



The Residential Real Estate Market in Israel

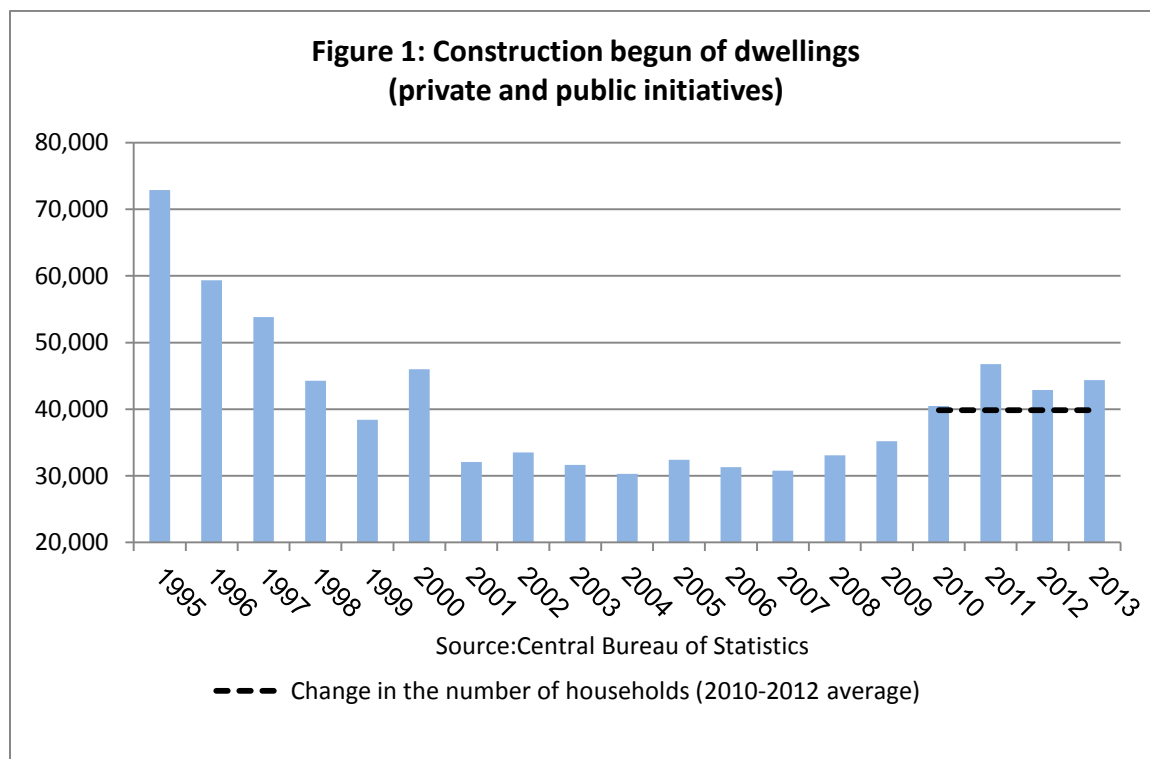
March 2014

*Finance & Economics Division
Economics Department*

Author:
Sagiv Malki

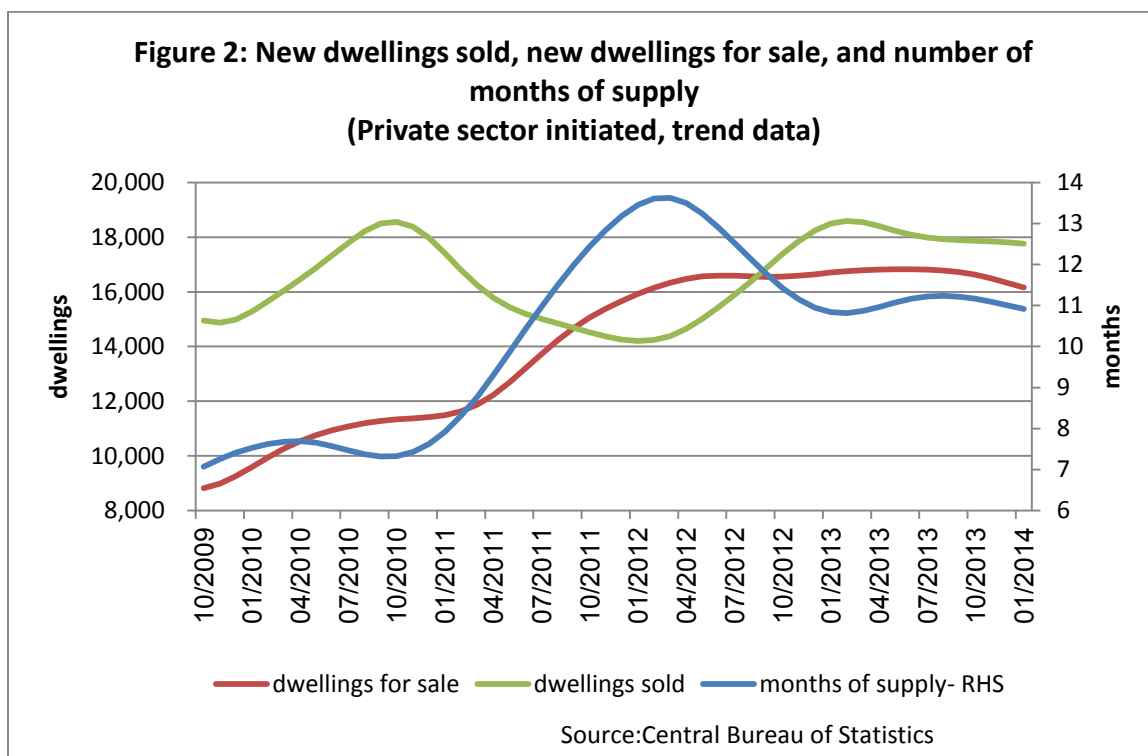
English Editor:
Noach Hager

Housing starts in 2013 amounted to 44.3 thousand housing units, which is an increase of 3.4% compared to 2012. Figure 1 illustrates that this number is greater than the average annual increase in the number of households from 2010-2012. It appears that in the steady-state, this level of housing starts is an adequate level for the domestic market. In addition to the increase in the number of households, additional factors affecting demand include the replacement of old buildings (depreciation) and purchases by foreign residents (with a portion not being rented out).



According to a report for the third quarter of 2013 by the Ministry of Housing, from January–November 2013, the Israel Lands Authority (ILA) approved the applications for 26.6 thousand housing units (29 thousand annualized). This level is higher than that of 2012 but similar to the level of approvals in 2010 and 2011. It is difficult to translate this data into precise forecasts for the number of housing starts in the coming years for two reasons: housing starts include construction on privately owned land and; there can be a long and variable period of time between building approval and laying a building foundation (known as stage 7, which is defined as “housing start”). However,

based on historical data, applications approved by the ILA account for 50% of total housing starts and the time period between application approval and laying the building's foundation is a year and a half, on average. Therefore, we believe that the first half of 2014 will likely be characterized by a moderate decline in housing starts with a recovery in the second half, resulting in a forecast of 39-42 thousand housing starts in 2014, with an increase in the number of housing starts in 2015.



The report by the Ministry of Housing also showed that in the first 10 months of 2013, sales of new and second hand apartments amounted to 90.7 thousand units (108.9 thousand units annualized), which represents an increase of 10% compared to the corresponding period in 2012. There are several reasons for this increase: a portion of transactions in the second quarter were fast tracked in anticipation of the increase in VAT in June, cessation of the financial incentives for buying new homes in the periphery¹,

¹ Government resolution (3282) from June 5th, 2011, which includes assistance of up to NIS 100 thousand for young couples and first time home buyers who purchase a house in the periphery. Government resolution (302) from May 13th, 2013, canceled this benefit.

changes in taxation on luxury apartments as well as fear of government plans (not implemented) to raise the purchase tax on those upgrading their dwelling.

According to data from the Central Bureau of Statistics, new home sales accounted for approximately a quarter of all sales. In 2013, 24.4 thousand new housing units (constructed under private and public initiatives) were sold, representing an increase of 9.4% compared to 2012.

Figure 2 shows the number of total sales of apartments by private sector initiated construction, the level of housing inventory and the number of months of supply². In recent months there has been a decrease in the number of apartments sold. Simultaneously there has been a decrease in the level of housing inventory, which lead to a slight decrease in the number of months of supply.

According to the report by the Ministry of Housing, in the first 10 months of 2013 the majority of transactions were carried out by first time home buyers and those upgrading their housing (36% of the transactions were carried out by each of these segments). The proportion of apartments purchased as an investment was 22%. A recent review of the Bank of Israel³ analyzed the proportion of apartments purchased as an investment in Israel over the past decade. This figure, which peaked at 30%, has experienced significant volatility as a result of several key events.

The shifts in the share of purchases for investment (buy to let) over the past two decades was influenced by changes in tax laws, such as: revision and broadening of tax on capital gains, tax on income from assets held abroad, an increase in the purchase tax rate and a reduction in tax exemptions on rental income; Geo-political events, such as the "Iraq War" (known also as the "Second Gulf War" -- 2003); Policy reforms targeting the credit market, such as limitations on the LTV ratios for specific purchasing segments (first time

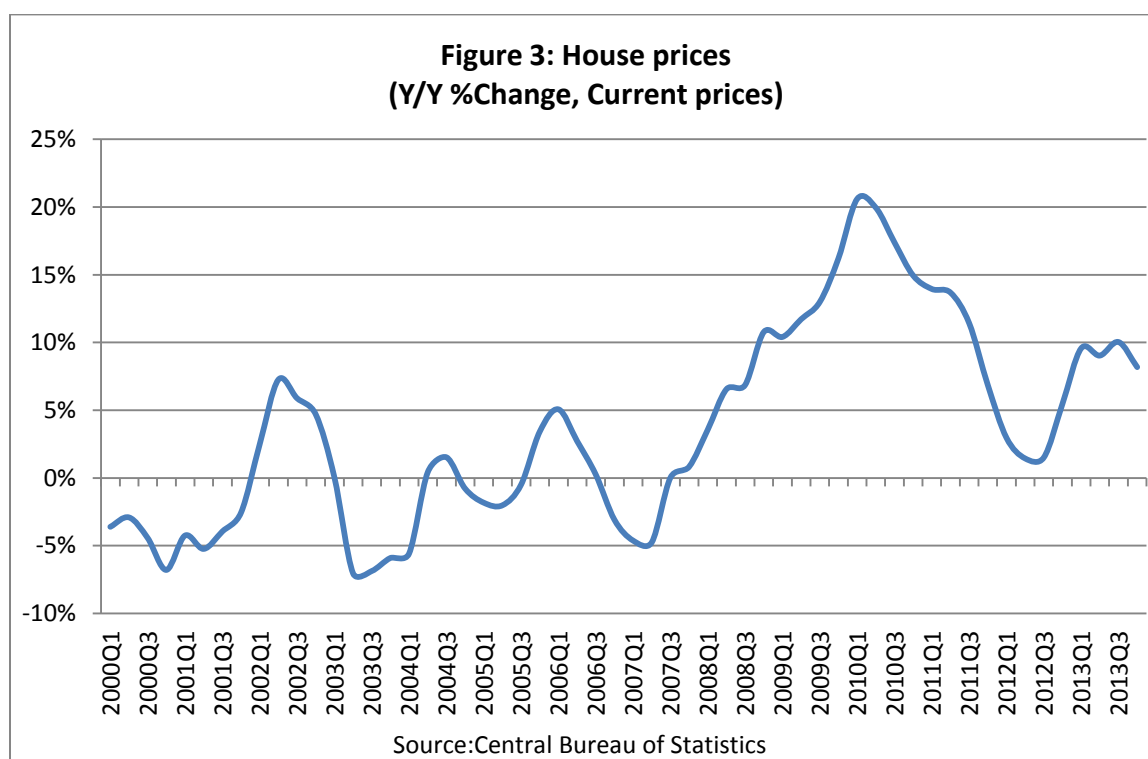
² Number of months it would take for the current inventory of homes on the market to be sold, given the current pace of home sales.

³ "Home Purchasing Patterns by Domestic Investors, 2003-12", Recent Economic Developments (April-September 2013), vol. 136.

homebuyers, investors etc.) and restrictions on the composition of the interest mix of mortgages.

Another aspect contained in the review by the Bank of Israel was the geographical breakdown of housing purchases for investment purposes. In 2005–2006 there was a significant increase in housing purchases in the center of the country, followed by an increase in transactions in the North and South. This transition was the result of high housing prices in the center, which minimized the potential profitability from capital gains and rental income.

Figure 3 displays the change in the housing price index (which is based on Israel Tax Authority data on real-estate transactions), which measures the monthly change in housing prices after adjusting for discrepancies in the profiles of apartments sold. These transaction based data are not included in the CPI. As illustrated in the graph, the trend of housing price increases that began in 2007 is continuing.



The report by the Ministry of Housing, which presents housing prices without adjusting for differences in the characteristics of dwellings, showed that the average price for a residence in the third quarter of 2013 was NIS 1.26m. This represents a nominal increase of 5.3% compared to the corresponding quarter in 2012 (3.7% in real terms) and an increase of 2.6% over the previous quarter. The following table displays housing prices and rates of change for new and second hand homes in different areas within Israel.

Housing Prices (3Q 2013):

Area	Total			New Apartments			Second Hand Apartments		
	Average Price (NIS m)	Rate of Change (Y/Y)	Rate of Change (Q/Q)	Average Price (NIS m)	Rate of Change (Y/Y)	Rate of Change (Q/Q)	Average Price (NIS m)	Rate of Change (Y/Y)	Rate of Change (Q/Q)
Jerusalem	1,531	-3.1%	-5.3%	1,985	13.2%	5.4%	1,382	-7.9%	-10.0%
Tel Aviv	1,794	7.3%	4.9%	2,298	0.3%	4.6%	1,583	1.8%	2.3%
Haifa	992	11.6%	5.6%	1,292	2.6%	18.5%	857	7.8%	-0.6%
Center	1,431	2.2%	-2.1%	1,647	0.0%	-2.0%	1,300	3.0%	-4.1%
North	748	5.1%	-1.4%	1,069	6.2%	18.0%	674	8.2%	-2.2%
South	898	9.9%	5.2%	1,169	8.8%	7.3%	795	9.1%	3.4%
Judea & Samaria	1,152	6.9%	0.8%	1,177	9.3%	10.1%	1,130	3.7%	-3.9%
Total	1,264	5.3%	2.6%	1,529	5.6%	9.4%	1,143	3.1%	-1.5%

Source: Ministry of Housing

The median price for a residence in Israel was NIS 1.18m during the third quarter of 2013, with the median price for new and second hand dwellings were NIS 1.4m and NIS 1.03m, respectively. This data represents an increase in the median apartment price in each of the segments of 11%, 3.3% and 10%, respectively, compared to the corresponding period in 2012.

A review by the Bank of Israel from October 2012⁴ examined the change in prices for land available for residential construction from 1998–2012. This review is particularly relevant because the price of land is a significant component that contributes to the final price that the purchaser of an apartment is required to pay. The analysis, which took into account parameters like location, size and zoning, found that the greatest price increases occurred during 2008–2011. The review also showed that during

⁴ "Residential Land Prices, 1998-2012", Recent Economic Developments (October 2012-March 2013), vol. 135.

the period under analysis (1998–2012), land prices and construction input costs increased at a faster pace than housing prices. However, after 2007 the trend was opposite, with housing prices rising at a much faster rate.

A geographical breakdown of the data shows that there is a high correlation between the rate of change of land prices and housing prices in the center of the country. In this manner, from 2006–2011, both land and housing prices rose by 60%. However, in the periphery (North and South), land prices rose by 15% during the same period, while housing prices rose by 50%. In absolute terms, during the period of 2006–2011, the price of land per housing unit in the center (excluding VAT) rose by NIS 250 thousand while average housing prices increased by more than NIS 500 thousand. For comparison, in the periphery, land prices rose marginally during the same period while average housing prices increased by more than NIS 250 thousand.

It is important to note that according to the homebuilders association, the gap between the increase in housing prices and land prices in the periphery was a result of improved planning and construction standards that came into effect at the beginning of the decade (which attributed to NIS 170 thousand of the increase in housing prices on average). In the periphery, construction costs are a larger component in the overall cost of housing and therefore the association claims that the effect of the changes was greater, leading to increased housing prices.

There are two main factors that affect the increase in the price of land: the distance from Tel-Aviv and the socio-economic environment of the area. The importance of the first factor (distance from Tel-Aviv) can be inferred from data published by the Israel Lands Authority that shows the proportion of land purchased from total land marketed through tenders. From 1998–2012, the proportion of marketed land in the center of the country that was sold was 84%, compared to 58% in the periphery. Furthermore, from 2010–2011 the proportion of land in the center that was sold was 94%. These figures illustrate the shortage of land available in the center of Israel, which contributes significantly to high housing prices in the area.

We estimate that the change in the housing price index, according to data published by the Central Bureau of Statistics, will be in the range of –2% to 5%

during 2014. Factors contributing to our forecast for the continuation of housing price increases, albeit at a moderate pace, include pressure on the supply side (inventory available for sale remains low for the near term), low financing costs (mortgage rates) and an unemployment rate which is expected to increase at a moderate rate during the course of the year. It is important to mention that it seems that housing prices in the periphery are more vulnerable to price shocks as a result of the amount of land that can be made available for residential construction.

Furthermore, a new proposal was announced in the middle of March 2014 for the exemption of VAT on the purchase of a new apartment by specific segments of the population. If the proposal is approved and enacted in its current form, it should result eventually in additional demand for new housing and a moderate decline in demand for second hand apartments.

The data, information, opinions and forecasts published in this publication (the "Information") are furnished as a service to the readers and do not necessarily reflect the official position of the Bank. The above should not be seen as a recommendation and should not replace the independent discretion of the reader, nor should it be considered an offer or invitation to receive offers or advice – whether in general or in consideration of the particular data and requirements of the reader – to purchase and /or to effect investments and/or operations or transactions of any kind.

The Information may contain errors and is subject to changes in the market and to other changes. Likewise, significant discrepancies may arise between the forecasts contained in this booklet and actual results. The Bank does not undertake to provide the readers with notice, in advance or in retrospect, of any of the aforementioned changes by any means whatsoever.

The Bank and/or its subsidiaries and/or its affiliates and/or the parties controlling and/or parties having an interest in any of them may, from time to time, have an interest in the information represented in the publication, including in the financial assets represented therein