

Press Release

Israel's housing market is approaching saturation. The Shores Institution's Dr. Noam Gruber warns of the growing danger of a price crash in the housing market.

A new study by Dr. Noam Gruber of the Shores Institution for Socioeconomic Research shows that Israel's housing market is approaching saturation. Under such circumstances, it would become increasingly difficult for landlords to find tenants, leading to a decline in housing prices and rents. This raises a concern of a possible housing price crash and collapse of the construction sector. Dr. Gruber's main findings are as follows:

- Low interest rates are continuing to push investors into the housing market. These investors are primarily high-income households and renter households. Despite a decline in the share of owner-occupied homes, investment in residential properties has caused a rise in the percentage of Israeli households owning housing units.
- However, construction in recent years has outpaced demographic growth. At the same time, Shores Institution research has shown that pent-up demand, as reflected in the share of multi-family households, has been declining – an indication that the housing market may be on the verge of saturation, and subsequent price drops.

Based on his findings, Dr. Gruber warns of a growing danger of a housing market crash, with sharp price reductions and the potential for a crisis in the construction sector.

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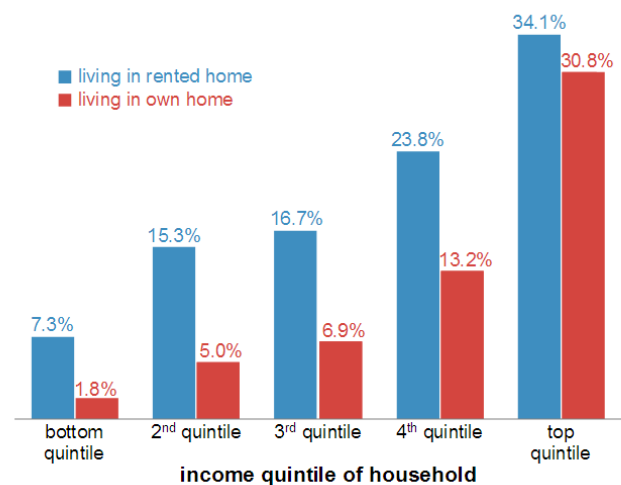
Despite the continued rapid rise in housing prices, Dr. Noam Gruber of the Shores Institution for Socioeconomic Research finds clear signs that Israel's housing market may be approaching saturation. After years in which growth in the number of families outstripped increases in new apartments, the housing market may have reached an as-yet unnoticed inflection point in 2013. That year, the pace of construction caught up with, and began to overtake, the rise in natural demand. Because pent-up demand for housing – as reflected in

the percentage of multiple-family households – is low, Dr. Gruber surmises that in the near term, housing investors may have difficulty in finding tenants, and that this will translate into a decline in rents. Such a process would reduce the feasibility of housing investment, possibly leading to a decline in housing prices.

Renters own investment apartments at high rates in relation to their income

- The ShoresH study finds that renter households own investment properties at higher rates than do owner-occupied households at similar income levels. These gaps suggest a strong tendency by renter households to “gain a foothold” in the ownership market by purchasing investment apartments. The gaps also indicate that renter households receive substantial funding assistance, presumably from relatives, so that they can make these purchases. It is likely that, in some cases, such assistance actually constitutes proxy investment by relatives who already own apartments and are taking advantage of preferential funding and taxation conditions that apply to first-home buyers.

Owners of one or more housing units for investment purposes*
households by type of living arrangement and income quintile, 2014



* A housing unit that the household does not reside in.

Source: Noam Gruber, ShoresH Institution for Socioeconomic Research
Data: Central Bureau of Statistics

- Against this background, Dr. Gruber argues that the various government programs instituted to help first-time apartment buyers, such as “Zero VAT” and “Target Price” in past years and today’s “Mechir Lamishtaken”, are often used to fund the purchase of investment apartments. He adds: “It is hard to understand how the government’s professional and political echelons are willing to forego billions of shekels in annual government revenue to fund investment activity, when that money could be used to solve the formidable systemic construction authorization problems which would increase the supply of land approved for construction and lower its cost.” Dr. Gruber continues: “The efficacy of governmental efforts to reduce investor purchases by raising the purchase tax is clearly limited in its effectiveness since governmental authorities are unable to identify investment purchases by or via renter households.”

The pace of construction has outstripped demographic growth

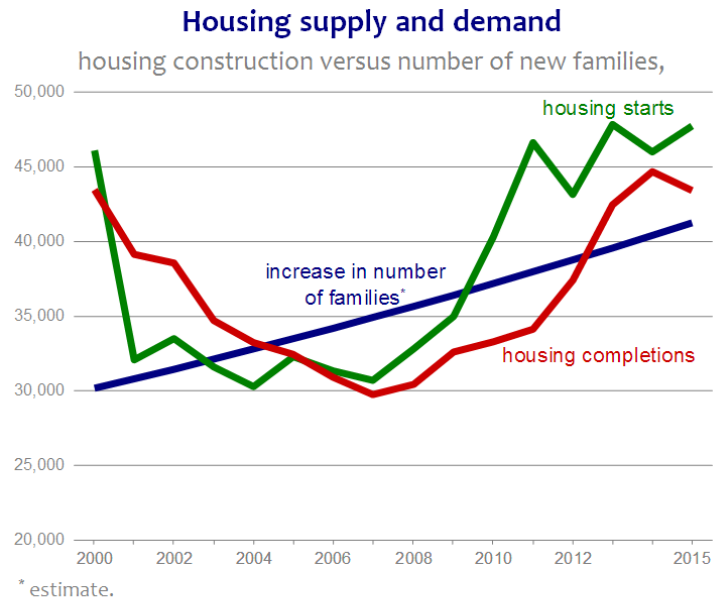
- Housing investment became lucrative when the ease in which residential property investors could find tenants led to an upward-rising trend in rents. This ShoresH Institution study finds that the pace of construction (number of new apartments) has been substantially exceeding the increase in natural demand (the number of families) since 2013. Should this situation persist, Dr. Gruber believes that investors

will eventually find it hard to secure tenants, due to a surplus of rental units, and both apartment prices and rents will decline. As a result of the fall in investment returns – possibly into negative territory – such a scenario could bring the current housing investment wave to an end.

- To monitor this process, the Shores Institution study also looked at pent-up demand for apartments, which can be approximately measured in terms of the percentage of multiple-family households – i.e., households comprising two or more families (for example, when a married couple lives with the parents of one of the spouses). Dr. Gruber shows that during the years 2003-2008, when housing prices fell in real terms overall, pent-up demand also declined. In other words, fewer and fewer married couples chose to share a household with another family when the alternative – living in a household of their own – was relatively inexpensive. In 2004 multiple-family households accounted for 2.5% of all households; by 2008 that figure had declined to 1.9%. When prices in the housing purchase and rental markets rose, more and more families chose to share homes with other families. As shown by Shores Institution policy research, the percentage of multiple-family households increased to 2.6% in 2011, the highest figure recorded for the period covered by the study. According to Dr. Gruber, “it is interesting to see that, despite the continued rise in prices, the trend started to reverse itself in 2012 and the percentage of multiple-family households declined, reaching 2.1% in 2014.”

Growing risk of a price crash in the housing market, and construction sector collapse

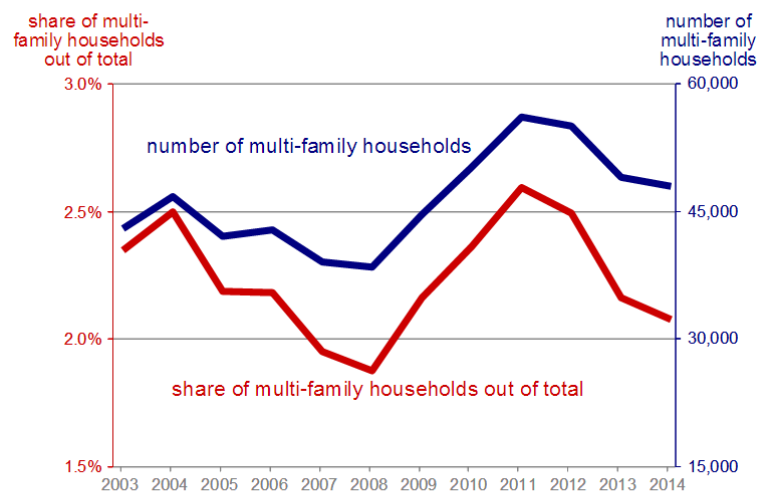
- After 9 years of rising prices, a false assumption may now prevail within the Israeli public that the trend is permanent and that housing prices will never decline. Dr. Gruber: “As can be seen from Israeli and world experience, this assumption is altogether unrealistic. The pace of construction is outstripping growth in the number of families, and the quantity of apartments under construction is expected to remain



Source: Noam Gruber, Shores Institution for Socioeconomic Research
Data: Central Bureau of Statistics

Pent-up demand for housing*

The share and number of multi-family households, 2003-2014



* Pent-up demand for housing is measured by the share of multi-family households. These include a married member other than the household head and his/her spouse). An example of multi-family households are two families in one home (e.g. married couple living with parents).

Source: Noam Gruber, Shores Institution for Socioeconomic Research
Data: Central Bureau of Statistics

high over the next two years.” Given the low level of pent-up demand for housing, Dr. Gruber feels that there will be an apartment surplus in the Israeli market which will, in turn, lead to declining rents and apartment prices. If this process will be rapid and intensive, it could precipitate a major crisis in the construction industry and reduce the value of many investors' assets.

- Such a housing surplus would manifest itself differently in different parts of the country. In certain areas, the surplus could appear earlier and/or be greater than in others. In some places, investors could cope with a shortage of long-term tenants by converting their properties into short-term vacation rentals. In Dr. Gruber's view, governmental involvement, as exemplified in blanket agreements (*heskemei gag*), may distort market mechanisms and create extensive supply in low-demand areas. Nevertheless, housing price trends in Israel's districts are closely correlated. This phenomenon points to great interchangeability between districts and indicates that declining prices in one area can have a strong impact on prices in nearby areas.
- Although it is hard to precisely predict the timing and scope of this scenario, Dr. Noam Gruber feels that its likelihood will increase for as long as construction outpaces the rise in natural demand (the number of families). At the same time, interest rates play an important role: a clear trend toward rising interest rates would precipitate, and possibly exacerbate, the possible market crash. By contrast, should interest rates stabilize at a low level, the decline in prices could potentially slacken or be delayed, enabling the construction sector to adjust gradually and avoid a crisis. Given the looming risk, Dr. Gruber hopes that both developers and apartment buyers will prepare accordingly and reduce leverage in their investments.

The Shores Institute for Socioeconomic Research, headed by Professor Dan Ben-David, is an independent, non-partisan policy research center providing evidence-based analyses of Israel's economy and civil society. The Shores Institute informs Israel's leading policymakers and the general public, both inside and outside the country, through briefings and accessible publications on the source, nature and scope of core issues facing the country, providing policy options that ensure and improve the well-being of all segments of Israeli society and create more equitable opportunities for its citizens.

For details, or to arrange an interview, please contact Dr. Noam Gruber (054-4693253)