

ISRAEL'S URBAN TRANSFORMATION

Resolving Israel's Housing Shortage: Solutions and Opportunities

Brian J. Friedman, CFA - June 30, 2020



View of Tel Aviv. Image by Yair Melmed.

Israel's annual population growth of 1.9% is the fastest in the developed world, leading to housing shortages and rising home prices. Fortunately, as we noted in our newsletter from the second quarter of 2018 ("[Booming Home Prices in Israel Are Finally Moderating](#)"), the supply of new homes is improving relative to demand.

To keep up with household formation, Israeli real estate developers need to build more than 50,000 new housing units each year. Developers built just 37,000 new units in 2013, but that number rose to 55,000 new units in 2018 and 46,000 new units in 2019 (see Chart 1).

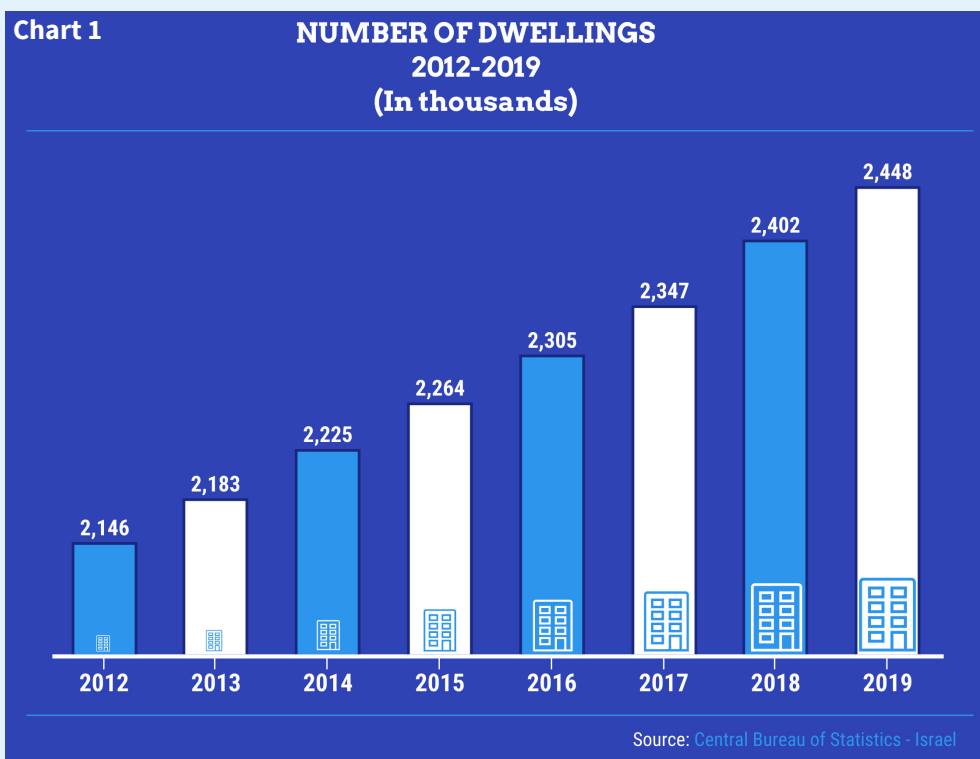
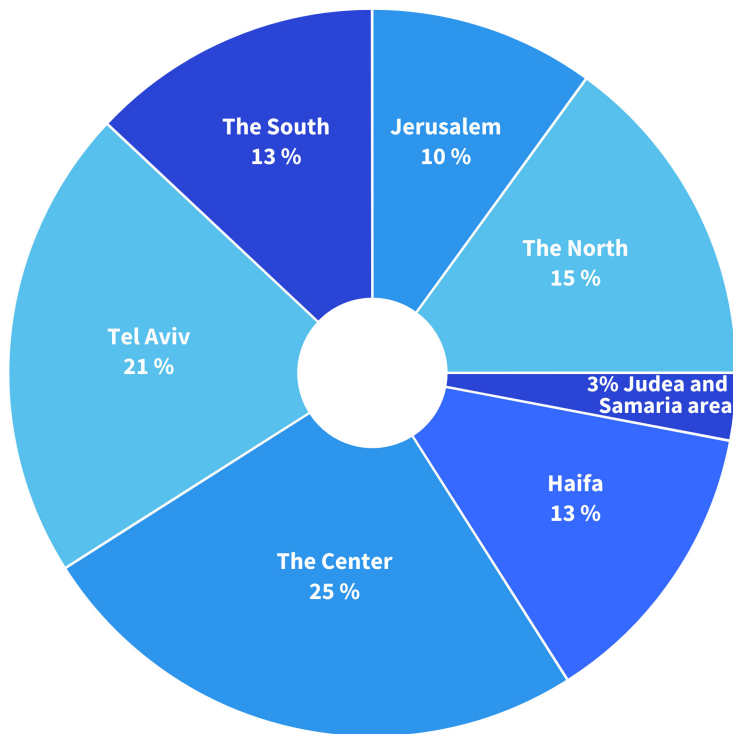




Chart 2

DISTRIBUTION OF DWELLINGS BY REGION IN ISRAEL - 2019 (%)



Source: Central Bureau of Statistics - Israel

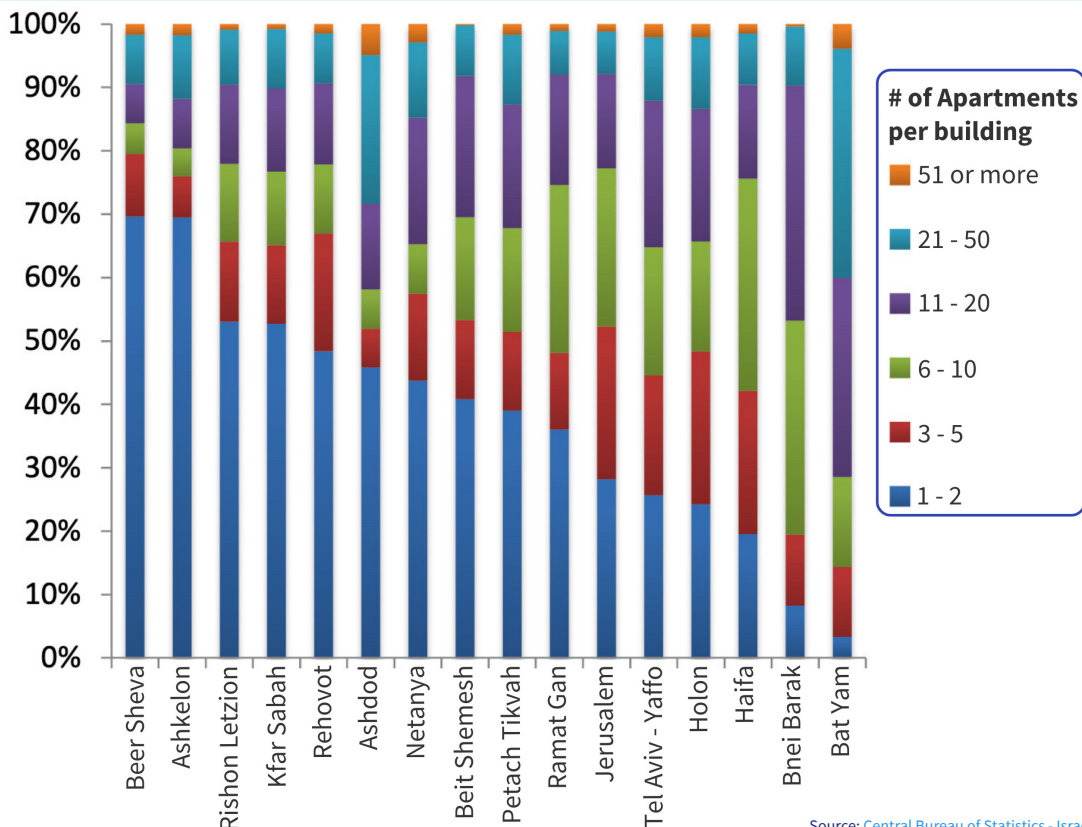
Real estate development has been a politically contentious issue in Israel. New projects traditionally traverse a byzantine labyrinth of national, district, and local approvals, often confronting public opposition along the way. While almost everyone recognizes the need for accelerated construction, nearby residents often worry about overburdened infrastructure as population density increases.

How dense is the urban population? The Tel Aviv greater metropolitan area (Tel Aviv + The Center) accounts for 46% of Israel's housing units (see Chart 2). Within the city of Tel Aviv, population density is 7,522 residents per km². Although well below Manhattan's 28,000 per km², Tel Aviv's density is on par with Queens and could approach Brooklyn's 14,000 per km² in the coming decades.

Most urban apartment dwellers live in smaller, older buildings. Although large residential towers increasingly dot Israel's skyline, most apartment buildings are much smaller. There are 16 cities in Israel with populations exceeding 100,000, and buildings with fewer than 50 apartments comprise most residential structures (see Chart 3). Taller buildings exceeding 50 units, which are concentrated in cities along the coastline, still comprise only 2.1% of all residential buildings in Tel Aviv, 2.9% in Netanya, 3.9% in Bat Yam, and 4.9% in Ashdod.

Chart 3

Distribution of buildings by number of dwellings in cities with more than 100,000 inhabitants (%)



Source: Central Bureau of Statistics - Israel





How the Government Is Fast-Tracking Construction

The Israeli government enacted a variety of programs to streamline the approval process for real estate developers, but some are controversial and additional reform is required. The two most prominent programs for urban redevelopment are TAMA 38 (“TAMA” is the Hebrew acronym for National Outline Plan) and Pinui Binui.

Before 1980, Israel's building code prescribed lax earthquake standards, and only apartments built after the 1990 Gulf War have a “Merkhav Mugan,” popularly known as a “Mamad” or safe room, to protect residents from missile or chemical attack. Starting in 2005, the Israeli government enacted several programs to incentivize private real estate developers to undertake urban redevelopment projects. One such program, TAMA 38, aims to beautify and strengthen older apartment buildings. Unit owners collectively contract with developers to improve their building in exchange for several extra floors that the developer can sell for a profit.

Another large-scale urban redevelopment program is Pinui Binui, or “Vacate and Rebuild.” As with TAMA 38, current owners sign over their property to a developer in exchange for an upgraded apartment. Through Pinui Binui, however, the developer demolishes blocks of low-rise buildings and replaces them with a complex of apartment towers and common space. Existing property owners trade their dilapidated unit, often only 50 or 60 square meters (540 to 650 square feet), for a brand new four- or five-room unit with modern finishes, Mamad, parking, and often a balcony. Residents of the razed buildings typically occupy 25% to 30% of the new complex, and the developer sells the remaining units for a profit.



View of Tel Aviv. Image by Yair Melmed.

The Israeli government voted to wind down TAMA 38 over the next two years and is debating a new National Outline Plan (NOP) with improved infrastructure investment. Many real estate professionals in Israel believe the new NOP will tilt toward larger Pinui Binui projects that can incorporate more significant infrastructure investment such as parking, sanitation, schools, and synagogues. The government is also exploring partnerships with private sector infrastructure companies to expand public transportation, roads, water, and sewage systems.





Residential Construction is an Estimated \$400 Billion Opportunity

With Israel's rapidly growing population, rising incomes, strong banks, expanding capital markets, and mounting pressures to streamline the approval process, new residential construction should accelerate. Israel is a dense country where new tall towers will have to comprise a larger percentage of the housing supply. The opportunity for real estate developers is immense, as new household formation will likely rise to almost 70,000 units per year over the next decade and perhaps as high as 80,000 per year over the next two decades. An additional 15,000 to 20,000 units per year require replacement as the shoddy construction from Israel's socialist early decades continues to crumble.

With average apartment prices in the country approaching \$500,000 and even higher in the Tel Aviv metropolitan area, residential construction offers an estimated \$400 billion opportunity in the coming decade. Israel's publicly traded real estate, financial services, construction, and infrastructure firms are poised to realize much of this opportunity. Hopefully, so are their investors, including us.

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A high-rise apartment building in Yaffo.
Image by Robert Kowalczyk via Unsplash.



View of Tel Aviv. Image by Yair Melmed.

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