

STATE OF ISRAEL

Economic Analysis and Information Division

Ministry of Construction and Housing

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Developments in the Construction Industry and Ministry of Construction and Housing Activities, March, 2012

In the year 2011, there was a consistent reduction in the rate of increase of apartment prices, and the second half of the year brought with it a monthly decline of prices for the first time since 2008. This moderation of apartment prices was influenced by the continual rise in supply, in light of the continued and significant marketing initiative of the Ministry of Construction and Housing and the Israel Lands Authority, as well as the moderation seen in demand especially during the second half of the year. However, the data shows a considerable increase in demands in the month of December 2011 and includes initial data from January 2012.

It appears that the improvement in demands at the end of the year was influenced by the interest rate cuts by the Bank of Israel, who was assisting potential apartment buyers. On the other hand, the large amount of supply and inventory, in contrast to the low volumes in 2009, allowed a reasonable response to the demand while maintaining stability or even a drop in prices.

Today, the price of apartments is only 3% higher than the long-term trend line, while over the years, the deviations ranged from 29% over the trend line in 1997 to 19% under the trend line in 2007.

The following are details of major trends of the supply and demand in 2011 which affected the slowdown of the rise of apartment prices:

Supply

- **Marketing** – The scope of marketing of the Ministry of Construction and Housing and the Israel Lands Authority through public tenders as well as additional frameworks reached about 37,200 housing units in 2011. Approximately 9% higher than the scope of the previous year and about 44% higher than in 2008 (25,800). The marketing volumes in 2011 are the highest since 1997.

- **Housing Starts** – The amount of housing starts in 2011 reached approximately 44,000 housing units, compared with 40,000 in 2010 and 35,000 in 2009 (in the years 2001-2008 there were only 32,000 housing unit starts). In the last quarter of this year there was a relative decline.
- **Privately initiated Building Permits** reached 36,000 in 2010, and based on estimates for 2011 the magnitude will be similar; this is a significant increase compared to previous years (about 23,000 to 30,000 in the years 2000-2009). However, it is evident that the second half of 2011 showed a slowdown in the volume of permits issued (yielding an annual rate of 33,000).
- **The number of dwellings under construction** continues to rise and has reached close to 80,000 at the end of 2011; this is a peak in increase since June 1999, 14% higher compared to the end of the previous year. The increase in housing construction is particularly striking since mid-2009.
- **The supply of new dwellings for sale** (of dwellings whose construction has begun) continues to rise rapidly to about 20,000 units in January 2012 (of which 5,500 are from public initiative) compared to about 15,000 at the end of 2010. This is an increase of about 32% which comprises an addition of 5,000 housing units.
- **Encouraging the sale of investment properties** – during 2012 an increase in the supply of dwellings available for investment purposes is expected in light of legislative reforms which included an increase in Betterment tax exemptions until the end of the year and more stringent eligibility conditions for exemptions for selling investment apartments starting in 2013.

The increase in government initiated marketing is expressed as an increase in housing starts on State land that reached 50% in the second half of 2011 compared to 45% in 2010, an increase in construction investment and investment in public construction and an increase in the relative number of housing starts from public initiative to more than 16% of the total in 2011 compared to only 12% in the previous two years. This initiative is expected to bring an increase in sales in 2012 in light of the increase in marketing and housing starts.

Housing starts initiated by the Ministry in 2011 originated mainly from marketing at the end of 2009. As a result of the extensive marketing in 2010 and 2011, it appears that a higher pace of housing starts, at least in the next two years, is to be expected.

Demand

- **The interest rates of the Bank of Israel** dropped by 0.75 accumulated percentage points from October 2011 and reached 2.5%. This points to a changing trend in rising interest rates which began at the end of 2009 when interest rates stood at 0.5%. The decline in interest rates results, among other things, from signs of local economic slowdown, the danger of financial crisis, global recession and a lowered inflation environment. The Bank of Israel interest rate affects the free interest rate of housing loans (with lagging influence) and was one of the main reasons for the rising costs of housing in 2009 and

2010 and their leveling off in the second half of 2011. The recent decline in interest rates helps to improve the demand for the purchase of apartments.

- **Upon implementing new housing loans** a decline of about 45 billion NIS in 2011 compared to about 48 billion NIS last year is evident. The decline sharpened with each quarter in 2011 from 12.8 billion in the first quarter to about 8.5 billion in the last.
- **The scope of housing transactions (new and previously owned dwellings)** showed a significant moderation which was evident in 2011 and throughout all quarters of the year. The total volume of transactions reached about 86,400 compared to more than 100,000 in the two previous years. Since November 2011 an improvement in the scope of transactions is evident compared to the slump seen in the three previous months.

This decline is particularly evident in new housing transactions whose relative weight of the total number of housing transactions decreased to about 22% in 2011 compared to about 24% in the previous two years.

- **Decline in the number of new dwellings sold** – in 2011, 19,200 new dwellings were sold (about 1,600 monthly average) compared to 22,700 in 2010 (a decrease of about 15%). Very low volumes were recorded during August to November 2011 (an average of 1,220 monthly). In December 2011 and January 2012 there was an improvement (1,970 monthly average).

Construction for Own Use – the number of housing units for ‘construction of own use’ in 2011, reached about 19,000 housing units, an increase of 8% from the year before of about 17,500 units. In the last quarter of 2011 the scope was relatively low.

- **A decrease in homes purchased by investors** – from Treasury data processed by the Economic Analysis and Information Dept. of the Ministry of Construction and Housing, it was found that in 2011 about 21,000 apartments were purchased for investment, a decrease of 30% in comparison to the previous year. In the last quarter of the year about 4,500 homes were purchased, a decrease of about 51% compared to the corresponding quarter in the previous year, which was characterized by an especially high volume of purchases. The proportion of apartments purchased for investment in 2011, stood at about 25% of total transactions.
- **Decrease in the rate of GDP**- in the second half of 2011 the increase in the rate of GDP slowed down to 3.6% in the annual calculation compared to 5.3% in the first half of the year and 5.8% in the second half of 2010 (in 2011 a quarterly decline began from 4.8% to 3.2% at the yearly product growth rate).
- **Decrease in the Capital Market Value** in 2011 amounted to about 18% in the Tel Aviv 25 index, which reflects expectations of economic activity, reduces the public’s savings and sense of wealth and consequently the demand for apartments. Raising

the tax rate on capital market gains to a rate of 25% from the beginning of 2012 (instead of 20%) creates some benefit to purchase investment dwellings as an alternative investment to capital marketing.

- **The unemployment rate for ages 15 and older** decreased to 5.6% in 2011 compared to 6.6% in 2010 and 7.5% in 2009. The decline is pronounced during the quarters of 2011 (from 6.0% in the first quarter to 5.4% in the last). The rate of participation in the workforce saw a slow increase and reached 57.4% in 2011.
- **State income from Real Estate Tax** in 2011, amounted to 7.3 billion NIS; a real increase of 7% compared to the last year. However, low volumes are evident since August 2011 compared to previous months in 2011 (516 and 674 million NIS monthly average, respectively). The growth compared to the previous year resulted from additional collection for transactions from previous years and the slowdown later in 2011 was influenced by the decline in demand.

The main causes which influenced the moderation of demand during 2011 and especially in the second half of the year were measures taken by the Bank of Israel in the area of interest rates – the lagged impact of the increase of interest rates from 2009 through the first half of 2011, limitation of credit in variable interest rates for one-third of the total loans in May 2011, expectations of moderating housing prices and the social protest. However, at the end of 2011 a change was evident and there was a rise in demand relative to the months of August to October. In contrast, there was a distinct continued decline in the unemployment rate and a rise in the rate of participation in the workforce despite the slowdown in economic growth.

Additional aspects of activity in the industry:

Number of salaries required to purchase an apartment

An assessment of the home buying situation may be determined by evaluating how many average salaries are necessary in order to purchase a home. Beginning in 2005 until mid-2008 the rates of change in housing prices and salaries was similar. Since then, housing prices have risen by about 42% more than the rate in which salaries rose for the average wage earner (about 62% and 14%, respectively). **It should be noted that since 2005 the average real wage per employee did not rise, but remained stable, and as a result of the rise in housing prices, it became significantly more difficult to purchase an apartment.** A further assessment of the Economic Analysis and Information Dept. indicates that the number of salaries required to purchase a four room apartment in 2011 comes to an average of 138 monthly salaries (cost of a new apartment is 149 monthly salaries and a previously owned dwelling is 133 monthly salaries).

Apartment Prices versus Rental

An examination of the ratio between housing prices (based on privately-owned dwellings index) compared to rentals indicates that from 2005 until mid-2009 the rates of change were similar.

Since then housing prices have gone up by a nominal rate of 32% compared to only 13% for rentals, creating a gap of 18% between the two indices while the average rate of return from rentals declined. **It should be noted that during 2011 the gap between 16% to 20% stabilized.** A relative price rise in housing prices is expected to increase demand for rental apartments from potential renters, while a decline in demand for purchasing apartments, thereby creates pressure to reset the equilibrium.

Employees in the Construction Industry:

The average number of Israeli residents employed in the construction industry in 2011 came to about 162,500 compared to 157,000 during the previous year. The pronounced increase in the number of Israeli residents employed in construction in the last decade is influenced by the decline in the number of foreign workers, and in the last two years, by the increase in the volume of activity in this sector, especially in residential construction. At the same time and due to increased demand for workers, there was an increase in the average wage per employee in the industry to about 86% of the average wage in the general economy compared to about 83% in 2007 (for Israelis only, about 90% compared to 86% in 2007). In the construction industry there was an increase in the number of job vacancies from about 8,000 at the end of 2010 to 12,000 at the end of 2011. In the “wet work” (actual construction work) alone there was an increase from about 3,000 to 6,000 vacancies, respectively).

The number of non-Israeli workers' permits stands at about 19,500 for Palestinians (not including Palestinians working in the West Bank), including an additional 4,000 permits issued in 2011. The numbers of foreign workers is in the range of 8,000 workers, while a gradual replacement of workers in Israel by workers from Bulgaria and Romania as part of bilateral agreements is expected.

Affordable Housing and Assistance to those with Eligibility

The marketing increase also focuses on designated populations and those lacking housing. Recent decisions include promoting construction projects for renting in two tracks, while offering a discount on the land (tenders are expected shortly in Modiin, Ra'anana and Kfar Saba, and among other places as well). At the same time, there is a plan to market land to build student dormitories by allocating land without payment. Additionally, the Ministry is operating a project within the framework of ‘specially reduced apartment prices’; for people who fit into special criteria categories and who do not own apartments. Decisions taken by the Israel Lands Council include new criteria for allocation and require the construction of small apartments that include land discounts.

Within the framework of ‘assistance for the eligible’, as of July 2011 there is a ‘Grants and Subsidy’ development program for purchasing new apartments in approximately 28 communities in the periphery. The program includes a conditional grant of 60,000 NIS and an increase of subsidies for land development. The Ministry is working to increase marketing in these communities.

At the beginning of 2012 the Government approved a subsidies update for development expenses in communities in the National Priority areas while adding communities and ranking them anew.

Beginning early 2012 the interest rate on mortgages for those with eligibility was lowered to only 3%. This decision is expected to increase the realization of State loans by those with Ministry eligibility.

Additional information about the Ministry's activities in the area of eligibility assistance may be found on the Ministry's website at: www.moch.gov.il.

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