Banking Supervision Department
Supervisor's Office
March 20, 2022
22LM4381

To: The banking corporations
Attn: Chair of the board of directors
Bank CEO

Re: Increase in credit risk to the construction and real estate industry

Dear Sir or Madam:

1. In the recent period, there has been an increase in the banking system's credit risk to the construction and real estate industry. This has been reflected in accelerated growth of credit balances and the risk characteristics to the industry in some of the banking corporations. During 2021, balance sheet credit to the construction and real estate industry in the five largest banks increased by NIS 44.5 billion, growth of approximately 26 percent.[1] This growth was accompanied by, among other things, an increased risk appetite, easing in underwriting standards, and a decline in the pricing of new transactions in a manner that is not in line with the risk characteristics.
2. In the second half of 2021, letters were sent to the banking system, in which the banking corporations were instructed, among other things, to take the following measures:
   2.1. To enhance the processes of monitoring and control of the development of credit risk, particularly in new transactions defined as being at heightened risk, and to examine the need for setting limitations on this component.
   2.2. To adjust, starting with the financial statements for 2021 and onward, the collective allowance for credit losses in a manner that will adequately reflect the increasing risk in the construction and real estate industry.
   2.3. To verify that as part of the financial statements for 2021, suitable qualitative and quantitative disclosure is provided on the increasing risk in the construction and real estate industry.

3. Further to these steps, and in view of the continued trend of growth in credit risk to the construction and real estate industry, we have decided to adopt additional supervisory measures, the goal of which is to strengthen the risk management, the transparency and the supervisory consistency as well as the ability to monitor the risk in the portfolio. The additional measures include:
   3.1. <u>A requirement to allocate additional capital in respect of financing highly leveraged lands</u>—the banks will be required to increase the risk-weight of loans that have been provided and that will be provided for purchasing land for the goals of development or construction, with an LTV exceeding 75 percent.
   3.2. <u>The Banking Supervision Department will provide examples that represent underwriting and credit classification processes</u>—examples that arose during the

[1] From 2021 financial statements, activity in Israel.

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examination processes by the Banking Supervision Department, with regard to the construction and real estate industry. The examples refer to, among other things, financing of construction loan projects and of land acquisitions, and they are presented in order to illustrate the process of analysis used by the Banking Supervision Department's examination teams, and thus to assist management of underwriting and classification of credit processes by the banks.

3.3. Expansion of the reporting to the Banking Supervision Department on the construction and real estate industry—expanding and enhancing the information received in the report to the Banking Supervision Department regarding the construction and real estate industry will allow better monitoring of risk development in the industry.

4. These three steps will be published within the framework of the generally accepted consultation processes.
5. The Banking Supervision Department will continue to follow the developments, and will consider taking additional measures in the future, as needed.

Sincerely,

Yair Avidan
Supervisor of Banks