Ministry of Finance, Ministry of Construction and Housing, Bank of Israel, Israel Land Administration, and local authorities. All these are reluctant to undertake measures that could have an adverse effect on the accumulated wealth of this affluent stratum, as their wealth serves as the economic engine for all of Israel: Their savings turn into business investments and the taxes they pay are the main source of state revenues. Israeli governments have also been sensitive to the pressure brought to bear by powerful players in the private sector – the big banks and real estate developers – for whom the real estate activity of the affluent is a direct source of profit.

This paper also points out that current government policies not only do not benefit the public at large, but undermine the Israeli economy as a whole, as monies that could have been invested in economic growth and job creation are now diverted to the housing market.

Thus, as long as government policies subscribe to a "free market" ideology, the market forces in housing will continue to favor the moneyed class, rather than prioritizing the needs of most Israelis. Given this situation, the government's vision of "suitable and affordable housing in an appropriate neighborhood for every family" remains a vision unrealized.

Below are the main findings that are more fully explicated in this paper.

## **The share of the affluent in the housing market**

1. In 2014, the average price of an apartment owned by those in the top income decile was some 76% higher than an apartment owned by the rest of the population (approximately NIS 2.54 million on average in the top income decile compared with NIS 1.44 million for an average apartment owned by those in income deciles 1–9).
2. Among the top income quintile (deciles 9 and 10), ownership of two or more apartments rose from 8.9% in 2008 to 22.4% in 2013. In the next two deciles (7 and 8), the rate rose from 4.5% to 9.6%.
3. In 2016, some 54,000 households in Israel owned three apartments or more; the average gross monthly income of these households was NIS 46,000, while the average gross monthly income of all households in Israel (in 2014) was roughly NIS 18,000. The median income that year was NIS 14,000.
4. In the years 2002–2013, approximately 280,000 apartments purchased were defined by the State Revenues Authority as investment properties. Families in the top income decile purchased apartments valued at approximately 40% of the value of all investment properties; the top 1% alone purchased apartments valued at almost 10% of the value of all the investment properties during this period.

## The housing crisis

1. Among young married couples aged 20–29, homeownership dropped from 55.8% in 1997 to 43.3% in 2012. Among those aged 30–39, it dropped during this period from 74.3% to 63.4%. Conversely, the percentage of homeownership among married couples aged 50–59 rose from 86.1% in 1997 to 87.8% in 2012; and even higher among those aged 60+ – from 78.9% to 86.7%.
2. In the period 2003–2013, homeownership fell among those in the middle–income deciles – by 7.5% in decile 4 and 6.1% in decile 7.
3. Between 2007, the eve of the financial crisis, and 2015, the price of apartments doubled while the average wage rose by 25% and the median wage rose by a few percentage points.
4. The housing problems of Arab citizens of Israel are particularly acute: Because of limitations on development as well as the lack of planning or government investment, these towns are densely populated, have a lower standard of living, and their infrastructure is dilapidated or nonexistent. Arab localities are generally not included in country–wide housing plans.

## Housing market activity of government arms

1. The budget of the Ministry of Construction and Housing, which had been NIS 9.84 billion in 2000, declined to NIS 1.89 billion in 2015 (at 2015 prices). The budget of this ministry, which had constituted 5.14% of the state budget in 1995, was only 0.5% of the state budget in 2015.
2. In 2014, the Finance Ministry collected a total of NIS 7.7 million in real estate taxes, a real increase of 66% from 2004. In addition to direct revenues from real estate taxes, government coffers were also filled by the payment of VAT on new apartments – this amounted to NIS 7.6 billion in 2015, according to the Bank of Israel.
3. In recent years, and particularly since 2013, the number of housing units included in successful tenders issued by the Israel Land Authority (ILA) has increased and stabilized at 30,000 housing units a year. ILA revenues hit a record high of NIS 9.4 billion in 2015.
4. Low interest–rate policy set by the Bank of Israel is one of the main factors in the rise of housing prices and creation of the real estate bubble since 2008. At the same time, Bank of Israel policies rest on the assumption that a sharp drop in housing prices could lower the value of property and ultimately contract economic activity and consumption, a dynamic that could harm the economy.

## **The big banks and real estate companies**

1. In 2007, the banks issued some NIS 2 billion in mortgages monthly; by 2015, this had increased 2.5 times to NIS 5.4 billion.
2. Construction and real estate continued to be the industry to which the most bank credit is extended. In 2015, some 29.3% of the credit issued to the business sector went to construction and real estate, higher than any other industry in the business sector.
3. Between 2005 and 2015, bank net profits almost tripled from home mortgages and loans to the construction and real estate business. In 2015, the five largest bank groups earned a net profit of NIS 926 million from mortgages and NIS 2.2 billion from credit to construction and real estate companies.
4. The average gross profit made on residential housing projects by Israel's largest public real estate developers rose from 16% in 2007 to some 19% in 2015, and even climbed to 24%–25% in 2011–2012. In absolute numbers, the gross profit of the ten largest real estate companies in 2015 was some NIS 1.1 billion, up from NIS 600 million in 2007 – virtually half the amount.

## **The real estate bubble and the Israeli economy**

1. From early 2000 until the real estate crisis in 2008, investment in residential housing constituted about a quarter of the total investment in fixed assets in the Israeli economy. Since 2008, the construction of residential housing has drawn a larger and larger proportion of the investment in fixed assets, reaching 34% in 2015.
2. From 2008 to 2013, the construction industry grew by almost 8%, but its contribution to overall economic growth was only 0.3%. In terms of jobs, the construction industry does not bring good tidings: Looking only at the employment of Israelis, jobs in the industry rose by 3.1%, compared with an increase of 2.7% in the employment rate in general.

# Introduction:

## The Split Housing Market

About ten years ago, in November 2006, the Israel Ministry of Construction and Housing wrote a "Strategic Plan for Sustainable Development." A vision for the Ministry's work was articulated in this document:

*Suitable and affordable housing in an appropriate neighborhood for every family. Every family in Israel, regardless of religion, age, gender, ethnicity, or socioeconomic background has an equal right to live in a quality home that meets its needs in a safe, comfortable neighborhood that has sufficient public institutions, leisure venues, etc. All this at an affordable price that can be paid by normative outlays from the family income.<sup>2</sup>*

This vision was formulated under the leadership of Dr. Chaim Pialkof, deputy director general at the time of the Ministry of Construction and Housing. Pialkof adopted this vision from the 1949 Housing Act enacted under the Truman administration in the United States. The concept also conforms to international covenants anchored in the UN's Universal Declaration of Human Rights.

Unfortunately, this worthy vision exists only on paper.

At the very time the vision was being formulated, the Ministry of Construction and Housing was in the midst of functional and budgetary cutbacks that turned this statement into a dead letter. Indeed, this ministry, like the others, had already adopted the "free market" approach that calls for limiting state involvement. Thus, responsibility for realizing the vision of November 2006 was transferred from the government to the "free market."

The phrase "free market" appears in quotation marks throughout this paper because, contrary to the claims underlying hegemonic economic theory, the market is never free. Those who operate in the market differ from each other in resources and abilities: Some are strong players able to dictate national market trends in keeping with their preferences – we call these "market forces" – while most are families who, at best, can provide a roof over their heads. Furthermore, the so-called "free market" is never entirely free of government intervention: When "market forces" seek to promote their preferences, they often make use of state mechanisms – interest rates, credit policy, employment policy, etc.



The Israeli government adopted the "free market" ideology as part of the 1985 Economic Emergency Stabilization Plan. This plan marked a retreat from "the developmental state" of Israel's first decades, in which the state bears responsibility not just for security, growth, and jobs, but also for the health, education, and housing of the population. Israeli governments in those years had assumed direct responsibility in the field of housing – planning, development, and construction. Alternatively, they subsidized the price of housing via mortgages and rent support for those eligible; or they simply oversaw the construction costs – the price of materials, wages, and investments.

The developmental state approach did not ensure equality in the housing market. As in the title of Sami Michael's classic work, some were equal and others, more equal. Arab citizens, who constitute a significant portion of the Israeli population, were historically left out of the government housing plans, and this followed on the confiscation of large tracts of their land on which they could have planned independent construction. Another significant population group, hundreds of thousands of Jewish immigrants, most from Islamic countries, were housed for years in transit camps and later given cheap housing in development towns far from the center of the country or in urban, "south of the track" neighborhoods.

The policies put in place with the 1985 Economic Emergency Stabilization Plan exacerbated the inequality, but it didn't happen all

at once. Several years after the plan was in effect, in 1989, a wave of Jewish immigrants from the former Soviet Union and Ethiopia began to arrive in Israel, and the state, which strove to ensure their absorption, responded by stepping up its budgetary involvement, either by loans for home purchase or financial support for construction. The transition to a "free market" policy was implemented fully only in 2002–2003. Then, in response to the economic crisis brought on by the second Intifada, Finance Minister Benjamin Netanyahu drastically slashed the state budget. In short order, the Ministry of Construction and Housing budget tumbled from NIS 8 billion to NIS 1.89 billion a year.

The first victim of the state's abandonment of the housing market was the universal aspect of the Ministry's vision – "suitable housing for *every* family." In a "free market" economy, there is no commitment, as governments in the past had committed, to housing for every family. Furthermore, the "free market" policies initiated in 1985 widened the economic gaps that had emerged at the time of the large waves of immigration. This happened through the creation of a stratum of senior managers who received high wages in commercial establishments, some of them privatized from the state and the Histadrut Labor Federation, such as high tech and the financial industries, but also senior managers in the civil service and the military. Within one generation at most, a relatively thin stratum of families were enjoying incomes sufficiently high to allow them significant savings, and they followed this with housing upgrades.

Later, when lowered interest rates turned real estate into a preferred investment, this stratum became a significant "market force" as "investors."

The affluent stratum, the "investors" in particular, helped create the real estate bubble, which undermines the ability of middle- and lower-income Israelis to acquire housing. At the same time, the financial interests of the "investors" conflict with the interests of those who wish to lower the cost of housing, as lowering the cost would lower the value of their savings – invested in real estate and in the value of their residential homes (far higher than that of most homes in Israel). In other words, the "free market" policies gave birth to a clear collision of interests between the stratum represented by the "investors" and most of the Israeli public – those who want housing but have insufficient capital for the down-payment; those living in rental housing whose monthly payments are rising in a private market that lacks oversight and regulation; and those who purchased housing, but have crippling mortgage payments, such as households in the lower income quintile of the population whose mortgage payments swallow almost 40% of their income.<sup>3</sup>

The "housing bubble" will end one of these days – whether because the Bank of Israel raises interest rates, or new construction provides a supply that meets the demand, or for other reasons. Of course, this will not necessarily reduce housing prices, certainly not in the center of the country. But, more impor-

tantly, the end of the "real estate bubble" will not necessarily augur a change in the Israeli class structure or in patterns of wealth accumulation. It will mean primarily that wealth is shifting to new investment channels – in Israel or abroad.

The analysis in this paper regarding Israel's housing market in the previous decade has implications for a future macro-economic policy. A desirable policy will create investment goals designed to benefit the entire Israeli population, above all investment in productive activity that will upgrade the professional and economic standing of workers and significantly enlarge the ranks of the middle class. An investment policy of this sort can ultimately lead to a more equitable distribution of wealth, which will prevent the ongoing systemic shocks that follow the migration of accumulated wealth from one industry to another.

# 1.

## The Affluent as a "Market Force"

The primary "market force" currently affecting the housing market in Israel is the relatively affluent stratum for which real estate investment is a way to accumulate wealth and maintain its value.

Within this stratum are two fairly distinct groups:

One group is comprised of families in the top 1% and 0.1% income brackets, who have enjoyed unprecedented wealth in Israel in recent decades. These families operate in a distinctive market niche of particularly expensive real estate, primarily luxury high-rises in the large cities of central Israel. Luxury apartments are essentially a closed market in which only the very affluent can participate, but they have an effect on the housing market – they raise the cost of housing in their vicinity and set new and higher standards of architecture, finish, accessories, and maintenance services, which trickle down to the Israeli housing market as a whole and contribute to the rising prices.

The second group includes families in the upper middle class whose income grew in recent decades relative to that of the general population, and who belong to the

highest income decile or the upper part of the ninth decile.

These two groups have enjoyed the fruits of the Economic Emergency Stabilization Plan of 1985, which included privatization of government companies and services and left in its wake unprecedentedly high wages for entrepreneurs and managers and above-average wages for employees of companies whose products are geared for foreign markets, such as high tech. Both also enjoyed tax reduction policies introduced in 2003 by then Finance Minister Binyamin Netanyahu.

The resources of this group allow its members to live in homes that are significantly more expensive than those of the other deciles. In 2014, the average apartment owned by members of the top decile was 76% more expensive than the average apartment owned by the rest of the population (approximately NIS 2.54 million on average in the top decile compared with NIS 1.44 million for an average apartment owned by those in income deciles 1–9).<sup>4</sup>

But the real estate activity of this affluent stratum is not just about acquiring a residence and maintaining its value. Ever

since the global financial crisis of 2008 and following the low interest rate policy of the Bank of Israel, many families have turned to real estate on the assumption that this market would enable them to maintain and even augment the value of their savings, among others, in order to insure their level of income at retirement. The Ministry of Finance and the media refer to these families as "investors." In 2013, with 22.4% of Israeli households in the upper quintile (the two highest income deciles) owning more than one apartment, this amounted to some 85,000 households.<sup>5</sup>

The influence of the affluent on housing market trends emerges from the following data:

1. From 2010 to 2013, households in the three highest income deciles were issued 50% of the bank credit for housing;<sup>6</sup> only 7% of the housing credit was issued to the three lowest income deciles.
2. During the previous decade, "investors" purchased between a quarter and a third of all apartments offered for sale each year.
3. In the highest quintile (income deciles 9 and 10), ownership of two or more apartments jumped from 8.9% in 2008 to 22.4% in 2013. In the fourth quintile (income deciles 7 and 8), the percentage rose to 9.6% during that period.<sup>7</sup>
4. In 2016, some 54,000 households in Israel owned three or more apartments; the aver-

age gross monthly income of these households was NIS 46,000,<sup>8</sup> compared with NIS 18,000 for all households in Israel (in 2014) and a median income of NIS 14,000.<sup>9</sup>

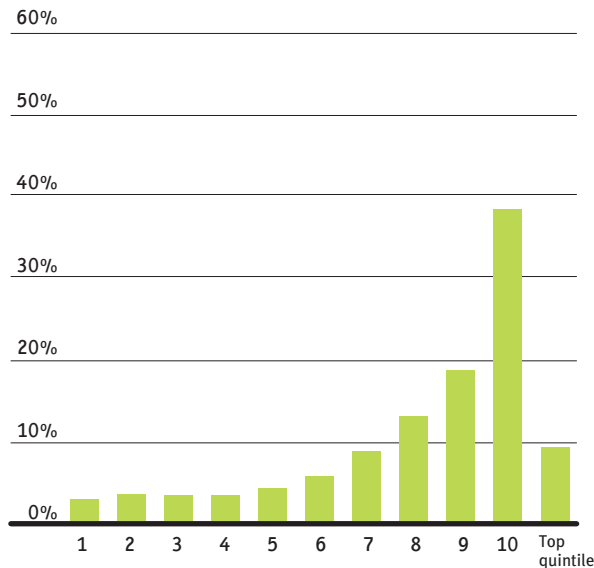
5. During the years 2002–2013, approximately 280,000 apartments were purchased that were defined by the State Revenues Authority as investment properties. Families in the top income decile purchased apartments valued at approximately 40% of the value of all investment properties; the top 1% alone purchased apartments valued at almost 10% of all investment properties during this period.<sup>10</sup>

The key role played by what we have called the affluent stratum is particularly salient due to the relatively small size of the middle class in Israel compared to western countries: A comparative study from the middle of the previous decade<sup>11</sup> found that the middle class<sup>12</sup> comprised 36% of Israeli households, was significantly lower than the 50% of households that are middle class in most western European countries and about 60% in Scandinavia. These figures have probably not changed much over the past decade.

When the middle class constitutes the largest stratum of the population – as it does in most developed countries – it generally serves as the main target population for government policy as well as the main subject of political and economic discourse. It is also the class that embodies the collective – "the nation," "the public," the "work force," "tax payers," "the voting public," etc.

## Households Owning Two or More Dwellings, 2003–2013

In percentages, by quintiles of net income per standard person

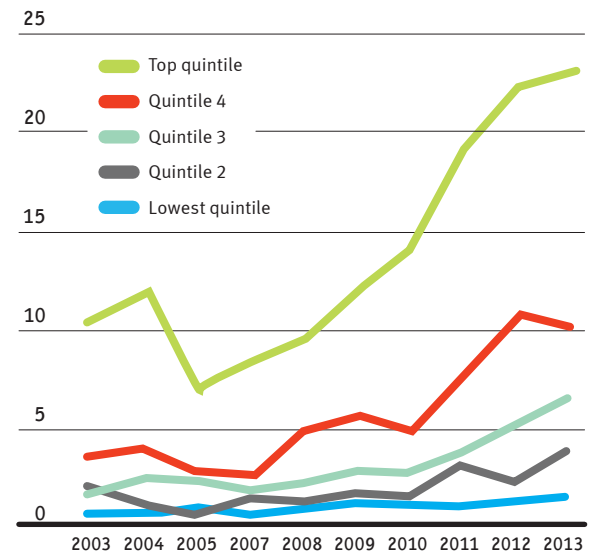


**Note:** The figure does not show data for 2006 due to irregularities in the data that year.

**Sources:** CBS, *Survey of Household Expenditures 1997–2012*, January 2015; data courtesy of the CBS Consumption and Money Department, July 2015.

## Share of Income Deciles in the Value of the Purchase of Dwellings for Investment

Average for the years 2002–2013



**Source:** State Revenues Authority, *Annual Report 2013–2014*, Chapter 10: "Receipts from Property Taxes and Residential Real Estate Taxes 2012–2014."

When the middle class is small, however, political and economic attention focus on the more affluent, which we have called the "affluent stratum." This group is then perceived as "the engine that powers the economy" or the "market force," without whose support and financing any government would have a hard time implementing macro-economic and macro-social policies. When this happens, public policy shifts to preventing the affluent households from falling into the middle class, rather than seeking to lift the working class into the middle class.

The power of the affluent is not just economic. The "investors" are in effect the ruling, commanding, and managing class of Israeli society. This is the stratum from which the decision makers come as well as those who have the ear (and heart) of the decision makers. Housing policy that harms the "investors" would devalue the assets of their families, neighbors, and colleagues. A concrete example of this can be found in the investigative report published in *The Marker* about the number of apartments owned by Knesset members: "The question of how

many apartments they owned...divided the Knesset into two main groups: those who have no problem providing the information at once...and those who adamantly refused to reply..." Among those who agreed to furnish the information, sixteen reported ownership of at least two apartments.<sup>13</sup> It is a reasonable assumption that if all Knesset members had responded to the question, the number of "investors" among them would have risen. And this is true not just of lawmakers, but also of senior politicians, including the prime minister: In the context of the political struggle over imposing a tax on owners of three or more apartments, Prime Minister Benjamin Netanyahu issued a statement that he has a conflict of interest on this issue since his family owns three apartments.<sup>14</sup> One can assume that high rates of "investors" would also be found among senior managers in private and government companies, high-ranking military officers, mayors, and university professors.

According to the Financial Stability Report issued by the Bank of Israel, "Although the lower deciles have a higher risk of defaulting [on mortgages] due to their risk profile, they account for only a small proportion of total housing credit."<sup>15</sup> The higher deciles, on the other hand, will find it easier to handle their mortgage payments, but the size of their debt explains the great interest in preventing a significant decline in the value of their assets.

All this helps explain why most of the official bodies that deal with the housing bubble have not fully applied themselves to significantly lowering the price of housing. A general decrease in price would harm all home owners, but particularly those for whom real estate is not just a roof over their heads, but also an investment. This also helps explain the fact that many solutions proposed by the government do not directly address the general problem of housing prices, but rather circumvent it by creating projects to assist low-income earners. These programs seem designed to alleviate the distress of young couples, but are not likely to lower the price of housing in general.

# 2.

## The Housing Crisis

*The housing distress in Israel is real. It is not fabricated or artificial, but a real problem, and whoever has eyes in his head and compassion in his heart understands that there is a problem. For young people who earn well, the purchase of an apartment is still beyond their means. They're forced to live with their parents and will soon be living with their grandparents...We must bring housing within the reach of Israel's citizens<sup>16</sup> (Prime Minister Benjamin Netanyahu at a press conference in the context of the social protest demonstrations, 25 July 2011).*

For over five years, ever since the social protest demonstrations in the summer of 2011, the subject of housing has topped the public agenda. Not a day seems to pass without discussions about the "housing crisis." But what is this crisis? Housing problems, poor neighborhoods, crowded living conditions – these are not new in Israel. Until the last decade, however, housing problems were the lot of the poor in Israel, while today they beset Israelis from the middle class and above who "earn well," as characterized by Prime Minister Netanyahu. In other words, this time it is about the sons and daughters of the relatively well-off. Because this is also the stratum that rules, commands, and man-

ages, the "housing crisis" has received public attention – also because this is the stratum that reports, broadcasts, and makes use of social networks.

Ostensibly there is a paradox here, as many leaders of the protest movement are the sons and daughters of the "investors." How is it that these people rose up to protest housing prices and the cost of living in general? Sociologists Zeev Rosenhek and Michael Shalev provided an incisive answer:

*The leaders of the 2011 protest were the children of the liberalization of Israel's political economy. They grew up in middle and upper-middle class families in the 1990s and the early 2000s just as most members of those classes were enjoying a significant improvement in their standard of living and were adopting modes of conspicuous consumption that were quite novel in Israel. Their parents were the main beneficiaries of the liberalization of the Israeli economy, and this shaped their experiences as a class-generational unit. However, when reaching early adulthood, they found themselves in a situation where the successful reproduction of their parents' life chances was in no way guaranteed, including the level and modes of consumption to which they*



*had become accustomed during their formative years...many of the sons and daughters of the beneficiaries of the neo-liberal regime became its losers.<sup>17</sup>*

After World War II, homeownership became one of the defining characteristics of the middle class. In Israel, homeownership was also an important marker of the absorption of hundreds of thousands of Jews who immigrated to Israel after 1948. The various governments viewed home purchase as integral to nation building. Financial help to purchase an apartment was basic to absorption policies in the 1990s as well, when the state mobilized to facilitate the immigration of hundreds of thousands of Jews from the former Soviet Union and Ethiopia.

Government policy of encouraging homeownership created a social norm. The rate of homeownership in Israel in 2009, then 69.0%, was higher than the average of the OECD countries – 63.2%.<sup>18</sup> Although the homeownership rate has somewhat declined in Israel since then, it still remains high – 67.3% (data from 2014).<sup>19</sup> It should be noted that the relatively low rates of home ownership in some Western European countries derive, among others, from the fact that the policy in these countries was designed to encourage long-term rental of residential housing.

However, the figures on a decline in homeownership in the population at large conceal the fact that the most significant decline was among young people from the middle class.

Among married 20–29-year-olds, the homeownership rate dropped from 55.8% in 1997 to 43.3% in 2012; and among 30–39-year-olds, it dropped from 74.3% to 63.4% during that same period. Among 50–59-year-olds, on the other hand, homeownership rates rose from 86.1% in 1997 to 87.8% in 2012, and climbed even more among 60+ year-olds – from 78.9% to 86.7%.<sup>20</sup> For single people, homeownership declined in all age groups except for those aged 60 and up.

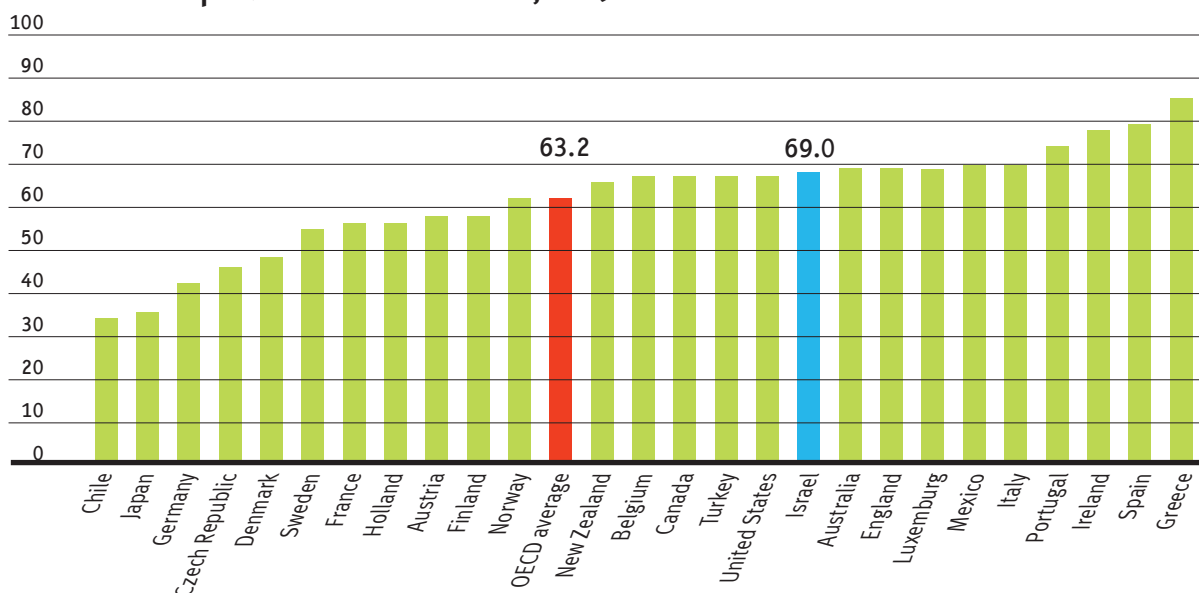
Statistics about homeownership by income decile reveal similar trends: Between 1997 and 2014, the percentage of those residing in their own home among the middle deciles – 4 and 7 – decreased by 7.5% and 6.1%, respectively. In the highest decile, on the other hand, home ownership remained relatively stable, with a small increase of 1.1%.

These trends are primarily explained by the rise in housing prices. Between 2007, the eve of the financial crisis of 2008, and 2015, apartment prices doubled, though the average wage increased by 25%, and the median wage increased by only several percentage points (data for the median wage up to 2013).

The steep rise in housing prices, combined with the moderate increase in wages and the significant attrition of state assistance, created a new reality referenced by Prime Minister Benjamin Netanyahu in the above quotation. Over the past decade, those in the middle- and upper-middle class have been forced to take out much larger mortgages, while



## Homeownership Rates in OECD Countries, 2009



Source: CBS, *Housing in Israel: Findings from the Household Expenditures Survey 2012*, November 2013.

## Percentage of Persons Living in their Own Homes, by Age and Family Status 1997–2012

	Total	29–30			39–40			49–50			59–60			60+		
		Total	Family status		Total	Family status		Total	Family status		Total	Family status		Total	Family status	
			Married	Single		Married	Single		Married	Single		Married	Single		Married	Single
1997	70.2	52.3	55.8	50.5	68.7	74.3	54.5	78.7	83.2	64.1	81.2	86.1	79.0	72.1	78.9	39.0
2002	69.6	48.8	54.6	46.0	65.9	74.0	45.8	76.8	83.7	50.5	82.6	87.9	77.5	73.6	79.2	54.3
2007	69.3	52.3	54.0	51.9	61.6	69.8	42.7	75.0	81.6	53.7	81.1	88.2	63.2	77.2	82.6	59.1
2012	67.9	44.9	43.3	46.7	56.9	63.4	39.2	74.3	80.9	59.5	80.7	87.8	62.7	78.9	86.7	59.2

Source: CBS, *Housing in Israel: Data from the Household Expenditures Survey 1997–2012*, January 2015.

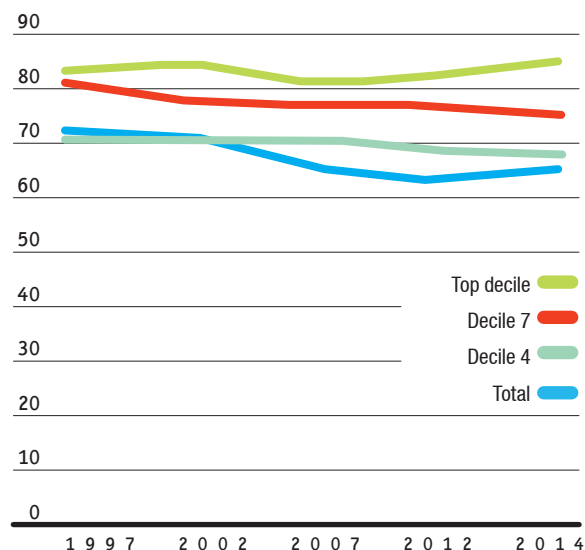
those unable to purchase an apartment have turned to rental housing.

With regard to mortgages, research by the Bank of Israel found that the rise in housing prices brought about a significant increase in the size of mortgages. Nevertheless, they note, monthly mortgage payments have not

increased, which they attribute to longer mortgage periods, a decline in the average interest rate on mortgages, and a modest increase in the real income of households. In parallel, to enable the banks to continue to issue mortgages, the down-payment amount required was raised.<sup>21</sup> The larger down-payment required seems to be the

## Rate of Own Home Ownership, 1997–2014

Selected deciles of households, by net income per standard person



	Total	Decile 4	Decile 7	Top decile
1997	70.2	71.7	81.1	84.0
2002	69.6	70.3	77.5	84.7
2007	69.3	65.3	76.7	82.1
2012	67.9	62.5	76.5	82.4
2014	67.3	64.2	75.0	85.1
Change 2014–1997	–2.9	–7.5	–6.1	1.1

**Source:** CBS, *Housing in Israel: Findings from the Household Expenditures Survey 2014*, November 2015.

main obstacle preventing young couples from purchasing an apartment. Home purchase based on income from salaries alone is no longer possible.

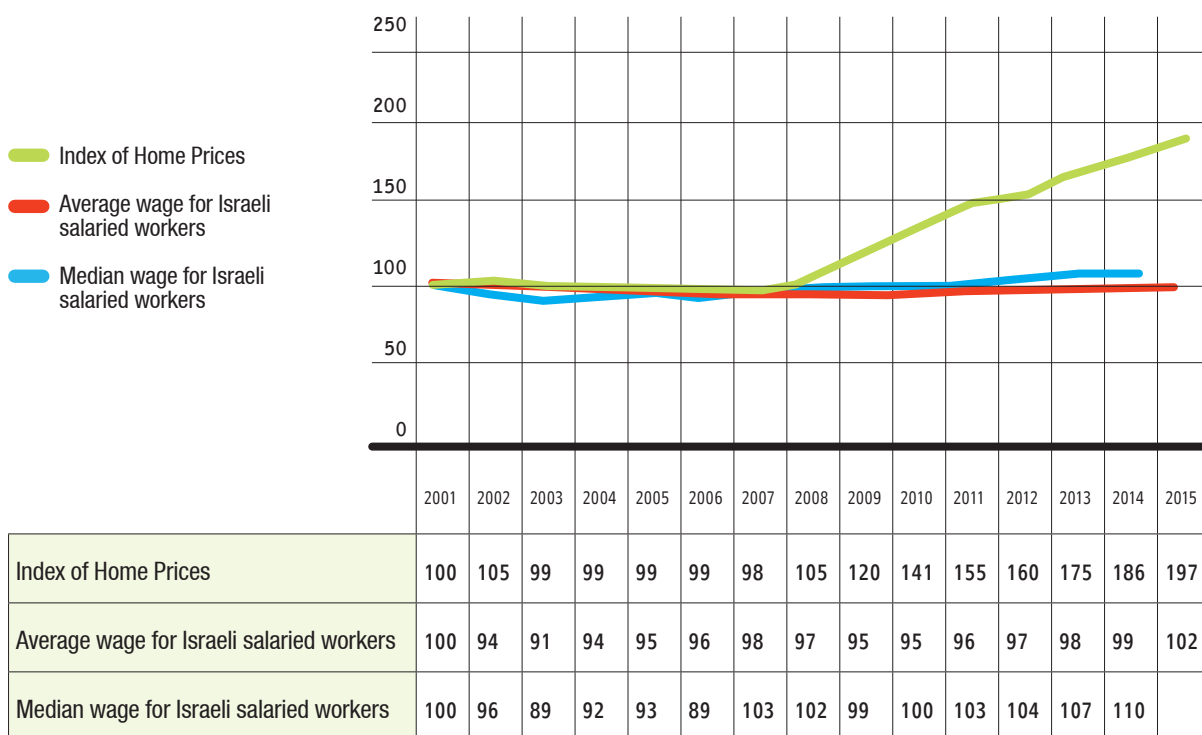
For those in rental housing, the "housing crisis" has special significance because no solid, safe alternative for long-term rental at reasonable, stable prices exists in Israel. Although rents rose during this period less than housing prices, regulation is completely lacking in the rental market, leaving it an unbridled private market where renters are vulnerable to precipitous evictions, price gouging, and, in areas of high demand, a supply of small, dilapidated units.

It should be noted that in contrast to the decline in the rate of homeownership, the rate of households owning at least one dwelling has remained almost unchanged over the

past decade. This rate was 72.7% in 2003, decreased by 2008 to 70.4% and rose to 72.1% in 2014.<sup>22</sup> This discrepancy is perhaps due to the phenomenon of home purchases by households not necessarily for the purpose of residence. In the absence of direct data on these households, one cannot fully explain it. However, it is conceivable that there has been an increase in the number of households, including those of young couples from the upper middle class, who, unable to buy a home matching their needs, purchase another, less expensive apartment. Thus, it is possible that due to the rise in housing prices, alongside the reduction of the cost of credit, the number of young couples who purchased an apartment on their own or assisted by their parents as an investment – often with the expectation of using the profits in order to purchase a more suit-

## Index of Home Prices Compared to the Average Wage and Median Wage, 2001–2015

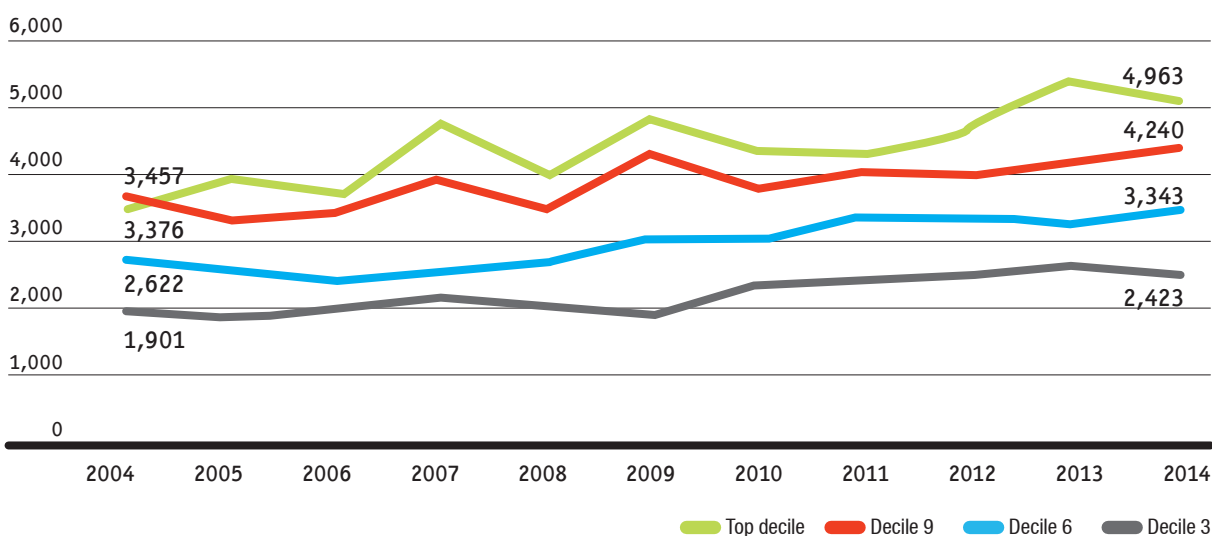
2001 Index = 100



**Source:** Adva Center analysis of data from CBS, *Statistical Abstract of Israel*, various years; National Insurance Institute of Israel, *Wages and Income from Work by Locality*, various years.

## Expenditures on Rent for Households in Rental Housing, 2004–2014

For selected income deciles of households, by net income per standard person



**Source:** CBS, *Household Expenditures Survey*, various years.

able apartment in the future, has increased.

The social protest movement in the summer of 2011 stirred hope for change and led to the government's appointment of the Trajtenberg Committee, for which the housing crisis figured prominently. Housing issues also headlined the public policy chapter in the report written by Professors Yossi Yonah and Avia Spivak on behalf of the "Experts Committee," which accompanied the protest movement. Finally, the issue of housing was fundamental to the election campaign of the Kulanu Party headed by Moshe Kahlon, currently Minister of Finance.

And yet none of this has engendered change in the "free market" policies, the declining rates of homeownership, rising apartment prices, or the increased burden of housing costs on most Israeli households, particularly those of young couples. The problem that brought hundreds of thousands of Israelis into the streets and was core to the campaign pledges of two successive finance ministers, Yair Lapid and Moshe Kahlon, still remains unresolved.

One of the main reasons for this is that the various parties involved in the housing market – the Ministry of Construction and Housing, Ministry of Finance, Bank of Israel, Israel Land Administration, commercial banks, and real estate developers – are reluctant or unwilling to take steps that could adversely affect the accumulated wealth of the affluent – the engine for the entire Israeli economy: Their savings become the investments and

the taxes they pay constitute the main source of state revenues.

This is reflected clearly in the following statements by Finance Minister Moshe Kahlon and Budget Director in the Finance Ministry, Amir Levy:

*The contractors, banks, developers, and strong interest groups are fearful about price trends in housing. You see the campaigns, you see the madness...there are large interest groups, including the banks, who do not want the prices to go down. (Finance Minister Moshe Kahlon, 17 August 2016)<sup>23</sup>*

*Some discourse seems to say that they want the housing prices to fall. But there is an entire stratum of the population that benefits from the rising prices of housing, in addition to an entire stratum of contractors and developers who profit from it. This, in general, is the reason there is a need for public solutions to the housing problem, and one of these is public housing. (Amir Levy, Budget Director in the Finance Ministry, 26 May 2016)*

## The Housing Distress of Arab Citizens of Israel<sup>24</sup>

Housing policy discussions in Israel are almost invariably about housing for Jews. The housing problems of Arab citizens of Israel have never been an organic part of national housing plans, and certainly never their focus.

Evidence of this can be found in the following data:

Between 1948 and 1972, years when the government played an active role in public housing, the Arab sector benefited from only 1.4%–2% of the total investment in public construction in Israel.<sup>25</sup>

Between 2001 and 2005, Arab citizens were granted only 5,756 of the 122,005 housing mortgages.<sup>26</sup>

Since the founding of Israel, not one new locality was established for the Arab population, other than Bedouin towns in the Negev. Only 134 of 1,200 localities in Israel are Arab.<sup>27</sup>

Note that during the first two decades of Israel's history, Palestinians who became Israeli citizens were subject to military rule and confined to their own villages. The revocation of military rule allowed them freedom of movement, but most continued to reside in their home villages, some of which grew into towns and cities.

In 2014, 78.9% of Arab families lived in homes they owned (compared to 66.7% of Jewish citizens that year).<sup>28</sup> The high rate of homeownership is not an indication of wealth, but rather of insufficient housing: Arab citizens build their own homes, but construction is gradual, keeping pace with the availability of family funds. Because these are usually built on family-owned plots, the result is neighborhoods of extended families. Today, most of the family land reserves for construction have been used up.<sup>29</sup>

Because most of the Arab village land was

confiscated by the state over the years, housing development is limited. Arabs are also prevented from purchasing land owned by the Jewish National Fund, which is designated for Jews only. Furthermore, most Arab locales have outdated town plans or no town plans at all. As a result, they have poor infrastructure or none at all, are densely populated, and have a lower standard of living.

Recent years have seen the migration of Arabs from villages into mixed urban towns such as Haifa, Lod, Ramla, Acre, and Nazareth Illit (not including East Jerusalem), most to neighborhoods with an Arab majority. About a hundred thousand Arabs from middle-class families have thus relocated, seeking a better quality of life than that which is available in their home villages. Transition to Jewish neighborhoods is more difficult, as exemplified recently in Afula. There, Jewish residents demonstrated in December 2015 against the award of 48 plots of land to Arab citizens as part of a "Build your Home" tender issued by the Israel Land Authority of Afula.<sup>30</sup> In response to a petition submitted by some of the protesters, the Nazareth District Court cancelled the tender on the grounds that there were irregularities in the procedures and administration and the wording was vague.<sup>31</sup> A comprehensive solution to the housing crisis in Israel must incorporate fundamental change in state attitudes to the housing distress of Arab citizens. This would entail the inclusion of Arab citizens in every government housing program, the provision of land for the development of Arab towns, and comprehensive, robust state support for ensuring that the Israeli housing market is open to all its citizens, without discrimination against any group whatsoever.

# 3.

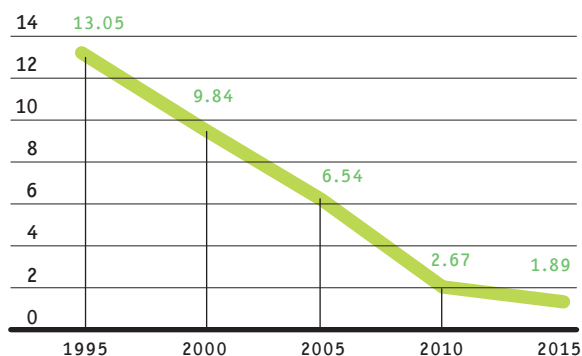
## State Agencies

- **Ministry of Construction and Housing**
- **Ministry of Finance**
- **Israel Land Authority**
- **Local Authorities**
- **Bank of Israel**

In the first decades of Israel's history, the Ministry of Construction and Housing was a leading player in the field of housing, reflected in the size of its budget. Although transition to a "free market" policy was expected after approval of the Economic Emergency Stabilization Plan of 1985, large waves of immigration from the former Soviet Union and Ethiopia led to delay of the transition and continued government involvement. Ultimately, the large cutbacks came in the late 1990s, particularly during the economic crisis accompanying the second Intifada. The ministry budget, which had been NIS 13.05 billion in 1995, was slashed to NIS 9.84 billion in 2000, and continued to decline until 2015, when it fell to NIS 1.89 billion (at 2015 prices). In 2015, the budget of the Ministry of Construction and Housing was but 0.5% of the state budget, compared to 5.14% in 1995. The cutbacks included reductions in rent subsidies, mortgage assistance and public housing.

### Ministry of Construction and Housing Budget, 1995–2015

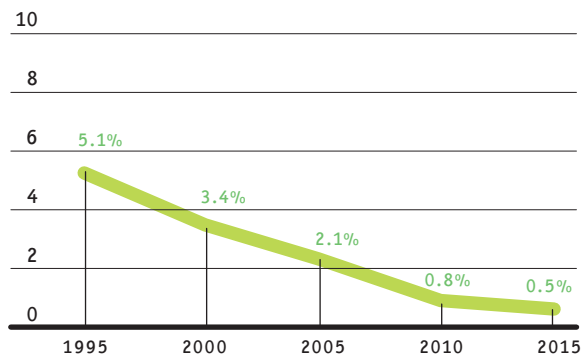
Net expenditures in NIS billions, at 2015 prices



**Source:** Adva Center analysis of the Ministry of Finance, Accountant General, *Financial Report*, various years.

### Ministry of Construction and Housing Budget as a Proportion of the State Budget, 1995–2015

Net expenditures in percentages



**Source:** Adva Center analysis of the Ministry of Finance, Accountant General, *Financial Report*, various years.

The decrease in involvement of the Ministry of Construction and Housing is also reflected in the ministry's changed goals articulated in the annual work plan. Missing from the current plan, unlike the past, is the vision of "suitable and affordable housing in an appropriate neighborhood for every family," which was replaced by goals such as "having an influence on lowering the price of housing" and "providing a solution for affordable, quality housing for most of the citizens who cannot obtain reasonable housing with their own resources." These changes in the ministry's goals reflect, even on the declarative level, its abnegation of the responsibility for providing housing solutions for the general public.<sup>32</sup>

These changes were also reflected on the symbolic level, albeit temporarily: In late 2014, during Uri Ariel's term as minister, the word "housing" was removed from the name of the ministry, leaving only "construction."<sup>33</sup> In explanation, it was stated, "Our ministry has become a central factor in the construction industry, and after a process of branding carried out for months which included research and assessments, it was decided to change the name to "Ministry of Construction," which is appropriate in light of the challenges facing the Ministry."<sup>34</sup> After the election, Yoav Galant, the new incumbent minister, restored the original name – Ministry of Construction and Housing.<sup>35</sup>

The bottom line is that the state, which in the past shouldered responsibility for ensuring affordable housing for all, has now cast off this obligation and turned it over to market forces.

## Ministry of Finance

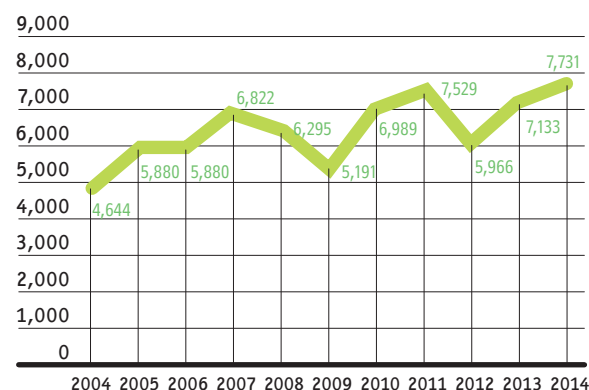
The Ministry of Finance has a dual institutional interest in maintaining the status quo:

- The Finance Ministry "enjoys" the far-reaching cuts to the Ministry of Construction and Housing's budget as it bolsters its overall policy – restraining the state budget and maintaining a low deficit;
- The Finance Ministry enjoys significant revenues from real estate taxation and transfers from the Israel Land Authority.

We start with the Finance Ministry's revenues from the direct taxation of real estate: purchase tax, capital gains tax, property tax, and sales tax.<sup>36</sup> In 2014, Ministry of Finance receipts from real estate taxes totaled NIS 7.7 billion, a real increase of 66% over 2004.

### Revenues from Real Estate Transactions, 2004–2014

Purchase tax, capital gains tax, property tax, and sales tax In NIS millions, at 2015 prices



**Source:** Adva Center analysis of Ministry of Finance, State Revenues Authority, *Annual Report*, various years.

In addition to the income from direct real estate taxes, the state also enjoys income from VAT payments on new apartments. The Bank of Israel estimates that in 2015, total receipts from VAT on new apartments amounted to NIS 7.6 billion. These two tax sources together constituted 4% of total state receipts during the last decade, rising to 7.6% in 2015.<sup>37</sup>

## Israel Land Authority (ILA)

The Ministry of Finance enjoys large revenues not just from real estate taxes and VAT, but also from the monies transferred by the Israel Land Authority to the state coffers. ILA revenues are determined by two factors: the number of land deals made and the price of the land sold. The ILA uses some of its revenues for financing its own activities and the balance is transferred to the owners of the land – the state of Israel and the Jewish National Fund. These transfers are recorded in the state budget book as capital revenues that serve to finance development, debt repayment, and other expenditures.

The ILA represents the supply side of the housing market: Because it controls 93% of all the land in Israel, it is the main factor determining the amount of land available for sale each year, hence the amount of housing constructed. When the social protest movement of 2011 raised the issue of the high cost of housing, the expected response was that the supply of apartments should be increased, or, in other words, that it was necessary to increase the amount of land

released for construction by the ILA. This comes through in Prime Minister Netanyahu's response to the protest of 2011 when he said, "The only way to lower prices in the long range is to see to it that there are many more apartments in Israel so that they will be less expensive. In another year and a half, we will add 50,000 apartments to the market and that will erase the current housing deficit...."<sup>38</sup>

ILA data indicate that in the wake of Netanyahu's declaration, the number of housing units offered indeed rose from some 15,000–25,000 in 2007–2010 to some 35,000–50,000 since 2011. In 2014, Netanyahu's goal was even met – 50,000 housing units were marketed that year (see figure on p. 25).

However, the number of housing units marketed by the ILA does not necessarily reflect the number of housing units in actual signed agreements. The main explanation for the gap between the two figures is the failure of some of the tenders, i.e., tenders that failed to elicit a response from real estate development companies. Thus, despite the ILA's success at stepping up the marketing of land, signed agreements increased at a much slower pace. This undercuts Netanyahu's claim that the only solution to the "housing crisis" is for the ILA to release more land for sale.

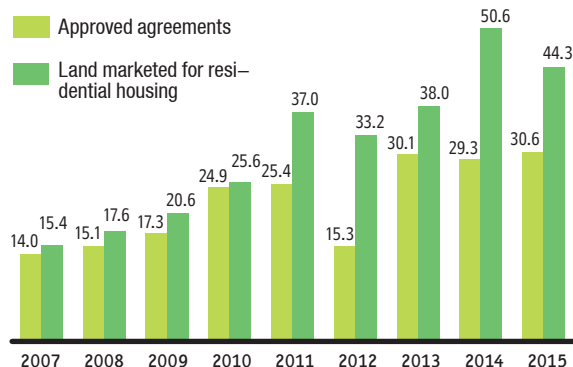
Yet, even though the finalized agreements did not keep pace with the increased amount of land for sale, the number of housing units



in tenders authorized by the ILA still rose in recent years, and held steady as of 2013, with 30,000 housing units a year. In 2016, Minister of Finance Kahlon sought to increase this number, and set a goal for the ILA of 40,000 housing units a year.<sup>39</sup>

### Israel Land Authority: Land Marketed for Residential Housing and Approved Agreements, 2007–2015

By number of housing units, in thousands



**Source:** Israel Land Authority, *Annual Report*, various years.

The ILA has enjoyed higher revenues in recent years because it has sold more land and sold it for a higher price. This increase has also drawn public ire, such as that expressed by Minister of Finance Moshe Kahlon:

*It was the state that set the housing market on fire. We as a state control more than 90% of the land. Through unacceptable profiteering on its own land, the state raised the price by 60%. So, the contractors also had to raise their prices.*

*(Minister of Finance Moshe Kahlon in a hearing of the Economic Affairs Committee, 10 November 2015)<sup>40</sup>*

The graph on p. 26 shows the increases in ILA revenues (the column height) and the allocation of revenues to ILA's own activity and transfers to the Jewish National Fund and the state.

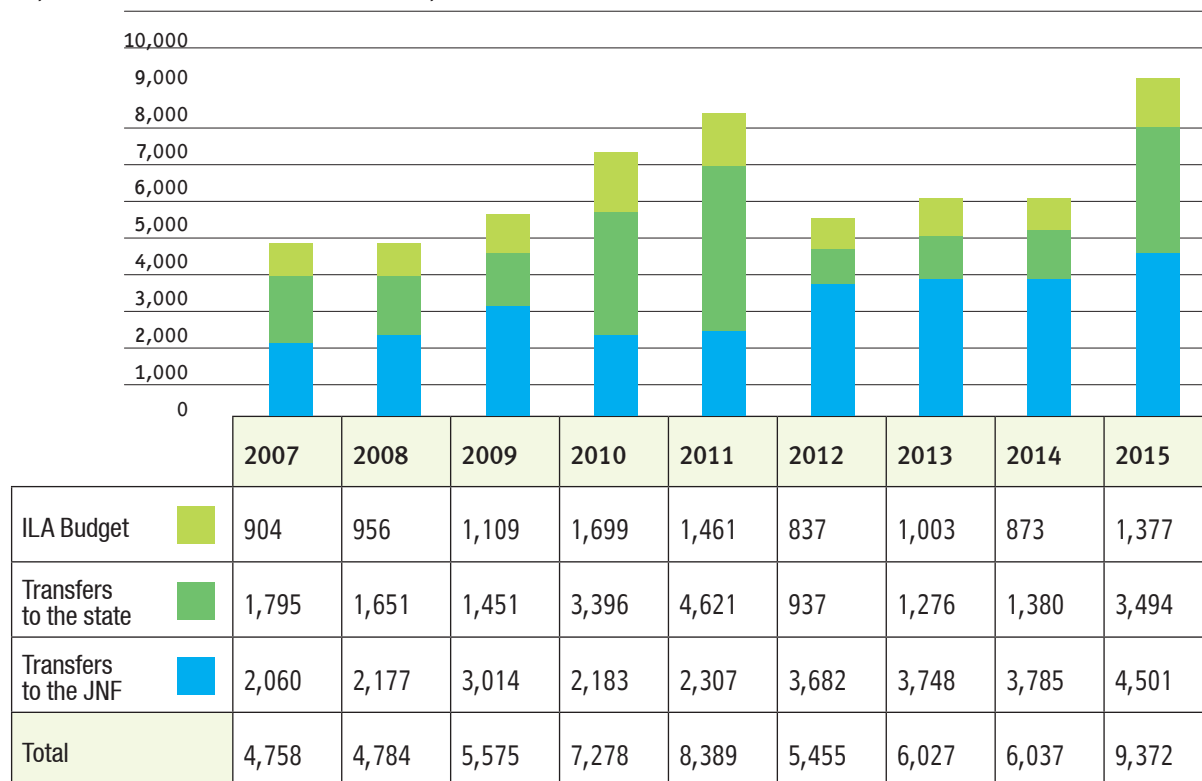
The bar graph shows rising ILA revenues from 2009 through 2011, which can be attributed to higher land prices as well as the greater number of agreements signed in those years. On the other hand, the decline from 2012 through 2014 can be explained by the smaller number of land deals signed in 2012 and a small number of tenders signed in 2013 and 2014 in expensive, high-demand areas.<sup>41</sup>

More income, in and of itself, is not the explicit goal of the Israel Land Authority. In the words of Mr. Adiel Shimron, acting head of the ILA, "The goal of the Authority is not to achieve record high receipts, but a fixed income...one that will enable us to meet the heavy obligations that the ILA has undertaken, which includes financing part of the transfer of IDF bases to the south, strategic agreements with the local authorities, frame agreements, and the provision of discounts on land via tenders of the "Buyer's Price" Program."<sup>42</sup>

Be that as it may, ILA revenues in 2015 did hit a record high of NIS 9.4 billion. This raises questions, as 2015 was the first year in which "Buyer's Price," the flagship program of the

## Israel Land Authority: Total Revenues, Own Activities Budget, Transfers to the State and the JNF, 2007–2015

Expenditures in NIS millions, at 2015 prices



**Source:** Ministry of Finance, Accountant General, *Financial Report*, various years.

**Note:** ILA revenues include income from annual lease fees and capital income.

Ministry of Finance, began to operate in its new format. The ILA explains the growth in revenues by the large number of agreements it signed in the first half of the year, prior to approval of the program; and also by revenues received from several particularly expensive tenders of land for industrial, employment, and commercial purposes.

## "Buyer's Price"

### Ministry of Finance Answer to the Housing Crisis

In June 2015, Finance Minister Moshe Kahlon announced the "Buyer's Price" program, his main strategy for dealing with the rising price of housing. The program constituted a revision and substantial expansion of an existing initiative, under which apartments were sold at discounted prices to applicants who met the many entitlement criteria, including a preference for large families. The new plan would apply to all the land marketed by the ILA and the entitlement criteria were significantly expanded to include all families and individuals over the age of 35 who do not own a home.<sup>43</sup>

In the framework of the revised "Buyer's Price," all ILA tenders are to be marketed at discounted prices, and the developers who apply are to compete with each other to set the cheapest price for sale of an apartment while still meeting the given criteria and standards. In addition, the state is to subsidize the land development and give grants to purchasers of homes in areas where the value of the land is low.

"Buyer's Price" reflects some willingness on the part of the government to spend more money to ease the housing shortage, though it primarily reflects a willingness to forego income, mainly tax income, rather than spend more budget money. The Accountant General of the Finance Ministry estimated that by July 2016, the cumulative loss of revenues to the

state as a result of lowering the price of land would be about NIS 1.2 billion; and budget expenditures on subsidizing infrastructure development plus grants to purchasers would amount to some NIS 760 million.<sup>44</sup> This, of course, is only an estimate – the true cost of the program will be known only upon publication of the actual expenditures.

Today, the government no longer presents "Buyer's Price" as an initiative to reduce the price of housing,<sup>45</sup> but rather as a program designed to help eligible applicants purchase housing at a discount.<sup>46</sup>

The Government Appraiser also made an effort to lower expectations, noting that not only will "Buyer's Price" not necessarily affect "market prices," but that consideration should be given as to whether it should be included in the "market price" calculation performed by his office.<sup>47</sup>

Although the program cannot impact the general housing market unless it reaches its declared goal of selling tens of thousands of discounted apartments in the coming years, by the end of 2016, relatively few housing units will have been sold. That this objective will be difficult to achieve is already evident. No developers at all applied for one large tender in this program offered in the southern region, on the grounds that the

discounted prices were not sufficiently profitable for them.<sup>48</sup> In Afula, the first project in which apartments were sold, the banks made it very difficult to obtain a mortgage.

In its 2015 annual report, the Bank of Israel addressed this issue, noting that as of its writing (April 2016), only about 6,000 housing units had been sold in the framework of "Buyer's Price." The Bank further related to the program's capacity for providing a full solution for those who wish to purchase their first apartment:

*A rough calculation indicates that out of some 100,000 housing sales annually, only about 15% could be handled within the framework of "Buyer's Price." This is low in terms of the potential of those eligible – first-time homeowners – since in recent years [the potential] was some 40% of the annual housing sales.<sup>49</sup>*

Whether the government succeeds or not in creating a large number of discounted housing units, one serious criticism of "Buyer's Price" remains – that the program offers a (not very large) discount for buying an apartment, and thereby helps only a small segment of the population who can afford to purchase a home, even at a discount. And the program offers no help for those who are unable to scrape together the initial down payment or meet the high mortgage payments.

## Local Authorities

Local authorities tend to prefer non-residential over residential construction. This is due to several reasons. First, the tax on business structures produces significantly more municipal income than the tax on residences. In 2013, for example, the property tax per square meter of a business structure in the Tel Aviv district was four times higher than the property tax per square meter of a residence.<sup>50</sup> Second, local authorities spend more on a residential neighborhood than they receive in income from it, generated primarily from the *arnona* (local property tax). In Tel Aviv, for example, the gap to the municipality between income and expenses per household was roughly NIS 13,000 in 2013.<sup>51</sup>

At a time of soaring housing prices, which is usually ascribed to an insufficient supply of homes, the resistance of local authorities to residential construction constitutes a problem.

In recent years, the government has sought to incentivize local authorities to approve plans for large numbers of housing units in their jurisdictions. Part of this effort has produced the "roof agreements" – package deals with the local authorities in which the state promises to finance infrastructure and social services in return for the town approving large residential neighborhoods in areas of high demand,<sup>52</sup> or smaller plans in which the local authorities are rewarded for approving a large number of housing plans.<sup>53</sup>

Resistance by local authorities to residential

construction is of particular concern with respect to smaller than average apartments, which are affordable by many more families. Some local authorities "are not interested in absorbing a less established population such as young couples or the elderly – who are the main consumers of small apartments."<sup>54</sup>

These families are also heavier consumers of public services, hence the local authorities prefer more well-to-do families, which purchase larger apartments and pay more real estate taxes (though still less than the tax on commercial buildings).<sup>55</sup> Hence, a bill tabled by the government in March 2016 and passed by the Knesset in July 2016 obligates local authorities to build more small apartments.<sup>56</sup>

Thus, local authorities also end up favoring the interests of the affluent stratum, whether by advocating less residential construction, or by failing to allow the construction of small apartments.

## **Bank of Israel**

In the eyes of many, the Bank of Israel is the main culprit for the high housing prices because of its adherence to low interest rates ever since the global financial crisis, a policy intended to encourage economic activity by making credit less expensive. Were it not for the low to negligible interest rates, it is safe to assume that people with savings would diversify their investments, rather than concentrate them in real estate, and would channel at least some of their money to other invest-

ment instruments, thereby allowing housing prices to drop. With respect to interest rates, the Bank of Israel is abiding by the conventional wisdom of the central banks in most developed countries as well as the political and economic leadership of Israel, who prefer to avoid a recession over lowering the price of housing.

The monetary policy of the Bank of Israel is thus a reflection of "national interests." However, the Bank of Israel also has "sectoral interests" related to the financial system of the country. The Bank of Israel, as the body responsible for supervision of the commercial banks and the stability of the entire financial system, has an institutional interest in preventing a sharp drop in the price of housing, a drop that could undermine financial stability.

According to the Bank of Israel Law, the role of the Bank is to maintain price stability, support the objectives of the government's economic policy – primarily growth, employment, and reducing social gaps – and support the stability of the financial system.<sup>57</sup>

Our interest is in the last-mentioned role, financial stability, defined as a situation in which the financial system – the financial institutions headed by the banks and insurance companies, the financial markets, and the payment and clearance system – function properly. Over the past few decades, financial stability has become a key concern in the world of money, and many countries have introduced it as one of the main roles of the

central bank. In 2003, the Bank of Israel established a separate "Financial Stability Unit," which publishes a semi-annual report.<sup>58</sup>

For housing, banks are the main financial players. Ever since the government reduced its involvement in housing, commercial banks have become the primary source of home mortgages: In 2015, 93% of the home mortgages to households were issued by banks.<sup>59</sup> In parallel, banks also serve as an important source of credit for private builders. The housing and real estate market constitutes the largest target audience for bank credit, as almost half (45%) the total credit portfolio of banks is extended as credit to contractors who build the homes and as mortgages to households that purchase them.

This large credit portfolio is of concern to the Bank of Israel, particularly to its Financial Stability Unit, which wrote in its semi-annual report of June 2015:

*The high level of the banks' exposure to housing credit, consumer credit and credit to the construction and real estate industry, and the correlations that exist between them, remained the main source of risk to the banking system. This is exacerbated by the low interest rate environment that has prevailed in the economy over time and which encourages greater risk-taking in the search for yield, including the risk of over-leveraging by borrowers.*<sup>60</sup>

In its semi-annual report from June 2016, the Financial Stability unit continues to warn

about a drastic fall in the price of housing:

*The steady increase in asset prices, and their relatively high level today, expose the financial system to the risk of a reversal of trend and a steep decline in prices...a downturn in asset prices may inflict losses on private investors, banks, and ordinary citizens who save via institutional investors. A steep decline in asset prices may also depreciate assets at the macro level and roll over into contraction of activity and consumption—possibly to the detriment of the economy.*<sup>61</sup>

These concerns have led in recent years to measures by the Bank of Israel to limit the exposure of the banks to the construction and real estate industry by setting a lid of 20–22% credit to construction and real estate out of the total credit issued by the banks.<sup>62</sup> The banks themselves do not share this concern, however, and have pressured the central bank to increase their exposure to the real estate and housing industry, whether from the lack of attractive alternatives or because of the lucrative profits in this sector.<sup>63</sup>

One question that should be asked in this context is why the Bank of Israel did not from the outset try to prevent the large exposure of the banks to the construction and real estate industry. And another question is why the government insisted on privatizing mortgages to the banks, a step that opened new and profitable areas of activity for the commercial banks, but harmed many of those in need of housing.

One is left with the impression that the Bank of Israel remembered to close the cheap credit gate only after the horses had already left the stable. In other words, the financial regulator was nowhere to be found when the bank horses galloped toward the profit-rich meadows, but now, as concerns grow about a possible crisis, it wakes up and asks the horses to slow down a little of their own volition.

## State Agencies – Summing Up

Over the past twenty years, since the waves of immigration from the former Soviet Union and Ethiopia have ebbed, the Israeli government and its various arms have withdrawn from active involvement in the housing market. Today, the financing, initiative, and implementation of home construction are almost exclusively the purview of the private sector. Withdrawal has exacerbated the already evident housing gaps, while the real estate bubble generates significant revenues for the state coffers – not at all consistent with the stated policy of lowering housing prices.

Regarding the Israel Land Authority, its activity is funded by income from the sale of land. Thus, as long as the ILA has no other source of income, it cannot be expected to reduce the overall price of land beyond discounts that are part of programs such as "Buyer's Price."

The local authorities also have policies that run counter to the declared desire of the decision makers to lower the price of housing. They tend to approve the construction of large homes for affluent families, which enhances their income via the local *arnona*

tax and reduces the town's outlays on social services, which affluent families need less.

And the Bank of Israel, by virtue of its role as guardian of Israel's "financial stability," is fearful of a significant drop in the price of housing, which could undermine the stability of the banking system.

All these lead to the conclusion that, given the current situation, if the state chose to play an active role in the housing market again in order to provide long-term solutions to the "housing crisis," this would entail, on the one hand, a loss of tax income to the Finance Ministry and, in parallel, renewed budget increases for construction and housing, which would probably necessitate heavier taxation on the affluent stratum (or cutbacks to the budgets of other ministries). A change like this would also entail larger aid packages to local authorities, as well as changes in the financial system to ensure its continued orderly operation in light of the reduced housing prices.

Meanwhile, the state through its various arms continues to pursue a policy whose direct or indirect outcome is preservation of the privileged position of the affluent stratum. In all matters related to young families whose means are limited, the state is willing to make only minor policy changes that offer partial solutions to a relatively small segment of those without housing. The current policy is far from meeting the vision of the Ministry of Housing from a decade ago – to provide "suitable and affordable housing in an appropriate neighborhood for every family."



# 4.

## The Large Banks

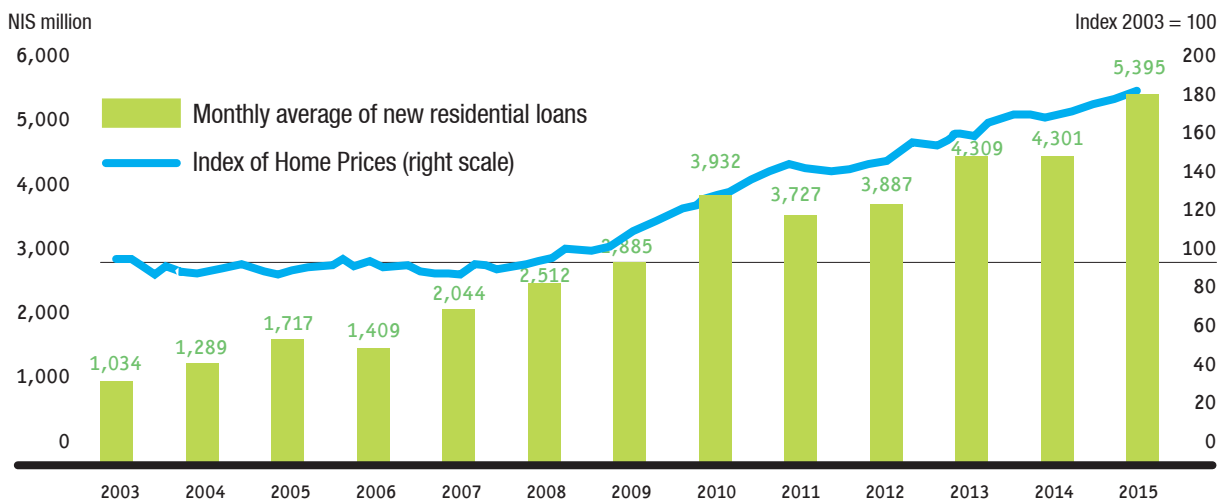
For banks in Israel, particularly the five large banking groups, the housing market today is a central and lucrative channel of activity. Banks are the main source of credit for the housing market – both to purchasers, most of whom use a bank loan (mortgage) to buy a home, and to developers and builders, who require financing for construction of the housing.

The total scope of mortgages issued by

banks is derived, of course, from the total number of mortgages and their size, which in turn are related to the price of housing. With the rise in housing prices and the increased activity of the real estate industry, the total scope of mortgage loans made by banks has also risen. In 2007, banks issued some NIS 2 billion of mortgages every month, and this has grown by a factor of 2.5 in 2015 to NIS 5.4 billion (at current prices).

### Monthly Average of New Housing Loans Granted

Total Banking System, and Index of Home Prices, January 2003 to December 2015  
Index (2003 = 100)



**Note:** The Index of Home Prices is up to date as of October 2015.

**Source:** Bank of Israel, *Israel's Banking System – Annual Survey 2015*, June 2016. Figure 1.36.



A graph from the report by the Bank of Israel's Supervisor of Banks clearly shows the correlation between rising home prices and the growing number of housing loans made by the banks to the public.

In 2015, 32% of all the credit issued by the five largest banks went to mortgages – double the amount of 2001 – while credit given to the business sector (not including construction or real estate), declined during that period from 47% of the total to 30% – less than what was issued for mortgages. Regarding the credit to construction and real estate developers: From 2001 to 2015, their proportion of credit dropped from 16% to 13%.<sup>64</sup>

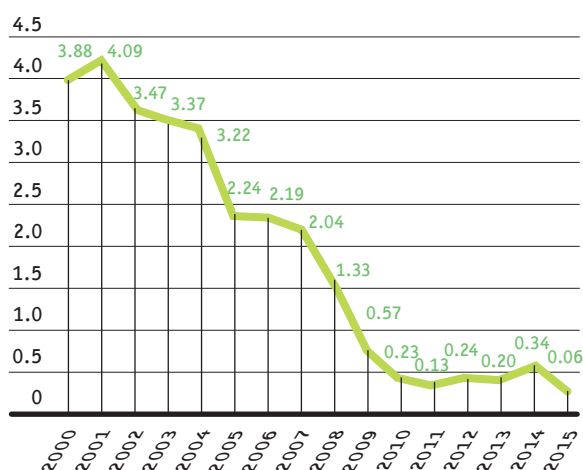
Nevertheless, the construction and real estate industry continued to dominate the field of credit to the business sector. In 2015, credit issued to construction and real estate was 29.3% of the total credit to the business sector – the highest proportion of all business branches, and much higher than the two branches that followed – business (excluding construction and real estate) and industry, which were 19.6% and 14.2%, respectively.<sup>65</sup>

This change in the credit portfolio of the banking world is the result, above all, of two changes in Israel's financial system. The first was the 2002–2004 decision by the government, then headed by Minister of Finance Benjamin Netanyahu, to drastically diminish government involvement in the housing market. As seen above, this manifested itself as far-reaching cuts in government support

for mortgages. As a result, the large majority of Israelis who need financial assistance to buy a home must turn to banks operating in a "free market" economy.

### Government Allocations for Housing Loans and Grants, 2000–2015

Net expenditures in NIS billions, at 2015 prices

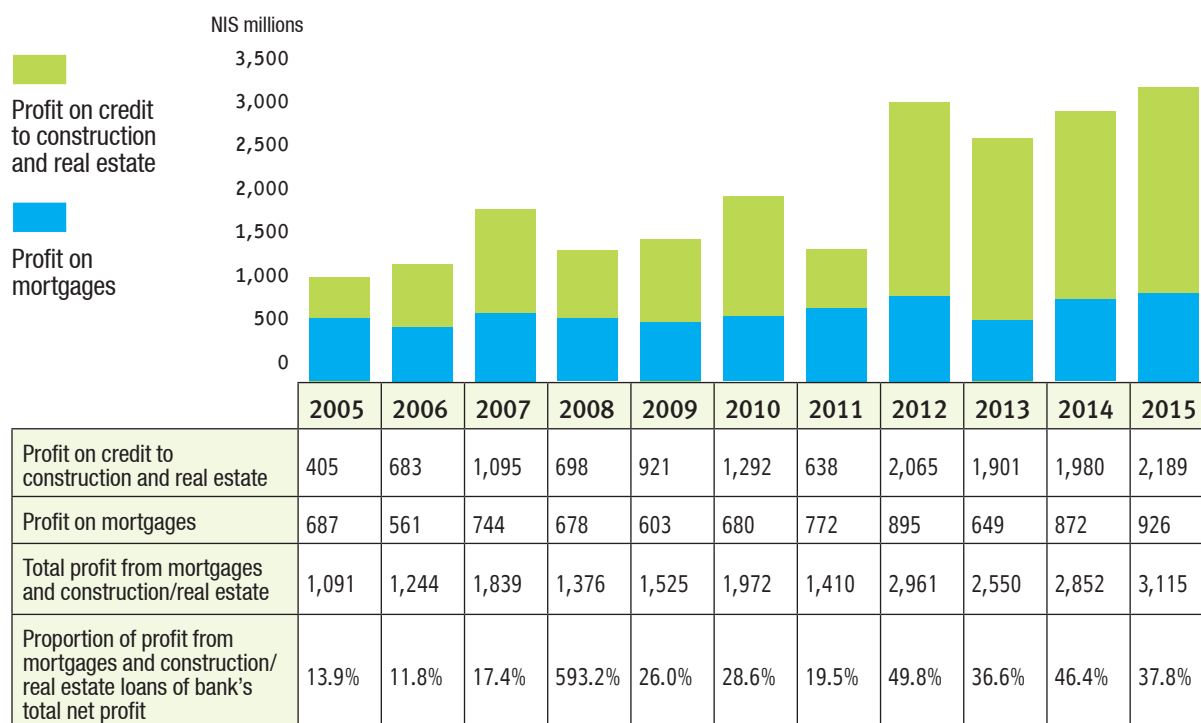


Source: Adva Center analysis of Ministry of Finance, Accountant General, *Financial Report*, various years.

The second change was the decision of the same government to privatize the pension funds, transferring ownership from the Histadrut to commercial insurance companies, which were to handle all new pension accounts. At the same time, the government changed the rules for the investment of pension savings: Until then, pension funds were required to invest at least 70% of the monies in government bonds and could invest up to 30% in other instruments; under the new rules, pension funds managed by the insurance companies would have to invest only

## Net Profit from Mortgages and Credit to Construction and Real Estate in Israel, and their Proportion of the Total Net Profit of the Five Large Banking Groups, 2005–2015

In NIS millions, at 2015 prices



**Sources:** Adva Center analysis of Bank of Israel, Supervisor of Banks, "Israel's banking systems – annual survey, various years; as well as annual reports of Bank Hapoalim, Bank Leumi, Discount Bank, Bank Mizrahi–Tefahot, and First International Bank, various years.

30% of their monies in government bonds and the balance could be invested in other channels. These changes placed the insurance companies into competition with the banks for financing Israel's business sector. According to Bank of Israel estimates, the banks in 2004 were the source of roughly 67% of the total credit supplied to the business sector, while in 2015, they constituted only 48% of the financing support of the business sector. Significantly, more than half the credit issued to the business sector today

comes from outside the banking system.<sup>66</sup>

On the other hand, insurance companies are not involved in extending credit to households, hence the mortgage business is reserved almost exclusively for banks.

Increased activity in the mortgage and construction markets has made these loans the most lucrative for the large, commercial banks. Over the past decade, the net profits earned by banks from mortgages and loans to the construction and real estate industry

have grown: In 2015, the five banking groups made a profit of NIS 926 million on mortgages and NIS 2.2 billion on credit to construction and real estate companies.

The fastest growth is evident in the credit provided to the construction and real estate industry, which leaped dramatically since 2012 and has maintained an annual profit of approximately NIS 2 billion, which constitutes between a quarter and a third of the total net profit of the banks. In parallel, profit from mortgages has grown together with the price of housing: Since 2009, profit from mortgages comprised about 10–15% of total bank profits. The chart below shows that in 2008, the year of the economic crisis, the banks experienced serious losses, with the exception of loans to housing and real estate, which continued to be relatively profitable and can be said to have saved the banks from ending the year with large losses.

In short, it can be said that the profit to the major bank groups in Israel generated from the housing and real estate markets grew markedly in the past decade, primarily since 2012. In 2015, bank profit from this market was NIS 3.1 billion – almost three times the profit earned from this sector in 2005, a decade earlier.

## **The Large Banks – Summing Up**

Withdrawal of the state from direct involvement in the housing market and the transition to "free market" policies enhanced the standing of the banks as key players in the housing market. With the drastic cuts to the government's budget for assistance, the banks' private mortgage portfolios grew concomitantly, together with their profit from mortgages.

Thus, the banks in Israel have a manifest interest in continuing the rise of housing prices, not just out of a concern for "stability," which is a consideration of the Bank of Israel, but also from simple profit-making motives. As noted, as long as housing prices continue to climb and the high demand for housing continues, the portfolio of mortgages and loans to contractors will grow and so will the bank profit.

In light of the central role played by the affluent in housing market activity, and as long as government policy remains unchanged, banking in Israel will continue to be guided primarily by the interests of this stratum, whose activity in the market is the most important source of bank profitability.

# 5.

## The Real Estate Companies

*Entrepreneurs want to make a profit, and that's only natural, we don't expect them to love the situation in which housing prices fall. The goal of entrepreneurs is for housing prices to go up, but they preach to us as if they want them to go down. (Amir Levy, Budget Director in the Finance Ministry, 6 June 2016)<sup>67</sup>*

Those with perhaps the greatest motive for keeping housing prices high are the companies that build the homes and sell them to the public – the real estate developers. Nevertheless, and strangely, developers and real estate people are often presented in public discourse, the media, and various conclaves as an "objective party," and asked to present their views about the housing market on one or another government program.<sup>68</sup>

Naturally, the more homes sold, the more profitable the real estate companies. This explains why these companies advocate to the state, the local authorities, and the Israel Land Authority to allocate more and more land for residential construction.<sup>69</sup> More land marketed, however, does not necessarily lead to more contracts, as real estate companies have a variety of business factors to consider.

Furthermore, real estate companies profit from the higher housing prices because this has not stemmed in recent years from more expensive raw materials or higher land prices, but rather from increased demand. Since the price of land also increases with the price of housing, the more time passes between purchase of the land and the sale of homes built upon it, the greater the profit to the real estate companies.

What is the profit made by the real estate companies in recent years from residential housing? Have they profited from the rise in prices; if so, by how much?

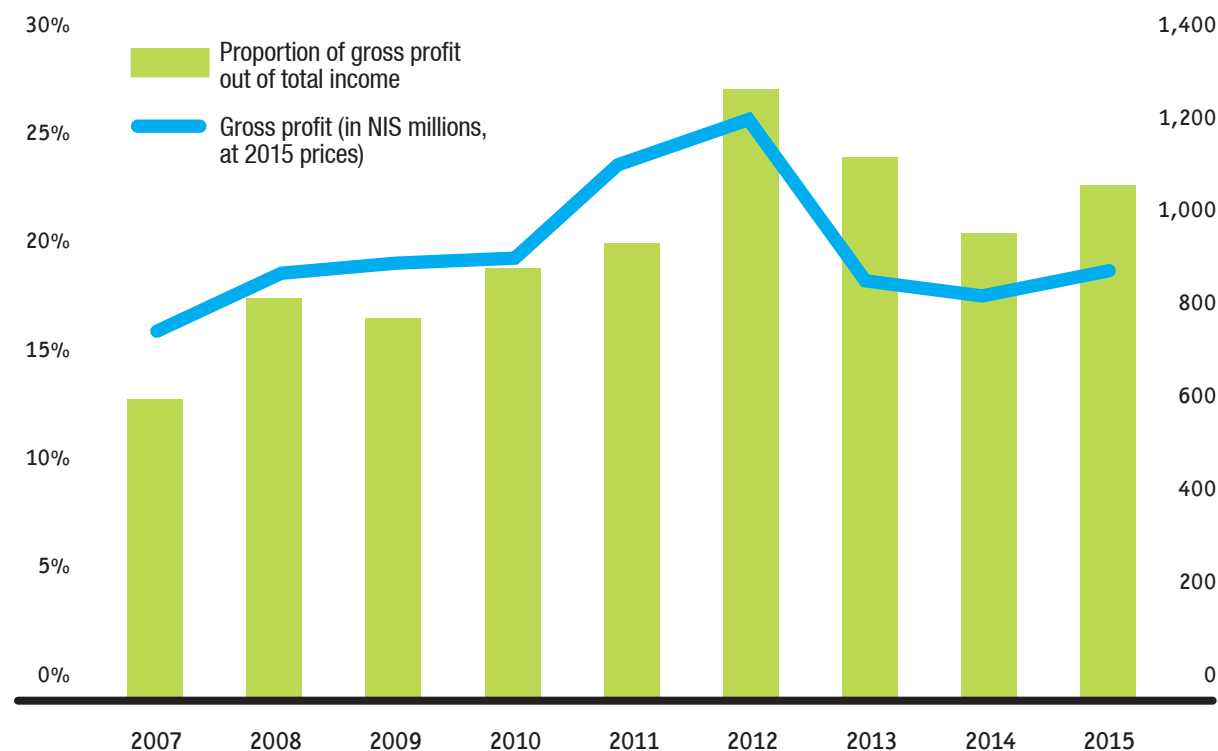
The answer to these questions is complex, as the Israeli housing market is relatively decentralized and there are hundreds of companies; some are very large and build luxury towers or entire neighborhoods, while most are medium or small, and may erect one apartment building or enlarge one. Note also that many of these companies, particularly the small ones, are private and do not publish data about their profits.

Nevertheless, it is still possible to examine the profit data of the largest, public real estate companies, whose business figures

## Gross Profit from Residential Real Estate Development, 2007–2015

Aggregate data of the ten largest, public real estate development companies in Israel

(Shikun and Binui, Africa Israel Residences, Azorim Investment, Ashdar, Y.H. Dimri, B. Yair, Kardan Real Estate, PBC, Minrav, and Prashkovsky)



### Notes:

Gross profit is the difference between revenues and imputed costs, without deducting monies spent on sales, marketing, administrative expenses, financing, or taxes.

In Shikun and Binui and B. Yair, it was not possible to isolate the figure for residential unit development, therefore the development of residential and non-residential units is presented together.

Data are from 2007; data from earlier years are not comparable because of changes in the system of accounting reports and adoption of the IFRS standards.

**Source:** Adva Center analysis of the annual reports of the surveyed real estate companies, various years.

are published in annual reports. We focus here on the ten largest, public real estate companies that develop and sell residential projects.<sup>70</sup> Although the real estate market in Israel is decentralized, the market share of these ten companies is not negligible, estimated at some 14% of all new apartment sales a year.<sup>71</sup>

Based on this, it can be seen that the average gross profit for residential projects of the large real estate companies in Israel rose from 16% in 2007 to approximately 19% in 2015, and was even as high as 24%–25% in 2011 and 2012. In absolute terms, the gross profit of the ten largest real estate companies in 2015 was some NIS 1.1 billion, compared

with NIS 600 million in 2007 – virtually half the amount.

Note that the figures above reflect the profits of real estate development companies, i.e., the companies that purchase the land, develop a residential project, and sell the homes to the public. These figures do not include construction companies hired by real estate developers to do the actual construction work, which enjoy much smaller profits: A study by *Globes* in 2011 found that the operating profit of construction companies was on average only 5%.<sup>72</sup> The precarious state of this industry has recently been given attention following the collapse of several construction companies, one after another, some of them large and well known.<sup>73</sup>

There are substantive conflicts of interest between real estate and construction companies. These appeared recently in the context of an initiative to bring foreign construction companies to Israel, which was supported by the real estate companies, but opposed by the local construction companies.<sup>74</sup>

## **The Real Estate Companies – Summing Up**

Those with the clearest motive for not lowering the price of housing, but for increasing the scope of construction, are the real estate developers, who profit directly from the growth of the housing market and the high price of their product. Thus, the developers work to increase the marketing of govern-

ment land and to lower construction costs, primarily by raising the quota of migrant workers in construction.

Like the banks, which profit from the activity of the affluent stratum in the housing market, so too the real estate companies. This then explains the lobbying of "senior real estate developers" against government programs that could adversely affect the affluent, as evident by their pressure on the Ministry of Finance against the proposed taxation on investors.

With respect to growth in the profit of real estate companies, the data above indicate that one reason for this is the increased value of homes. Nevertheless, the pace of their rising profits is slower than the pace of rising housing prices, as others have also increased their revenues as a result of the rising prices, including the state and the big banks.

The surge in real estate development profits combined with the continuing crisis in the construction industry raise the question of why there is no serious discussion about replacing the real estate companies with state agencies. The Ministry of Construction and Housing, for example, could take charge of the development, while construction is handled by contractors, ensuring a full return on investment while providing contractors with stable and profitable work. Such state activity would also encourage construction companies to adopt more modern construction technology, currently not done, given the cheapness of labor.

# 6.

## The "Real Estate Bubble" and the Israeli Economy: More Investment in Residential Construction, Less in Other Industries

*One day someone will investigate this strange period of recent years and ask why, just when money is cheaper than ever, investment in the economy is in decline. (Sami Peretz, The Marker, 22 January 2016)<sup>75</sup>*

The rise in housing prices, sometimes referred to as "the housing crisis" or "the real estate bubble," harms those who wish to purchase a home as well as those who have purchased one but are burdened with high mortgage payments. On the other hand, high housing prices are good for the affluent stratum, state revenues, and the profitability of banks and real estate companies. All this, however, adversely affects various sectors of the economy and various segments of Israeli society. But beyond all these, there is one more issue, which is the price that the Israeli economy as a whole is paying.

The "Israeli economy" is a much vaguer entity than "young couples from the middle class," and it conflates a variety of interests, some in conflict with one another. However, this is the

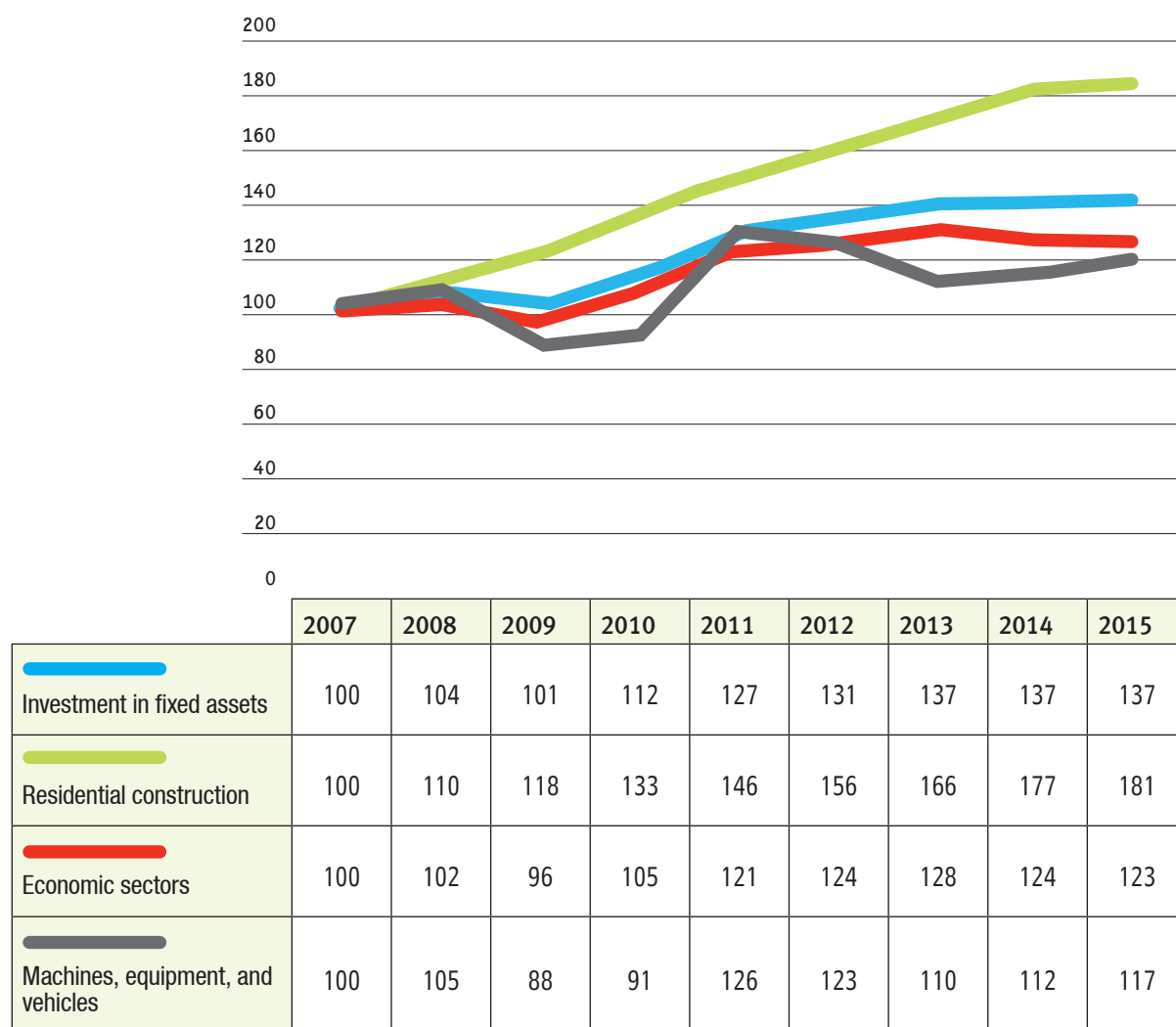
conceptual level on which the entire macro-economic discussion takes place.

The "economy," then, seems to fare poorly from the developments described above. Of primary concern is the fact that the "real estate bubble" attracts money to the housing market that could have been invested in economic activity that is productive and creates jobs. In other words, profits from the housing market enjoyed by "market forces" come at the expense of investments that could have advanced the economy as a whole.

The scope of the problem is evident in data about fixed asset investments. Fixed assets are assets that create income over the long term, and include investment in the construction of buildings and infrastructure; the purchase of machines, equipment, and vehicles; and the acquisition of intellectual property (patents and the like). Although investment in residential buildings is also a fixed asset investment, once these buildings are constructed, they no longer serve as business activity or generate new income. Therefore,

## Investments in the Economy: In Fixed Assets, Economic Sectors, Residential Construction, and Machines, Equipment, and Vehicles, 2007–2015

Index 2007 = 100



**Source:** Adva Center analysis of the CBS Central Databank, August 2016.

fixed-asset investment statistics generally distinguish between investments in residential buildings and investments in other economic sectors.

Data from the Central Bureau of Statistics reveal that during the period 2007–2015,

when the scope of investment in residential construction increased by 81%, investments in the other economic sectors grew by only 23%. In other words, ever since the "real estate bubble" came into being, residential construction has attracted an ever-growing



## Components of the Investment in Fixed Assets: Residential Construction and Investment in Economic Sectors

In percentages

	Investment in residential construction	Investment in fixed assets in other economic sectors	Total investment in fixed assets
2000	25%	75%	100%
2001	24%	76%	100%
2002	26%	74%	100%
2003	27%	73%	100%
2004	27%	73%	100%
2005	27%	73%	100%
2006	25%	75%	100%
2007	24%	76%	100%
2008	26%	74%	100%
2009	28%	72%	100%
2010	30%	70%	100%
2011	30%	70%	100%
2012	31%	69%	100%
2013	32%	68%	100%
2014	34%	66%	100%
2015	34%	66%	100%

**Source:** Adva Center analysis of CBS Central Databank, August 2016.

share of the monies invested in the Israeli economy.

The table on p. 42 shows that from the early 2000s until the financial crisis of 2008, investment in residential construction con-

stituted a quarter of the total investment in fixed assets in the economy. Since 2008, however, residential construction has drawn an increasingly larger share of the total investment in fixed assets, up to 34% in 2015.

Had the investment in fixed assets been distributed in 2015 similarly to their distribution in 2007, the other economic sectors would have enjoyed 10% more investment in fixed assets in 2015. This amounts to some NIS 22 billion. Rather than channeling this money to diverse economic sectors, it was invested in residential construction, which was profitable to all the groups and institutions surveyed here – but not necessarily to Israeli society as a whole.

Figures published by the Bank of Israel reinforce this claim, noting that construction industry product increased between 2007 and 2013 by 7.9%, a more rapid rate than that of the GDP, which grew by 3.5%. As a result, its share of the GDP increased from 4.4% in 2007 to 5.7% in 2013.<sup>76</sup> The Bank of Israel attributes this increase of investment in the construction industry to the sharp rise in demand, which led to increased investment in residential housing and a complementary increase in investments in other construction, particularly infrastructure.

But doesn't the construction of housing make a contribution to the Israeli economy, including job creation?

The Bank of Israel found that although there is a contribution, it is less than that of oth-

## Periods of Growth and Contraction in Construction Industry Product, 1961–2015

(annual average, in percentages)

Period	Average annual growth					Construc- tion's contribution to growth	Construc- tion's share in GDP
	Population	GDP	Construc- tion industry product	Investment in residential construction	Investment in other con- struction		
1961–1972	3.4	9.4	9.2	11.1	4.1	1.0	10.8
1973–1986	2.1	3.5	–2.0	–2.9	–2.3	–0.2	5.0
1987–1996	2.9	5.4	10.0	9.8	13.9	0.5	7.7
1997–2007	2.1	4.0	–1.1	–1.9	–2.3	–0.1	4.4
2008–2013	2.0	3.5	7.9	9.3	5.5	0.3	5.7
2014–2015	1.7	2.3	–2.2	0.4	–3.7	–0.1	5.3

### Notes:

The contribution to growth is equal to the growth rate of construction industry product multiplied by its share at the end of the previous period.

Construction's share in GDP is measured for the end of the period.

**Source:** Bank of Israel, Research Division. *The Construction Industry and its Contribution to Growth*. December 2015.

er sectors of the economy. First, the direct contribution of the construction industry to growth has declined over the years, similar to what is taking place in other developed economies. In the period 2008–2013 during which, as noted, the construction industry grew by almost 8%, its contribution to the overall economy was only 0.3%. With respect to its contribution to jobs, here, too, the building industry is not the bearer of good news: During the years that the construction industry expanded, there were 4.2% more workers in construction, while job growth in general increased by 2.8%. However, this increase in construction jobs was primarily due to the higher number of Palestinians and

migrant workers in those jobs: When the contribution of the construction industry to job growth is examined among Israelis only, it comes to 3.1%, versus 2.7% in the economy in general.<sup>77</sup>

## The Real Estate Bubble and the Israeli Economy: Summing Up

The real estate bubble has increasingly diverted investment money to the real estate market, both from developers and purchasers, monies that under other conditions could have been invested in economic activity that is productive and generates jobs.

The real estate bubble is not only damaging

to the Israeli economy, but itself obstructs the finding of a government solution. This is because the bubble created a growing dependence on the residential construction industry, a dependence that affects how decision makers perceive the implications of effective policies for lowering the price of housing.

An example of this can be found in the words of Yoav Galant, Minister of Housing, in response to the question of whether in his opinion the state has an interest in lowering the price of housing:

*Real estate is the anchor of the economic stability of the state. Lowering the prices could bring about an enormous economic crisis. Currently the economy is slowing down, whether we like it or not, and therefore any extreme measure could worsen the economic situation.*<sup>78</sup>

# Notes

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- 4 Adva Center analysis of data from the Central Bureau of Statistics (CBS), *Survey of Household Income and Expenditures 2014*, August 2016.
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