

# AGENCY FOR INTERNATIONAL DEVELOPMENT PPC/CDIE/DI REPORT PROCESSING FORM

ENTER INFORMATION ONLY IF NOT INCLUDED ON COVER OR TITLE PAGE OF DOCUMENT

1. Project/Subproject Number

2. Contract/Grant Number

3. Publication Date

4. Document Title/Translated Title

5. Author(s)

1. Milagros Navita - Kennett
2. John Miller
- 3.

6. Contributing Organization(s)

7. Pagination

8. Report Number

9. Sponsoring A.I.D. Office

10. Abstract (optional - 250 word limit)

11. Subject Keywords (optional)

1. Israel	4. Construction industry
2. Housing Policy	5. Housing Finance
3. Housing Needs	6. Settlement Establishment

12. Supplementary Notes

13. Submitting Official

14. Telephone Number

15. Today's Date

16. DOCID

17. Document Disposition

.....DO NOT write below this line.....

## **ABSTRACT**

### *An Introduction to the Israel Shelter Sector*

This report provides an overview of the major issues of the housing sector in Israel. It is based on readily available documents such as publications from the government of Israel, U.S. AID, and several online systems which have provided a large amount of current information.

The Government of Israel faces major challenges as a result of the Soviet decision to increase Jewish emigration last year. As part of this increase, it is expected that some 40,000-60,000 new immigrants will arrive in Israel in 1990.

The report emphasizes the main characteristics and major constraints of the housing sector, and reviews the most recent actions undertaken by the Government of Israel in relation to housing policy.

PJ-ABG-447

ISA 68890

**AN INTRODUCTION TO  
THE ISRAEL SHELTER  
SECTOR  
A Desktop Study**

**Milagros Nanita-Kennett  
John Miller**

**Prepared for  
U.S. Agency for International Development  
Office of Housing and Urban Programs  
August 1990**

**Abt Associates Inc.  
4800 Montgomery Lane  
Bethesda, Maryland 20814**

**Delivery Order No. 7  
IQC-PDC-1008-I-00-9066-00**

## TABLE OF CONTENTS

PREFACE . . . . .	i
REPORT HIGHLIGHTS . . . . .	ii
1. BACKGROUND OF THE STATE OF ISRAEL . . . . .	1
1.1 Historical Background . . . . .	1
1.2 Government and Institutions . . . . .	2
1.3 Regions and Settlement Patterns . . . . .	3
1.4 Population . . . . .	4
1.5 Economy . . . . .	6
2. CHARACTERISTICS OF THE HOUSING SECTOR . . . . .	10
2.1 Overall Characteristics . . . . .	10
2.1.1 Housing Size . . . . .	11
2.1.2 Construction Duration . . . . .	11
2.1.3 Housing Prices . . . . .	12
2.1.4 Construction Industry . . . . .	13
2.1.5 Land . . . . .	14
2.2 Dilemma of the Housing Sector . . . . .	15
2.2.1 The Challenge . . . . .	15
2.2.2 The Goal . . . . .	16
2.2.3 The Constraints . . . . .	16
2.3 Recent Actions in the Housing Sector . . . . .	18
2.3.1 Construction Techniques . . . . .	18
2.3.2 Privatization of the Housing Sector . . . . .	19
2.3.3 Mortgage Lending in the Housing Sector . . . . .	19
2.3.4 Foreign Investment in the Housing Sector . . . . .	20
2.3.5 Financial Incentives in the Housing Sector . . . . .	20

## BIBLIOGRAPHY

## PREFACE

This report has been prepared for the U.S. AID Office of Housing and Urban Programs as an overview of the major issues of the housing sector in Israel. It is based on readily available documents, such as publications from the Government of Israel, U.S. AID, and several online systems which have in themselves provided a large amount of the current information. Forthcoming field work in Israel will enhance this report, providing more extensive and concise information on the housing sector in Israel.

The Government of Israel faces major challenges as a result of the Soviet decision to increase Jewish emigration last year. As part of this increase, it is expected that some 40,000-60,00 new immigrants will arrive in Israel in 1990.

The report emphasizes the main characteristics and major constraints of the housing sector, and the most recent actions undertaken by the Government of Israel in the housing sector.

August 1990

## REPORT HIGHLIGHTS

- 0 The development pattern in Israel before 1948 was characterized by a highly organized rural society, directly connected through its marketing and consumption institutions to the main urban centers. However, by 1976 the Jewish population was preponderantly urban; only 9 percent of the total Israeli population lived in rural areas.
- 0 The present population data in Israel can be summarized as follows: total population: 4.4 million; population density: 519 inhabitants per square mile (1987); population distribution: 91.0 percent urban (1988); high income in urban areas 78.3 percent; population growth rate: 1.6 percent per year (1988); and projected population for the year 2000: 5,238,000.
- 0 The socialist economy of Israel is ridden with massive budget deficits, oppressive taxation, excessive government regulation and ownership of business, capital controls, industrial and labor monopolies, price controls and numerous barriers to free trade. These conditions worsened throughout 1989 despite billions of dollars in U.S. and world-wide Jewish community aid.
- 0 A recovery in housing construction began in 1986, especially in the upmarket areas of the major cities, but the outbreak of the intifada in December of 1987 caused major damage to the construction sector, both because almost half its workforce is comprised of Arabs from the occupied territories, and because it worsened the incipient recession and cut housing demand. At the present time, this slowdown of what used to be the "locomotion" of the Israeli economy has been the major factor in a rapid increase to 10 percent national unemployment and almost 21 percent annual rate of inflation.
- 0 The Government of Israel has failed to achieve even its marginal budgetary aims of introducing user fees and charges for public services -- such as high school tuition and health service -- for upper-income Israelis. The failure to reduce government spending on social programs resulted in a budget deficit of 8 percent of gross national product in 1989.
- 0 The Bank of Israel is responsible for maintaining stable prices. Inflation of 16.4 percent in 1988 forced the bank to devalue the Israeli shekel in January and again in June 1989 in order to reduce real wages and restore external competitiveness. Nonetheless, inflation was not contained and the rate of inflation for 1989 rose to 20.8 percent, compared with 16 percent in each of the previous two years. The rise in the inflation rate was the result of two main factors. The first was the two devaluations of the shekel, in January and June 1989, which produced a 25 percent rise in the rate of exchange relative to the dollar over the year. The second factor was the rapid increase in housing prices and

the anticipated potential for housing shortages. As a result of expectations of a real estate boom triggered by the arrival of hundreds of thousands of immigrants from the USSR, housing prices rose over 35 percent during 1989, contributing more than seven percentage points to the overall 20.8 percent rise of the consumer price index.

- 0 The Bank of Israel has made further small steps in the gradual relaxation of controls in the money and credit markets.
- 0 In 1988/89 the government began to deregulate the mortgage lending sector by removing lending ceilings. Mortgage interest rates, which peaked at 13 percent in real terms in 1985/86, have fallen from around 11 percent two years ago, to 9 percent early in 1989, through 7 percent in the summer, and presently as low as 5-5.5 percent for ten year loans. Mortgage banks have been actively issuing bonds to provide funds for housing loans. This trend may well spur demand in the long dormant low to middle income sector of the market.
- 0 Current government housing policy is directed at creating a building industry that will be responsive to market forces; much has been achieved in aligning the housing industry with market forces. However, under current development practices the building industry can only produce about two-thirds of the product, namely the building. This situation can become a real constraint when demand for new housing units increases abruptly (e.g., current Soviet immigration).
- 0 The average period of construction in Israel has been approximately 24 months per unit for the past several years. It should be noted that the residential construction period in the private sector tends to be approximately 25 percent shorter than that of the public sector.
- 0 During 1970-1975 an average of 56,400 housing units were started each year; during 1985-88 this average was reduced to 20,000 per annum, with approximately 80 percent of these units in urban areas. In particular, public sector construction, which previously comprised 40 percent of the construction activity, was dramatically reduced to only 3,000 units annually, about a 37 percent reduction. (Source: 1989 Economist Publication Ltd.)
- 0 Two factors are expected to moderate the pattern of growth in dwelling unit size. First, the average household size of Israeli families (currently 3.55 persons per household in urban localities) is declining; and second, the average household size of Soviet immigrants is even lower (2.6-2.8 persons per household). These trends may well lead to an increased demand for units somewhat smaller than the current average size being built, assuming that Soviet's consumer preferences do not change as a result of new environmental conditions or incentives.
- 0 While government sponsored housing now represents only one-third of total housing production, government sponsored site development probably accounts for about 90 percent of all building site activity. The remaining 10 percent occurs on privately owned land.

- 0 Following land prices, housing prices in Israel are highest in the central parts of the country, especially in the large cities, averaging \$85,000 per unit in Tel Aviv and \$81,000 in Jerusalem.
- 0 Land issues are very important in any housing development in Israel since 93 percent of the country's land is owned by the government and managed by ILA. The ILA does not sell land for development; instead, it issues leases for a term of 49 years, usually renewable after that period.
- 0 In the Tel Aviv metropolitan area, land costs account for approximately 38 percent of the total price of the housing unit, versus 24 percent nationwide. Land is not only considerably cheaper in the more peripheral regions, but government policies often provide for reductions (subsidized below market prices) in the assessed land value to further enhance development potential.
- 0 Recently the population of Israel has been influenced by the migration from the Soviet Union. When emigration rules were relaxed, the flood began. In the first three months of this year more than 17,000 arrived. Jewish emigration from the U.S.S.R. now runs at about 40,000-60,000 annually, up from 20,000 in 1988, 8,000 in 1987 and 900 in 1986.
- 0 To deal with this problem the Government of Israel must promote the construction of at least 50-55,000 housing units annually in the course of the next several years.
- 0 Housing production faces the following constraints:
- . Traditionally the government subsidy programs and the process for determining eligibility to the programs are extremely slow and tedious processes.
  - . The building trades hold strong monopolies in the construction industry and are rigid in their resistance to relinquishing their power.
  - . In 1976 the period from planning to occupancy in the housing sector took approximately six years, with the actual construction period taking three or more years. At present, the average period of construction is approximately 24 months. (Residential construction in the private sector tends to be approximately 25 percent shorter than that in the public sector.) (Figure to be updated for 1989.)
  - . Land availability is a critical factor in housing production with the overwhelming majority of land in Israel (approximately 93 percent) being owned by the government or Jewish National Fund and managed by the Israel Lands Authority (ILA).
  - . The absence of any organized construction lending system in the Israeli private sector causes developers to spend inordinate amounts of time and resources on financial matters. At present, the Israeli builder has to be a financial expert as well as a builder.

- . The use of foreign developers or construction firms in Israel to assist in reducing the housing shortages is fiercely resisted by national Israeli construction and development companies.
- . There is a lack of industrialization in the construction industry including the almost total lack of "prefabricated or modularized housing".
- . Severe construction labor shortages have been caused by the intifada, since a large proportion of construction unskilled labor is provided by Arabs from the occupied territories.
- 0 One bright spot in recent years has been the move towards privatization of the housing construction industry. The proportion of publicly-sponsored housing has declined in favor of private initiatives. The form of public involvement in housing has also changed with the government gradually assuming more of a "pump priming" role by encouraging private initiative through various incentives instead of operating as a developer.
- 0 In an effort to incorporate technological advances into the construction industry in order to more rapidly decrease the construction time period and reduce the labor needs, the government has undertaken an industrialized construction program.

# **1. BACKGROUND OF THE STATE OF ISRAEL.**

## **1.1 HISTORICAL BACKGROUND**

On May 14, 1948 the State of Israel came into being. The development pattern in Israel before 1948 was characterized by a highly organized rural society, directly connected through its marketing and consumption institutions to the main urban centers.

In the early 1950s, a large inflow of migration drastically transformed the entire structure of Jewish society in Israel: from a population of 650,000 in 1948, to 1,404,000 in 1951; from predominantly ex-European in 1948 to 400,000 ex-Asian and African Jews (Ashkenazi) in 1951. Israel new pattern of development emerged from a relatively economically homogenous society in the pre-state period to a society sharply divided into two socio-economic classes: rich ex-Europeans versus poor ex-Asians and Africans.

Since reclamation of the soil and development of arid areas are major national objectives, the government directed new immigrants to rural and new development areas and discourage urban agglomeration. The masses of new immigrants who arrived in the early 1960s offered an exceptional opportunity to settle the remote and underdeveloped part of the country. However, they often lacked appropriate skills and financial resources and were inadequately prepared to meet the challenge of new town development.

The success of these towns depended on the development of industries and the access to social services. A considerable proportion of public housing has been erected in such towns to provide people with an incentive for living there; priority has been given to construction of roads, schools, hospitals and other community facilities in these areas.

Because of the high share of new immigrants (specially from African and Asian countries) in new towns, there was no urban-rural division in the socio-economic sense, but there was a significant difference between the early villages and the new villages founded by immigrants.

By 1976 the Jewish population was preponderantly urban; only 9 percent of the total Israeli population lived in rural areas. The new towns which were supposed to become the cultural and economic centers for the surrounding rural areas could not compete with the old settlements or with the large cities a relatively short distance away.

The economic viability and growth of development towns remained heavily dependent on government efforts in employment provision and direction of migrant streams and investment capital. Development towns typically lacked a diversified employment base and were particularly sensitive to cyclical downturns in the Israeli economy. As a result, many development towns experienced sporadic growth and remained politically and economically weak vis-a-vis the established metropolitan areas.

In terms of housing, due to Israel's unique land tenure circumstances, a large part of the nation's site development and design process is not integrated with the residential construction process.

Current government housing policy is directed at creating a building industry that will be responsive to market forces. Much has been achieved in aligning the housing industry with market forces. However, under current development practices the building industry can only produce about two-thirds of the product, namely the building. This situation can become a real constraint when demand for new housing units increases abruptly (e.g., current Soviet immigration).

While government sponsored housing now represents only one-third of total housing production, government sponsored site development probably accounts for about 90 percent of all building site activity. The remaining 10 percent occurs on privately owned land. Most of the private development is on a very small scale since very few large privately owned parcels are available for development.

## **1.2 GOVERNMENT AND INSTITUTIONS**

Israel is an independent republic with a parliamentary form of government based on a multiparty system. Although Israel does not have a formal written Constitution, it relies on a number of basic laws, which taken together constitute the fundamental law, called the Knesset (a 120-member unicameral legislature).

The President, who is elected to a 5-year term by the Knesset, is the head of state. The President's functions are largely ceremonial, but they include negotiating with party leaders to resolve factional crises. Effective executive authority rests with the Prime Minister and the Cabinet, who are individually and collectively responsible to the Knesset and must retain the confidence of the majority in it. Because no party has ever had a majority in the Knesset, the Cabinets have all been coalition Governments, normally made up of 4 or 5 parties. The Knesset is elected by direct universal suffrage for a 4-year term.

Israel is a welfare state. The central premiss of the welfare state is that in certain situations it is the duty of the government to interfere in the spontaneous operation of the market. In Israel, for example, housing, free compulsory education, social and health security, etc. are all examples of such intervention.

The major institutions involved in the housing sector include the Ministry of Construction and Housing; Ministry of Finance; Israel Lands Authority; Bank of Israel; National Building Research Institute; Israel Institute of Standards.

### 1.3 REGIONS AND SETTLEMENT PATTERNS

The position of Israel at the eastern shore of the Mediterranean Sea and near the great desert belt of the earth forms the dominant feature of its climatic character: a zone of transition between Mediterranean and desert climate.

Israel is part of a subtropical zone which knows only two climatic seasons with short periods of transition: the warm and dry season (summer) and the cool and wet season (winter). The great differences in the distribution of temperatures and precipitation create a wide variety of climatic conditions within the relatively small area of the country, and sometimes sharp transitions from one region to another.

The soil of Israel reflects the climatic conditions of the country as well. Israel, in spite of its small size, offers a variety of landscapes. The reasons for this phenomenon are the relative proximity of the rift valley to the sea, the corresponding uplift of the intervening mountain block, and the climatic boundaries which cross the country from north to south as well as from east to west. Secondary natural factors are the differences in rock type and the resulting differences in erosional forms.

The definition of regions in Israel in terms of natural conditions is predominant over any other characteristics of the social environment. Israel is a land of immigration from all parts of the world. There exists no ethnic regional grouping because the immigrants were dispersed over the settled areas without regard to their origin.

Four different regions can be defined in Israel: (see map next page)

- **The North** contains the bulk of Israel's Arab population. It includes the Jordan River and its valley; upper Galilee; Hills and basins of lower Galilee; the Yezre'el valley, the coast of Galilee, the Carmel Range, Haifa (Israel's main port). Its climate climatically belongs entirely to the Mediterranean zone, and no part of it is affected by arid conditions.
- **The Center** is divided into the occupied territories (65 percent) and the original Israeli territory (35 percent). It includes the Sharon Plain, the Conurbation of Tel Aviv, the Yarqon-Ayyalon region, the Judean Plain, the Shefela, Jerusalem Corridor. This region contains all the Arab population of the former Jordanian territory and two thirds of all the population of Israel. Its climate is mainly Mediterranean, but in the south it is transitional to semi-arid, and its eastern fringe is arid.
- **The South** is the widest part of Israel, and its natural landscapes cover larger areas and distances. The dominant factor is the desert, and only on its northern fringe semi-arid conditions prevail. Topography, erosional forms, and vegetation reflect aridity, and human occupation is still groping for the best means of land utilization. This region includes the Northern Negev, the Central Negev, the Rift Valley, the fold Mountains, the Dead Sea.



- **Areas of Mandatory Palestine**
  - . Judea and Samaria
  - . The Gaza Strip

#### 1.4 POPULATION

---

##### Major Cities Population: (1989)

Jerusalem	493,000
Tel-Aviv -- Jaffa	318,000
Haifa	223,000
Holon	146,000
Petach-Tikva	134,000
Bat Yam	133,000
Rishon Lezion	124,000
Netanya	118,000
Ramat Gan	116,000
Beersheba	113,000
Bnei Brak	109,000

---

Population Density: 519 inhabitants per square mile (1987)

Population Distribution: 91.0% urban (1988)

High Income in Urban Areas: 78.3%

Population Growth Rate: 1.6% per year (1988)

Projected population for the year 2000: 5,238,000

---

##### Other Indicators

	25-30 years ago	15-20 years ago	Most recent estimate
Area-thou.sq.km.	-	-	20.77
Density per sq.km	123	166	211
Agricultural land-% land area	58.8	59.7	60.5
Forest and woodland-thou.sq.km.	0.99	1.16	1.10
Deforestation rate (net)-annual %	3.1	1.8	0

---

The present population in Israel is characterized by an early exodus of the Arab population after Independence, and by a continuous migratory flow to Israel. The Jewish population of the State of Israel on the day of its establishment was estimated at 650,000. The first population count taken on November 1948 showed the Jewish population of Israel as 716,700.

Since then the Jewish population of Israel has more than tripled within 20 years, the increase due mainly to immigration from all parts of the world. The strongest immigration wave immediately followed the creation of the State, doubled the Jewish population in 3 years.

The growth of population by net immigration accounted for more than half of the total population increase in the periods of high immigration, but only 20-30 percent in years of low immigration.

Recently the population of Israel has been influenced by the migration from the Soviet Union. When emigration rules were relaxed, the flood began. In the first three months of this year more than 17,000 arrived. Jewish emigration from the U.S.S.R. now runs at about 40,000-60,000 annually, up from 20,000 in 1988, 8,000 in 1987 and 900 in 1986. Over the past year, the number of Soviet Jews emigration to Israel has risen from a few hundred to more than 10,000 per month; beginning in July, according to officials of the quasi-governmental Jewish Agency, the number of arrivals could double again to 20,000.

---

**Israel's 1988 population of 4.4 million people, by country of origin and religious background, in percent**

Other European Jews	17.9%
African Jews	17.7
Native born Jews	17.5
Asian Jews	16.8
Moslem	14.2
Soviet Jews	6.5
North and South American Jews	5.3
Christian	2.3
Druse and Other	1.8

**Population Data (thousands)**

1968	2,803
1973	3,278
1978	3,690
1983	4,105
1988	4.444

---

A look at the Russians who have arrived so far suggests a future Israel enriched by talent and technical skill, confronted by economic challenges -- and moving dramatically to the political right.

Though the immigrants bring a wealth of talent -- almost a quarter hold qualifications as engineers, scientists or professionals -- many have skills too highly specialized to fit easily into Israel's much smaller labor market.

With so few opportunities for Israelis, and with growing economic hardships, a wave of immigration will only strain the governments ability to provide

resources from its already overextended budget. It may also create great resentment against the special privileges -- tax relief, subsidized housing, etc. -- granted to new immigrants to compensate them for the inordinate handicaps posed by Israel's overregulated economy.

Israeli politicians are aware of the system's inability to meet the challenges that increased immigration will pose. They are acknowledging the need for basic structural reform and even taking a few steps toward reforming the financial system and reducing regulations. But their steps toward basic reform are halting and their initiatives palliative -- such as the recently proposed "Hundred Projects," designed to reduce the red tape on 100 projects handpicked by the bureaucracy that created these impediments originally.

## **1.5 ECONOMY**

Since 1974, Israel's economy has suffered chronic stagflation which has resulted in high unemployment (currently 9.8 percent vs 7.1 percent in 1988). Its socialist economy is ridden with massive budget deficits, oppressive taxation, excessive government regulation and ownership of business, capital controls, industrial and labor monopolies, price controls and numerous barriers to free trade. These conditions worsened throughout 1989 despite billions of dollars in U.S. and world-wide Jewish community aid.

It seems that no significant progress has been made in Israel for adopting economic policies to lay the foundation for sustained growth. Many experts believe that unless serious attention is paid to the economy, no amount of foreign aid and charity will put the Israeli economy on an upward path.

The government failed to achieve even its marginal budgetary aims of introducing user fees and charges for public services -- such as high school tuition and health service -- for upper-income Israelis. The failure to reduce government spending on social programs resulted in a budget deficit of 8 percent of gross national product in 1989.

During the 1980s, more than 50 countries world-wide reduced their top marginal tax rates. Israel is one of three to raise rates. In an extraordinary anti-growth measure it imposed a 3 percent surcharge that increased the top marginal rate of income tax from 48 percent to 51 percent on annual taxable income over \$48,000. The Israeli government has failed to take into account the effects of high tax rates on incentives to work, save and invest. The government is strictly adherent to the concept of "net taxation," which treats the benefits and transfers that individuals receive from government as if they reduced the disincentives of high taxation. In other words, the more the government spends on social programs, the lower it claims taxes are.

At present, foreign direct investment totals a few hundred million dollars, no more than a twentieth of foreign aid, which exceeds \$4 billion. In 1989, fixed investment declined 3 percent, capital imports fell, industrial output fell 5 percent, profitability declined and private consumption per capita fell 3.5 percent.

Despite economic recession, the rate of inflation for 1989 rose to 20.8 percent, compared with 16 percent in each of the previous two years. This was probably one of the greatest setbacks for Israeli economy since the goal in January 1989 was to curb inflation to a single digit rate by the year's end.

The Bank of Israel is responsible for maintaining stable prices. An inflation rate of 16.4 percent in 1988 forced the bank to devalue the Israeli shekel in January and again in June 1989 in order to reduce real wages and restore external competitiveness. Nonetheless, inflation was not contained. The government has allowed the banks to charge borrowers rates as high as 60 percent on personal overdrafts during early 1989 while depositors received negative real interest on shekel accounts. In addition, the government made little progress during the year in selling the banks to private investors.

The rise in the inflation rate was the result of two main factors. The first was the two devaluations of the shekel, in January and June 1989, which produced a 25 percent rise in the rate of exchange relative to the dollar over the year. The second factor was the rapid increase in housing prices and the potential for housing shortages. As a result of expectations of a real estate boom triggered by the arrival of hundreds of thousands of immigrants from the USSR, housing prices rose during 1989 over 35 percent, compared with a rise of 20.8 percent in the consumer price index, contributing more than seven percentage points to the overall rise of the index.

By February 1990, the rate of inflation for the twelve months had dropped to 15.2 percent, a return to the previous level. At present, however, the high migratory flows from the Soviet Union has had the effect of provoking a sharp inflationary spiral in rents and housing prices inside Israel. (Prices in the occupied territories have been largely unaffected.)

Israel's consumer price index rose 1.6 percent in May 1990, The rise in the index, which measures price changes in a fixed market basket of goods and services, compares with 2.5 percent in April and 0.9 percent in May 1989.

---

**Trend of Income and Expenditure (% of GNP; at current prices)**

---

	1984	1985	1986	1987	1988
Public sector expenditure	73.3	71.2	65.5	62.7	62.8
Public sector revenue	54.5	68.6	67.4	61.4	58.2
Public Sec.deficit/surplus	-18.8	-2.6	1.9	-1.3	-4.6
Public debt					
internal	123.6	133.2	121.1	113.5	110.7
external	149.3	51.0	39.8	31.4	29.0

---

Source: Bank of Israel, Annual Report.

**Country Economic Profile**  
September 8, 1989

Revenue	52,390
of which:	
ordinary	36,857
of which:	
income tax	15,450
value added tax	7,602
customs	530
purchase tax	3,160
excise & fuel tax	780
transfer from development budget	6,964
development budget & debt repayment	14,033
of which:	
foreign sources	6,851
internal loans	12,104
transfer to ordinary budget	-6,964
Expenditure	52,390
of which:	
ordinary	36,857
of which:	
defense	10,596
health	558
education	3,036
agriculture	562
commerce & industry	41
construction & housing	92
interest	8,181
subsidies	595
development & debt repayment	14,033
of which:	
debt repayment	11,938

Ministry of Finance, State Budget 1989/90. New Israeli shekels.

**Socio Economic Indicators**

	1968	1973	1978	1983	1988
GNP (US\$) per Capita	1,630	2,680	4,250	6,470	8,650
Life Expectancy	71.1	71.7	73.1	74.6	75.4
School Enrollment (Primary)	-	-	96.0	98.0	95.0
School Enrollment (Secondary)	-	-	68.0	74.0	83.0

	25-30 years ago	15-20 years ago	Most recent estimate
Population growth rate	3.5	2.3	1.6
Urban	4.5	2.8	2.0
Urban/rural differential	5.0	4.1	3.9
Projected population:2000-thousands	-	-	5,238
Crude death rate/1000	6.3	7.1	7.0
Infant mortality rate/1000	27.4	22.9	11.9
Labor force (15-64)-thousands	922	1,279	1,727
Agriculture	12.0	7.9	-
Industry	35.4	33.7	-

Unit of measure is percent if not otherwise indicated

Source: World Bank

## 2. CHARACTERISTICS OF THE HOUSING SECTOR

### 2.1 OVERALL CHARACTERISTICS

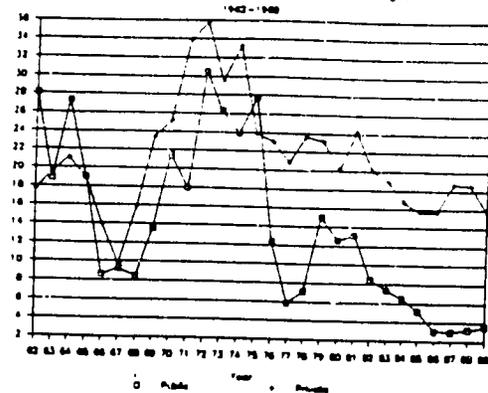
For the last 15 years (1975-1990) the Israeli construction industry has been contracting steadily. This crisis began with the marked decline in immigration to Israel in 1979 and reached its peak in 1983-86, when hyperinflation and subsequent restraining measures, coupled with a reduction in housing demand and excess capacity, forced many construction firms (including several of the largest) into bankruptcy. Others, such as the giant Solel Boneh, were only saved through government assisted rescue packages, although their sizes were significantly scaled down.

During 1970-1975 an average of 56,400 housing units were started each year; during 1985-88 the average was reduced to 20,000 per annum, with approximately 80 percent of these units in urban areas. In particular, public sector construction, which previously comprised 40 percent of the construction activity, was dramatically reduced to only 3,000 units annually. (See next page; source: Economist Publications LTD)

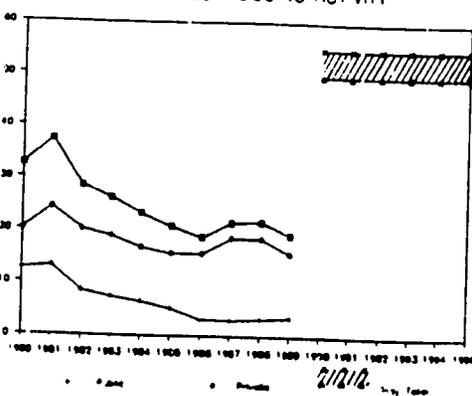
A recovery began in 1986, especially in the upmarket areas of the major cities, but the outbreak of the Intifada in December of 1987 caused major damage to the construction sector, both because almost half its workforce is territories, and because it worsened the incipient recession and cut housing demand. At the present time, this slowdown of what used to be the "locomotion" of the Israeli economy has been the major factor in a rapid increase to 10 percent national unemployment and almost 21 percent annual rate of inflation (source: 1989 Economist Publications Ltd).

Moreover, a sharp fall in interest rates brought about a dramatic fall in mortgage rates-which fell from 11 percent to 5.5 percent in one year-thereby rapidly increasing the demand for housing. At the same time a fall in long term yields of government bonds to record low levels-2 percent per annum-also encourage savers to investigate alternative investments such as housing development. However, the very high short term interest rates in effect in 1987-88 caused the widespread reduction of housing construction leading to the present inability of the construction industry to respond to housing shortages.

2. HOUSING STARTS, BY INITIATOR



1. PROJECTED HOUSING ACTIVITY



## Housing Starts, Completions and Units Under Construction

	Year				
	1984	1985	1986	1987	1988
Starts	23,300	20,900	18,800	21,500	22,300
Completions	27,400	24,800	21,800	21,500	20,600
Under Construction	55,900	51,400	49,000	49,000	50,000

Source: Residential Development in Israel

The housing and construction industry presently remains deep in decline, with residential housing starts down and government contracts fewer and harder to realize. The defense sector, in particular, more than halved its construction budget for the current fiscal year, thus forcing construction companies throughout the country to continue their struggle for existence. Although the number of bankruptcies seems to have ended, at least temporarily, it is only through a rescheduling of bank debts and the use of government aid that many construction firms have continued to operate. It is fair to assume that at present there is a large unused construction industry capacity in Israel.

### 2.1.1 HOUSING SIZE

Israel's housing quality, as expressed in terms of average unit size, has been steadily improving in both the public and private sectors. Overall, the average size of new private sector units is somewhat more than four rooms (excluding the kitchen and bathroom) in a total floor area of 125-130 square meters, as opposed to 3.5 rooms and 85-90 square meters in publicly-initiated units.

Two factors are expected to moderate the pattern of growth in dwelling unit size. First, the average household size of Israeli families (currently 3.55 persons per household in urban localities) is declining; and second, the average household size of Soviet immigrants is even lower (2.6-2.8 persons per household). These trends may well lead to an increased demand for units somewhat smaller than the current average size being built, assuming that Soviet's consumer preferences do not change as a result of new environmental conditions or incentives.

### 2.1.2 CONSTRUCTION DURATION

The average time needed to complete a dwelling unit in Israel depends not only upon construction management, availability of labor, scheduling and technological considerations, but also on fluctuations in the level of sales during the construction period. This is because a considerable proportion of units are sold on a pre-production basis; thus when sales slacken, developers are apt to slow the pace of construction in order to prevent a situation in which construction costs outpace revenues.

The average period of construction in Israel has been approximately 24 months per unit for the past several years. It should be noted that the residential construction period in the private sector tends to be approximately 25 percent shorter than that of the public sector.

**Average Construction Duration per Dwelling Unit  
(Month)**

	Year				
	1984	1985	1986	1987	1988
Average	24.0	24.7	24.6	25.1	22.4
Public	26.2	26.8	26.9	29.5	29.3
Private	23.0	23.5	23.8	23.7	20.4

Source: Residential Development in Israel

**2.1.3 HOUSING PRICES**

Over the years, housing prices in Israel have fluctuated relative to the general consumer price index. Since the 1960s, overall housing prices have risen at a rate more than double that of the consumer price index. A recent exception was the period 1985-89, when the housing price index rose less sharply than the consumer price index as a result of various market adjustments and a general slowing down of the economy. In 1989, however, this trend was reversed, with housing prices once again rising faster than the consumer price index. In October of 1989 housing prices rose by 3.7 percent, bringing the cumulative rise in housing prices to 36 percent per annum, compared with a rise of 20 percent in the consumer price index (of which one-third was caused by the rise in housing prices).

Following land prices, housing prices in Israel are highest in the central parts of the country, especially in the large cities, averaging \$85,000 per unit in Tel Aviv and \$81,000 in Jerusalem.

## Housing Prices in the Spring of 1989

Area	No. of Rooms (excluding kitchen and bathroom)			
	Average	1.5-2.0	2.5-3.0	3.5-4.0
Average	65	49	60	87
Jerusalem	81	58	75	105
Tel Aviv	85	67	84	127
Metropolitan Tel Aviv	70	51	67	102
Haifa	50	33	45	77
Metropolitan Haifa	40	28	34	55
North	36	25	32	48
South	53	26	40	67

Source: Residential Development in Israel (table in thousands of US\$)

### 2.1.4 CONSTRUCTION INDUSTRY

The construction industry has been in a state of decline throughout the 1980s. The problems began with the decline in immigration after 1979, and the rise in the real cost of mortgages once these became fully index linked. Many firms, including several of the largest, failed to adjust to the new market conditions, and were then even more severely hurt by the cutbacks in public spending that began in 1983.

In 1988/89 the government began to deregulate the mortgage lending sector by removing lending ceilings. Mortgage interest rates, which peaked at 13 percent in real terms in 1985/86, fell from around 11 percent two years ago, to 9 percent early in 1989, through 7 percent in the summer and presently as low as 5-5.5 percent for ten years loans. Mortgage banks have been actively issuing bonds to provide funds for housing loans. This trend may well spur demand in the long dormant low to middle income sector of the market (source: 1989 Economist Publication Ltd).

Base construction costs can be tabulated according to a price list published by the Ministry of Construction and Housing that is updated monthly according to the Construction Inputs Price Index (Table). This price list—an industry wide measure for standard residential units—is based on actual average project costs divided according to building types, special local construction requirements, number of units in projects, size of units, location, topography, etc. The price list also takes into account a profit margin for the contractor/developer, and it is used to calculate the purchase price of apartments in the event that the Ministry must exercise its purchase commitment to the developer.

## 2.1.5 LAND

Control over national land is vested with a quasi-autonomous agency, the Israel Land Authority (ILA). Land issues are very important in any housing development in Israel since 93 percent of the country's land is owned by the government and managed by ILA. The ILA does not sell land for development. Instead, it issues leases for a term of 49 years, usually renewable after that period.

Land is leased by the ILA for residential development in one of two ways:

**Public Tender** - under this arrangement, the ILA sets a minimum price for the site and then receives competitive sealed bids from developers. This arrangement has become increasingly common, accounting for approximately 40-50 percent of land released by the ILA for development during the past several years.

**Assessed Value** - under certain circumstances, the ILA waives its right to issue a public tender and awards the land to a designated developer based on the assessed value of the property. Land for publicly-initiated housing projects is typically awarded on this basis through a recommendation made by the Ministry of Construction and Housing.

During the past several years, ILA policies have increasingly favored the competitive approach because the revenues received from the leases have been high. However, because of renewed government efforts to provide housing for large numbers of immigrants, the amount of land made available under the second option is expected to increase significantly. This shift is intended to lower the overall cost of the housing unit by reducing land charges. This measure can be seen as a government subsidy.

As in 1980, the demand has shifted from apartment dwellings at a density of 20 to 30 units per acre, to individual dwellings at densities of 5 to 10 units per acre. If this trend continues, it can be anticipated that with the present demand for housing in Israel, the demand for land will increase abruptly.

As in most places, land prices in Israel vary in accordance with location, accessibility, topography and other physical features and zoning restrictions. Land is most expensive in the central parts of the country, especially in the large cities and suburbs of Tel Aviv, Jerusalem and Haifa. In the Tel Aviv metropolitan area, for example, land costs account for approximately 38 percent of the total price of the housing unit, versus 24 percent nationwide. Land is not only considerably cheaper in the more peripheral regions, but government policies often provide for reductions (subsidized below market) in the assessed land value to further enhance its development potential.

In addition to the geographic differentials shown in the accompanying table, land allocated according to its assessed value tends to be significantly cheaper than land awarded by competitive bid. This differential can be explained, in part, as an implicit grant in the form of 'subsidized' land costs.

## Land Prices

District	Assessed Value		Public Tender	
	Number of Housing Units	Aver. Price Per Unit	Number of Housing Units	Aver. Price Per Unit
Total	3067	\$11,600	869	\$32,900
Jerusalem	869	13,000	130	33,000
North	69	1,600	-	-
Haifa	240	9,900	68	8,300
Central	925	11,100	420	12,100
Tel Aviv	499	16,800	251	74,000
South	291	1,900	-	-
Judea	47	1,300	-	-
Samaria and Gaza				

Source: Israel Lands Authority, Annual Report 1988 in Residential Development in Israel

## 2.2 DILEMMA OF THE HOUSING SECTOR

### 2.2.1 THE CHALLENGE

The Israeli construction industry, at present, faces an enormous challenge from Soviet immigration, and is on the verge of a massive, and almost, overnight, change of direction.

As a result of the Soviet decision to open up emigration last year, more than 70,000 Jews were allowed to leave, up from 20,000 in 1988. It is expected that some 40,000-60,000 new immigrants will arrive in 1990. The prospect of massive immigration from the USSR upwards of 100,000 persons per annum, possibly continuing for several years, represents a major challenge to the government and construction industry.

Housing these new immigrants is a challenge the Israeli government has not yet faced. Even though large numbers of Soviet Jews began arriving a full year ago, by March 1990, the government had yet to break ground on even one of its planned housing developments. As a result, rents are soaring, with some owners requiring rent increases of as much as 40 percent. Housing costs had increased by 2.2 percent by the end of 1989, and this increase has been followed by another rise of 1.3 percent in February of 1990 (source: Israel Central Bureau of Statistics).

## **2.2.2 THE GOAL**

To deal with this problem the Government of Israel must promote the construction of at least 50-55,000 housing units annually in the course of the next several years. This represents a considerable increase in the previous five-year average. In order to achieve these goals, the government envisages a cooperative effort between public agencies and private developers from Israel and abroad who will take advantage of a variety of government-sponsored financial incentives.

The majority of the units to be built will be located in multi-family dwellings in medium-density (planned unit development) projects throughout the country. Housing types in these projects will be varied, including townhouses, garden apartments and apartments in 3-8 story buildings. Most of the units will be offered for sale or rent on the private market to Israeli citizens and foreign buyers, while a relatively small percentage will be purchased directly by the government to augment its supply of apartments in the public housing stock (Ministry of Construction and Housing).

## **2.2.3 THE CONSTRAINTS**

This goal of dramatic increases in housing production will require construction companies, which are used to retrenchment and caution, to swing suddenly into bold and aggressive expansion.

This quick expansion of the housing sector has several major constraints to its implementation.

- Traditionally the government subsidy programs and the process for determining eligibility to the programs are extremely slow and tedious processes. These problems are a direct result of the government's direct and indirect role in housing production in Israel.
- The building trades hold strong monopolies in the construction industry and are rigid in their resistance to relinquishing their power. The Federation of Labor, a monopolistic labor union in which most of the country's workers belong, can strike and threaten industrial actions which disrupt economic activity throughout the year. These rigid labor markets result in higher unemployment and rising real wages at a time when the private economy is stagnating.
- Housing production takes an extended amount of time in Israel. In 1976 the period from planning to occupancy took approximately six years, with the actual construction period taking three or more years. (Figure to be updated for 1989.) Although the present situation has improved, the total production cycle can still take years due to lengthy site development and governmental approvals. The Israeli planning and approval process operates on a cumbersome three-tiered bureaucracy

consisting of the national level (the National Planning Board), the regional level (six District Planning Committees) and the local level (approximately 110 Local Planning Committees).

- Land availability is a critical factor in housing production with the overwhelming majority of land in Israel (approximately 93 percent) being owned by the government or Jewish National Fund and managed by the Israel Lands Authority (ILA). The ILA does not sell land for development purposes; instead, it leases for a term of 49 years, usually renewable for an additional 49 years.
- The absence of any organized construction lending system in the private sector causes developers to spend inordinate amounts of time and resources on financial matters. To succeed, the Israeli builder has to be a financial expert as well as a builder. There is no present savings and loan industry to provide capital for private development. Since the Israeli banks have not made conventional housing loans for more than thirty years; virtually all construction lending has been in partnership with governmental or quasigovernmental institutions with the risks being assumed by the government (source: Israel Shelter Sector Update).
- In order to facilitate the cash flow of builders within government programs, the Ministry of Construction and Housing provides short term financing (24 months) at reduced interest rates (at present 4.5 percent linked to the consumer price index). However, it is believed that one cause of the decrease of construction activity in Israel was the fact that short term interest rates were in effect in 1987-88.
- The use of foreign developers or construction firms in Israel to assist in reducing the housing shortages is fiercely resisted by national Israeli construction and development companies. Foreign developers and companies are subject to a number of national taxes including a corporate tax of 40 percent, capital gains taxes, income taxes, acquisition taxes, municipal taxes, import taxes, property taxes, and value added taxes.
- One-quarter of Israel's industrial output is produced by officially designated monopolies and cartels on which government price controls are imposed. In the wake of the January 1989 currency devaluation, price controls were extended from 20 percent of the products sold in Israel to 50 percent of these products. The government believes that prices of goods and services must be controlled since Israel is a small nation and the various monopolies will overcharge consumers. However, this monopolistic system exists only because the government restricts imports of competing goods and services either through tariff or nontariff barriers. Free-trading countries such as Hong Kong and Singapore are not beset with legally-sanctioned monopolies and cartels nor extensive price controls.
- There is a lack of industrialization in the construction industry including the almost total lack of "prefabricated or modularized housing". This lack of industrialized construction has primarily come

from the resistance of construction trades and the past abundance and cheapness of unskilled labor.

- Severe construction labor shortages have been caused by the intifada, since a large proportion of construction unskilled labor is provided by Arabs from the occupied territories. However, a number of arriving Soviet Jews can eventually be trained to build and produce housing.
- International tensions exist on various issues of Israeli resettlement and occupation. U.S. funding guarantees and increases in Soviet emigration are directly and indirectly effected by future Israeli actions in these areas.

## **2.3 RECENT ACTIONS IN THE HOUSING SECTOR**

Recent activities have taken place that may mitigate several of the constraints and barriers identified in the previous section.

### **2.3.1 CONSTRUCTION TECHNIQUES**

The majority of construction in Israel is based upon on-site, non-industrialized techniques. The structural frame is generally made of reinforced concrete poured into forms at the building site with interior walls composed of concrete blocks.

In an effort to incorporate technological advances into the construction industry in order to more rapidly decrease the construction time period and reduce the labor needs, the government has undertaken an industrialized construction program. Industrialized construction (as used in Western Europe, Japan, and the U.S.) is the process in which the majority of building components are manufactured and prepared off-site and assembled at the building site.

Government efforts to promote the industrialization of the construction industry have taken three forms. First, information on industrialized housing have been disseminated to lay public and construction professionals. Second, pilot projects that demonstrate the advantages of industrialized techniques have been supported. Third, the government provides financial incentives to builders who use industrialized techniques. For instance, the Ministry of Construction and Housing awards grants to housing developers who make use of industrialized exterior walls or "drywall" interior partitions made from sheetrock or plasterboard. In 1988, the first year of the program's operation, approximately 1000 units were constructed under this program, and developers received an average grant of \$2500 per unit.

### **2.3.2 PRIVATIZATION OF THE HOUSING SECTOR**

In Israel, publicly-sponsored housing is not synonymous with public housing and does not refer to units built and managed by public bodies. Instead, publicly-initiated or sponsored housing may be defined as dwelling units whose initial planning and supervision are sponsored by the government (e.g. the Ministry of Construction and Housing); national institutions (e.g. the Jewish Agency); local municipalities and development companies entirely controlled by these institutions. Such housing is indistinguishable from privately initiated housing, both regarding its geographic location, architectural design and residential profile.

One bright spot in recent years has been the move towards privatization of the housing construction industry. The proportion of publicly-sponsored housing has declined in favor of private initiatives. The form of public involvement in housing has also changed with the government gradually assuming more of a "pump priming" role by encouraging private initiative through various incentives instead of operating as a developer.

Now, however, the policy has changed in the wake of the current surge in immigration; in fiscal year 1990/91, the public sector is expected to promote the construction of some 30,000 new housing units.

### **2.3.3 MORTGAGE LENDING IN THE HOUSING SECTOR**

The Bank of Israel's moves to deregulate the mortgage lending sector, especially by removing lending ceilings, has therefore come at an ideal time for borrowers. Mortgage interest rates, which peaked at 13 percent in 1985, have fallen from around 11 percent two years ago, to 9 percent early in 1989, through 7 percent in the summer of 1989, to presently as low as 5 percent for 10 year loans. Mortgage banks have been actively issuing bonds to provide funds to lend to home buyers, and insurance companies have begun to take advantage of their newly gained right to compete in this market. However, as discussed earlier, the negative side of this otherwise welcome trend is that the supply of housing has actually fallen and is unlikely to rise in the short term, so there is more money chasing fewer housing units which has inevitably led to rapid inflation of housing prices.

The Bank of Israel has also made further small steps in the gradual relaxation of controls in the money and credit markets. It has allowed the commercial banks to introduce several savings and loans schemes in which options feature protective mechanisms against possible devaluations and against fluctuation among various foreign currencies. In the 1970s U.S. AID and the Government of Israel have discussed joint opportunities for establishing an Israeli savings and loan industry since. A regulated national savings and loan system would materially reduce the dependence on government for financing housing and reduce the need for housing guarantee programs. However there are two primary impediments to the initiation of such a system. First, the Israeli economy has to be stabilized to the point where long-term capital can be generated through personal savings; and second, major changes must be enacted in banking practices and procedures.

### **2.3.4 FOREIGN INVESTMENT IN THE HOUSING SECTOR**

A major policy shift that has recently occurred in Israel is the welcoming of foreign investment in housing. Alternatives are being explored to involve foreign firms in the emerging large scale building programs. This option has been fiercely opposed by Israeli contractors in the past, but they may have no choice in the current situation. The scale of the undertaking, and the risks involved are daunting for the shrunken local industry, but the attraction for foreign contractors -- especially major Jewish firms such as the Canadian Olympia and York, owned by the Reichman brothers, and the Jewish Federation of Greater Phoenix -- is great, as is the interest of the Israeli government in these group becoming active in the Israeli economy.

Some sources believe that the market has advantages for U.S. builders. Apartments and condominiums are sold before construction, which improves cash flow for contractors. And the government and major banks already have eliminated many traditional bureaucratic and financing obstacles in order to attract American companies and entrepreneurs (source: PRNNewswire-The Business Journal-Phoenix).

Various programs have opened up allowing foreign firms to share in the government's financial incentives for housing construction. Another major possibility is the importation of prefabricated housing on a large scale, which is presently under investigation. In addition, guides have been developed to identify and describe the various procedures and processes that are followed in the housing construction sector. However, tax breaks for corporations which a high percentage of foreign ownership still exist. Without such breaks, corporate income tax is presently 45 percent for most companies.

### **2.3.5 FINANCIAL INCENTIVES IN THE HOUSING SECTOR**

Various financial incentives have been enacted in the Israeli housing sector to mitigate and overcome problems inherent in the past. For example, in an effort to shorten the duration of housing construction, in 1990 the Ministry of Construction and Housing inaugurated a program of grants for units built more expeditiously. The grant ranges from \$15,000 per unit for 304 room units in four-story buildings constructed within seven months, to \$2,000 for similar units built within 14 months.

## BIBLIOGRAPHY

- Bank of Israel, Economic Review, Jerusalem, 1990.
- Drain, Dan, The Evolution of the Urban Land Lease in Israel, Habitat International, Volume 11 Number 1, Oxford, 1987.
- Gabriel, Stuart A., et al., A Simultaneous-Equations Analysis of Urban Development: Migration and Industrial Growth in Israel's Towns, Journal of Urban Economics, 21, 364-377, 1987.
- Gabriel, Stuart A., Cyclical Fluctuations in the Israeli Housing Market, Journal of Urban Economics, 19, 249-263 (1986).
- Ginor, Fanny, Socio-Economic Disparities in Israel, Tel Aviv 1979.
- Israel Central Bureau of Statistics, Monthly Bulletin of Statistics, Jerusalem, 1989.
- Mars, Leonard, The Village and the State, Surrey, 1980.
- Ministry of Construction and Housing, Residential Development in Israel, Jerusalem, 1990.
- Sachar, Howard M., A History of Israel, New York 1979.
- U.S. AID Office of Housing, Israel Shelter Sector Update and Technical Assistance Recommendations, Washington, D.C., 1981.
- U.S. Department of State, Background Notes on Israel, Washington, D.C., 1987.
- U.S. Department of State, Israel, - Housing Investment Guaranty, Washington, D.C., 1977.
- World Bank, Social Indicators of Development, Baltimore-London, 1989.
- World Bank, World Tables, Baltimore-London, 1989
- Various online systems (computerized information systems): (e.g., 1989 Economist Publication Ltd and The Business Journal Phoenix)