

**BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

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Press release:

**Box from *Israel’s Banking System* Annual Survey for 2023, soon to be published:
Development of Credit in the Construction and Real-Estate Industry**

* **Balance-sheet credit from the five large banking groups to the construction and real-estate industry continued to grow vigorously (14 percent) in 2023, as before. This outcome was attained despite the increase in industry risk, particularly in view of the slowdown of housing-market activity, rising funding costs, and the effects of the Swords of Iron War.[[1]](#footnote-1)**
* **The increase in industry risk was reflected in an upturn in the coverage rate of the credit-loss allowance relative to credit taken by the industry. This rate increased throughout the banking system by 0.5 percent in the course of 2023, ending the year at to 2.4 percent, mostly due to the effects of the war.**
* **This box describes the developments in bank credit to the construction and real-estate industry parsed by the following activities:**
* **Credit for funding of land—the decrease in housing demand induced, *inter alia*, a decline in the success rate of land auctions and in winning prices in auctions successfully closed. Concurrently, the Banking Supervision Department demanded an additional capital allocation for high-leverage lending for land. These measures slowed the growth rate of credit for land financing relative to previous years.**
* **Residential construction loans—2023 saw a hefty 66 percent increase in financial credit for residential construction. The increase traced to the slowdown in sale of dwellings and occurred despite impediments to progress in construction when the war broke out.[[2]](#footnote-2)**
* **Income-producing real estate—the share of high-LTV credit for income-producing office and commercial real estate increased in 2023, for reasons including oversupply in the market for office space in certain parts of the country. As for income-producing residential real estate, the increase in the interest environment and changes in taxation made activity in this field less worthwhile and some companies chose to put up for sale dwellings that had been rented out or that were intended for rental from the outset.**
* **Credit not secured by real estate—much of this credit is extended for the activities of performance contractors. The risk in financing performance contractors was high even before the war broke out; since then, performance contractors have been exposed to additional risks, particularly labor shortages and increases in costs of labor and raw materials.**
* **Pursuant to the upturn in risk, the Banking Supervision Department is closely monitoring developments in credit to this industry and is acting to ensure that the industry’s credit risks are monitored and managed in accordance with accepted and appropriate risk management practices.**

**General remarks—main developments in the real-estate market**

Demand for housing began to slacken in the second half of 2022 and did so more strongly in 2023, manifested in a decrease in the number of home purchase transactions in the course of 2023 (35 percent relative to 2022[[3]](#footnote-3)), an increase in unsold new housing stock to 67,000, [[4]](#footnote-4) a downturn in home prices (1.4 percent[[5]](#footnote-5)) and a slump in mortgage performance (40 percent relative to 2022).

In the construction industry, activity slowed moderately relative to 2021–2022, both in housing starts and in issuance of building permits. Concurrently, housing completions increased (Figure 1).



The outbreak of the Swords of Iron War on October 7, 2023, occasioned a further decline in real-estate market activity. The moratorium on allowing Palestinian workers to enter Israel, placing much of the industry’s labor force off-limits, brought activity in many construction sites to a halt. The labor shortage is a major problem in the industry at the present writing,[[6]](#footnote-6) having an upward effect both on construction costs and on progress in performance. Due to the effects of the war, the Banking Supervision Department instructed the banking corporations to be lenient with borrowers, including those in the construction and real-estate industries, as part of the policy of leniency toward borrowers that the Bank of Israel and the government adopted.[[7]](#footnote-7) The five large banking groups’ balance-sheet credit (liabilities) to the construction and real-estate industry increased by a solid 14 percent in 2023 and came to NIS 293 billion (Figure 2). The annual growth rate is representative of the trend of rapid growth in credit to this industry in recent years. The upturn in lending to the industry occurred against the background of slowdowns in housing-market activity and home sales along with rising funding costs.



The credit risk of the construction and real-estate industry increased during the year and particularly after the war began, as is also reflected in the credit-quality indices. After several years of boom in the Israeli housing market, manifested in record numbers of home-purchase transactions, home prices increased as did prices of land marketed at this time, particularly in 2021–22. The surge was accompanied by rapid growth in outstanding credit and the risk characteristics of loans taken at this time, particularly in terms of loan-to-value (LTV) ratios.

Pursuant to the upturn in risk, the Banking Supervision Department has been closely following developments in credit to this industry and is acting to ensure that the industry’s credit risks are monitored and managed in accordance with accepted and appropriate risk management practices.

The increase in industry risk is reflected in upward movement of the coverage rate[[8]](#footnote-8) of the credit-loss allowance relative to industry credit. Thus, the share of credit-loss allowances in total credit (liabilities) of the five large banking groups to this industry came to 2.4 percent at the end of 2023 as against 1.9 percent year-earlier (Figure 3).



Below, credit to the construction and real-estate industry is reviewed by main areas of activity that represent, among other things, main activities and various stages of the building process: buying land, residential real estate under construction; income-producing real estate, and other credit (credit unsecured by specific property).

**Table 1
Development of outstanding balance-sheet credit to the construction and real-estate industry in Israel (NIS billion)**

|  |  |
| --- | --- |
| **Component** | **Balance-sheet credit risk** |
| **12/2023** | **12/2022** |
| **NIS billion** | **Pct.** | **NIS billion** | **Pct.** |
| Land | 101 | 34% | 94 | 36% |
| Real estate for construction—housing | 38 | 13% | 23 | 9% |
| Real estate for construction—income-producing | 15 | 5% | 13 | 5% |
| Income-producing real estate | 94 | 32% | 82 | 32% |
| Infrastructure | 12 | 4% | 9 | 3% |
| Credit not earmarked for funding of specific property | 35 | 12% | 38 | 15% |
| **Total borrower activity in Israel (total exposure, incl. off-balance-sheet)** | **295****(485)** | **100%** | **259****(435)** | **100%** |

**Source:** banks’ reports to the Banking Supervision Department.

**Land**

Total balance-sheet credit for land among the five large banking groups was NIS 101 billion as of the end of 2023, up 7 percent from December 31, 2022. The share of balance-sheet credit for land in funding that exceeds 75 percent, reflecting heightened risk, was NIS 58 billion at the end of 2023, 57 percent of balance-sheet credit for land extended by the five large banking groups. Furthermore, additional impediments in transitioning from the stage of land funding to construction loans, occasioned by the effects of the war and the industry’s labor shortage, are expected.

The slowdown in performance of credit for land in 2023 traces, *inter alia*, to measures taken by the Banking Supervision Department in recent years, particularly the requirement of an additional capital allocation on account of high-leverage land funding,[[9]](#footnote-9) as well as a decrease in the success rates on land auctions, particularly in 2023, and a decline in winning prices in auctions successfully closed.

These and other developments gave indication of a decrease in land value in some parts of the country, particularly land acquired in past years at high prices. For this reason, **the banks were required to comply with the aforementioned guidelines concerning an additional capital allocation on account of high-leverage funding of land for performance in the course of 2023 and adjustments in funding given.**[[10]](#footnote-10) It should be noted, however, that in view of the sizable profits that the developers have amassed in the past few years, many of them are able to absorb the effects of the changes in the economic environment and the implications of the war.

**Residential construction loans**

Dwelling sales slowed by 35 percent in 2023 relative to 2022, and, thereof, sales of new dwellings in residential construction projects dropped by 31 percent.[[11]](#footnote-11) Although the trend gathered strength due to the war, the end of the year saw some recovery in dwelling sales. Unsold housing stock in builders’ possession grew to some 67,000 units by the end of February 2024.

*Development of credit risk for residential construction loans*

The year saw a notable 66 percent increase in financial credit for residential construction loans, from NIS 22.7 billion at the end of 2022 to NIS 37.6 billion a year later.[[12]](#footnote-12) This is explained, *inter alia,* by the slowdown in new-dwelling sales. After the war began, however, there were also major delays in construction project progress, although the pace of housing completions remained relatively high,[[13]](#footnote-13)

**Discrepancy between the pace of engineering performance and pace of sales—**in the course of 2023, the share of the five large banking groups’ total exposure to projects in which performance outpaced sales[[14]](#footnote-14) increased from 27 percent to 36 percent.[[15]](#footnote-15) The share of exposure on account of projects for which the discrepancy between performance pace and sales pace is high (20 percent or more), however, increased more gently—from 10 percent at the end of 2022 to 12.4 percent a year later (Figure 4). It is also noteworthy that sales outpaced engineering performance in some two-thirds of projects.



**Absorption capacity[[16]](#footnote-16) in residential construction projects—**the rate of absorption capacity inresidential construction projects decreased slightly in 2023 but remained relatively high at 70 percent at year’s end. Notably, however, even though construction sites have been operating at less than full capacity since the beginning of the war, builders are continuing to absorb all fixed expenses, thus increasing construction costs. If these developments continue, they may impair absorption capacity in projects.

To contend with these difficulties and power the market despite the war and, particularly, to meet prior-sales targets—a prerequisite for the issues of construction loans—some developers offered special deals for homebuyers while refraining from lowering actual prices.

**Income-producing real estate**

Outstanding balance-sheet credit from the five large banking groups for real-estate activity was NIS 109 billion at the end of 2023, up 11 percent from year-earlier.

As of the end of 2023, outstanding balance-sheet credit from the five large banking groups for real estate in which construction was completed stood at NIS 94 billion, thereof NIS 18.8 billion (20 percent) at LTV rates exceeding 75 percent, indicating heightened risk.[[17]](#footnote-17) Similarly, outstanding balance-sheet credit from the five large banking groups for income-producing real estate under construction ended the year at NIS 15 billion, of which NIS 3.9 billion (26 percent) at LTV rates in excess of 75 percent.

Credit risk for income-producing real estate exists both at the construction stage, in which credit needs are high because receipts from rental of the property accrue only after construction is completed, and after completion of construction, due to the many years of repayment that are conventional in this form of credit. The upturn in the interest environment has a major effect on the level of industry risk in view of its steep credit needs.

*Income-producing real estate—office and commercial space*

Outstanding balance-sheet credit for income-producing commercial and office space, in which construction was completed, was NIS 61 billion at the end of 2023, up 14 percent from year-earlier. Credit as a share of funding that exceeds 75 percent, reflecting heightened risk, was NIS 11 billion at the end of 2023, up 18 percent from total balance-sheet credit for income-producing office and commercial space. Credit risk at the end of 2023 on account of income-producing office space was affected, *inter alia*, by the high-interest environment and changes in renters’ tastes and demand for rented offices, with distinctions made between new buildings and old ones and among different parts of the country.

*Income-producing residential real estate (including sheltered housing)*

Outstanding credit for income-producing residential properties (including sheltered housing), in which construction was completed, came to NIS 15.4 billion at the end of 2023, up 5 percent from year-earlier. Credit for this purpose in the share of funding that increased [exceeded 75 percent and that reflects heightened risk was NIS 3.5 billion at the end of 2023, 23 percent of outstanding balance-sheet credit for income-producing properties for residential use (including sheltered housing). Given the increase in the interest environment and, it became less worthwhile activity in this field and there are companies active in the field that are putting up for sale dwellings initially earmarked for rental or that were used for rental over a period of several years.

**Credit not secured by real estate**

Credit to construction and real-estate companies that is not secured by a specific property in Israel is given for several purposes, mainly to finance performance contractors’ activity and for short-term credit to borrowers in the industry, including borrowers in which sizable activity is concentrated. Since this credit is not secured by an encumbrance on property, it carries a considerable structural risk. Outstanding balance-sheet credit to borrowers in the construction and real-estate industry not secured by real estate was NIS 35 billion at the end of 2023, 8 percent down from year-earlier.

*Performance contractors*

Financing for performance contractors was a high-risk activity even before the war began, for reasons including the industry slowdown and the increase in the interest environment. Since the war erupted, performance contractors have been exposed to additional risks, particularly labor shortages and rising costs of labor and raw materials. Notably, as a rule, most credit to performance contractors is used for guarantees (off-balance-sheet credit), particularly performance guarantees linked to specific projects.

1. For elaboration on economic developments in the housing market, see the Bank of Israel *Annual Report* for 2023, Chapter 8, and “The Housing Market.” [↑](#footnote-ref-1)
2. Financial credit for housing construction loans purposes increased and the gap between construction costs related to progress in project performance and cash flow obtained from the sale of dwellings widened. [↑](#footnote-ref-2)
3. Central Bureau of Statistics, “Real Estate Transactions—Dwellings in 2023,” <https://www.cbs.gov.il/he/mediarelease/DocLib/2024/047/04_24_047b.pdf> [↑](#footnote-ref-3)
4. Central Bureau of Statistics, “Real Estate Transactions— Dwellings in December 2023–February 2024,” <https://www.cbs.gov.il/he/mediarelease/DocLib/2024/113/04_24_113b.pdf> [↑](#footnote-ref-4)
5. Decrease in current prices, November–December 2023, monthly data against year-earlier. [↑](#footnote-ref-5)
6. For elaboration, see box in the Bank of Israel *Annual Report* for 2023, “Employment of Israeli Workers in View of the Swords of Iron War.” [↑](#footnote-ref-6)
7. For elaboration, see Box 2 in Chapter 6 of *Israel’s Banking System, Survey for 2023*. [↑](#footnote-ref-7)
8. The coverage rate reflects the ratio of the credit-loss provision to outstanding balance-sheet credit (liabilities). [↑](#footnote-ref-8)
9. Banking Supervision Department Circular 2709-06, concerning an update of Directive 203: Capital Measurement and Adequacy, the Standard Approach—Credit Risk as of May 22, 2022. [↑](#footnote-ref-9)
10. Ibid. [↑](#footnote-ref-10)
11. Central Bureau of Statistics, “Real Estate Transactions—Dwellings in 2023,” <https://www.cbs.gov.il/he/mediarelease/DocLib/2024/047/04_24_047b.pdf> [↑](#footnote-ref-11)
12. Data: reports to the Banking Supervision Department, five large banking groups—Directive 831. [↑](#footnote-ref-12)
13. For elaboration, see Chapter 5 in the Bank of Israel *Annual Report* for 2023. [↑](#footnote-ref-13)
14. The discrepancy between the pace of engineering performance and the pace of sales is used as an index for the level of risk in construction projects. [↑](#footnote-ref-14)
15. Ibid. [↑](#footnote-ref-15)
16. Absorption capacity reflects the highest possible rate of decrease in dwelling sale prices without the bank absorbing a loss on the project. [↑](#footnote-ref-16)
17. Data from reports to the Banking Supervision Department, five large banking groups—Directive 831. [↑](#footnote-ref-17)