Banking Supervision Department
Onsite Examination Division

October 15, 2024
4.149.16051

To: The banking corporations
Attn: CEO

RE: Construction and real estate industry developments

Dear Sir or Madam:

1. In the past year there has been an additional increase in the risk level of the exposures to the construction and real estate industry. In this regard, beyond the continued impact on borrowers of the increasing credit risk in this industry, the higher interest rate environment, and the increase in the level of overall uncertainty in view of the Swords of Iron War, and pursuant to previous guidelines that we sent in this regard[1], we see it as correct to note the following developments:
   1.1. The impact of the slowdown in many building sites, in view of the labor force shortage. The shortage primarily adversely impacted the risk profile of the construction contractors.
   1.2. The impact of the increase in the projects' financing costs in view of the slowdown in construction or sales.
   1.3. The impact of the increased costs of construction on the projects' profitability.
   1.4. The impact of the growth in financing costs on the value of the lands purchased in recent years.
   1.5. The impact of the marked increase in home sales via various promotional campaigns by the developers, with the goal of increasing demand in a period of slowdown in home sales, by holding off on reducing their prices. The promotional campaigns include primarily sales with considerable deferred payments (hereinafter: 20-80 campaigns), and to a smaller extent, also housing loans subsidized by the developers (hereinafter: developer loans). The deferral of the main part of the payment led to a notable increase in the volume of balance sheet credit provided to construction loan projects[2], and to some increase in the risk regarding the ability of several buyers to comply with future payments.
   1.6. The impact of the growth in the relative share of credit to income generating real estate—offices and commerce—at a high LTV, in view of surplus supply in certain areas.

---

[1] This includes our letter on "Increase in credit risk of the construction and real estate industry" dated August 19, 2021, and the file "examples of issues that arose in examinations carried out by the Banking Supervision Department regarding underwriting and classifying real estate credit" dated May 15, 2022.

[2] Please also see our letter 4.149.16051 dated August 12, 2024 regarding the impact of the above on the allocation of capital for construction loans credit facilities.

1.7. The impact of the decline in activity in residential income generating real estate, in view of the increase in the interest rate environment and taxation changes.
1.8. Growth in the scope and severity of troubled debts in the industry.

2. In view of the above, you are required to conduct a comprehensive analysis of the impact of the developments on the exposure risks, both in the construction and real estate industry and in the housing portfolio, and their impact on the appropriateness of the controls and rules in the existing credit policy. The analysis shall be supported by data, including macro data and indicators that the bank checks when examining the risk (in the construction and real estate industry and in housing). Further to that, it should include recommendations for appropriate steps, including setting limitations, as needed.
   The analysis shall at least include reference to the following issues:
   2.1. Assessment of the risk in credit to financing of residential construction loan projects, including the impact of 20-80 campaigns. The assessment shall also include reference to contractors' resilience.
   2.2. An assessment of the risk in lands financed in recent years and the feasibility of advancing to the construction stage.
   2.3. An assessment of the risk in credit to contractors.
   2.4. An assessment of the risk in credit to borrowers in the construction and real estate industry that is not secured by a specific asset (ongoing credit)
   2.5. An assessment of the risk in credit to finance the construction and rental of real estate for offices.
   2.6. An assessment of the risk in credit to finance the construction and rental of residential real estate.
   2.7. The changes in the composition of the housing loan portfolio, with an emphasis on developer loans, and the impact of these changes on the risk level of housing loan borrowers, including the appropriateness of underwriting the credit for developer loans from the perspective of fully examining the sources of the payment and being transparent to borrowers with regard to the future risks.
   2.8. The appropriateness of appraisers' assessments in housing loans and their restructuring.
   2.9. The appropriateness of the manner in which the said impacts are reflected in the risk assessment of the borrowers, including the risk ratings and in classifying the debts.
   2.10. The appropriateness of the manner in which the said developments are reflected in the allocation of capital within the framework of the Tier 1 capital target established by the bank.

3. In addition, in accordance with the requirement in the Reporting to the Public Directives, with regard to reporting to the public for the third quarter of 2024 and onward:
   3.1. You are required to continue adjusting the allowance for credit losses in a manner that will provide adequate expression to the continued increase in the said risk and will ensure that the allowances are sufficient to cover in a cautious and conservative manner the updated estimate of credit losses.
   3.2. You are required to continue adjusting the quantitative and qualitative disclosure in the reports of the board of directors and of management so that it will give adequate expression to the continued increase in risk, and will clarify the main developments in the credit risk characteristics in credit to the construction and real estate industry

and in the housing loan portfolio, how the banking corporation manages the risk, and how the banking corporation takes the increased risk into account in its allowance for credit losses.

Please see additional guidelines regarding the required disclosure in our letter dated December 30, 2021, on “Increase in credit risk in the construction and real estate industry” and in the Reporting to the Public Directives regarding the reports of the board of directors and of management.

4. In accordance with the above, you are required:
   4.1. To submit for our perusal the said analysis and recommendations by November 30, 2024.
   4.2. To hold a discussion among the bank’s board of directors on the said analysis and recommendations, and to submit to us the minutes of the discussion close to when it has been held, and not later than December 31, 2024.

Sincerely,

Or Sofer
Deputy Supervisor of Banks

CC: Mr. Daniel Hahiashvili, Supervisor of Banks
Mrs. Raya Wittenberg Shpernat, Head of the Credit Risk Examination Unit
Mr. Ido Galil, Head of the Financial Reporting Unit