REDDUCING THE REAL ESTATE INVESTOR RATE IN ISRAEL TO INCREASE AVAILABLE HOUSING AND FIGHT SOCIOECONOMIC DISPARITY

by
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A capstone project submitted to Johns Hopkins University in conformity with the requirements for the degree of Master of Arts in Public Management

Baltimore, Maryland
December 2017

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ABSTRACT

Since 2008, Israel has experienced a rapidly expanding socioeconomic disparity, weighted by limited competition in the real estate market and a shortage of housing available for purchase. Investors in the real estate market, members of the upper class that own three or more properties, have made up roughly 40% of housing purchases, resulting in increasing housing prices and making ownership for the lower and middle class, and young families less obtainable. This capstone project presents the decisions that have led to the current housing issue and proposes a policy that will attempt to lower the rate of investor growth within the real estate market, expanding available housing, and catalyzing steps toward a smaller socioeconomic gap.

Advisor: Professor Paul Weinstein, Johns Hopkins University
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DECISION MEMORANDUM

December 5, 2017

To: Moshe Kahlon, Minister of Finance in Israel
From: Rachel Jetter-Cohen
Re: Reducing the Real Estate Investor Rate in Israel

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Action-Forcing Event

According to the International Monetary Fund’s March 2017 report on Israel’s economy, “the average cost of a home has risen to more than seven times the average household’s annual income, up from a ratio of about five in 2002-2007, with affordability significantly worse than in a range of other countries”.1

Statement of the Problem

Owning an apartment or house is a common indication of personal and financial success, which illustrates an opportunity for financial stability and social mobility. It also provides a sense of physical, and mental security that enables social continuity, increased civic engagement, and reduced crime.2 Yet in Israel, there is no guarantee that the traditional path to success, such as completing an academic degree and illustrating hard work and talent in a profession, will enable one to buy a home. Instead, Israel is dealing with a real estate buyers’ market that is closed off to most of the population and which suppresses the energies of realizing success through traditional achievements. Further, Israel’s expanding socioeconomic gap is negatively impacted by trends of the real estate market, which has a growing

1 International Monetary Fund. “Israel: Article IV Consultation – Press Release; Staff Report; and Statement By the Executive Director For Israel”, IMF, March 2017.
population of high-income households investing in multiple real estate properties. The result is a continuous lack of available housing and an average purchase price point that low and middle class households and young families can increasingly not afford. For the purposes of this paper, a real estate investor is any household that owns three or more housing units in Israel.

According to the Ministry of Finance, the average wealth of a landlord in Israel is 15 times greater than that of a tenant.³ This is at least partially due to the fact that the return on real estate value has sustained an average of 7-8% for over a decade, adding to the wealth of those that own property.⁴ Additionally, a 2016 study conducted by the Taub Center for Social Policy Studies in Israel, concluded that real wages in 2015 were similar to those in 2001 even though productivity during that time had increased by 15%.⁵ This research illustrates there is a dwindling correlation between productivity and wages enabling a worker today to have no more purchasing power than they had fifteen years earlier, despite an increase in consumer prices. Together, these financial factors contribute to a society characterized by an unequal opportunity for financial gain or social mobility through real estate investment. This societal feature is supported by the Organization for Economic Cooperation and Development (OECD), whose most

recent data, describes Israel’s economy as one of its member countries with the highest income inequality rates.⁶

In order to enable low and middle-income, and young families to purchase homes and begin to close the socioeconomic gap, interest levels have been intentionally kept historically low since 2008. The consumerism-based initiative however, has not been effective. In fact, it has backfired and resulted in a large percentage of high-income households taking advantage of the low interest rate and purchasing multiple properties for investment purposes, effectively taking available homes off the market, increasing overall housing prices by 49%, and lowering the market competition.⁷ Figure 1 below, shows the drastic increase in real estate market players due to investors entering the real estate market.

Figure 1⁸

![Annual Increase in Demand and Supply of Housing Units in Israel](image)

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A lack of regulation for apartment conditions or rent price control has encouraged the increasing investor population. Investors that rent out property have historically been under no legal obligation to provide a unit in good condition or at a fair price. Instead, a free-market mentality, devoid of government intervention, has determined what price and condition is acceptable. Burdens such as unreasonably high security deposits and obligations to pay for a landlord’s realtor fees have also often fallen on the renter. Owning multiple properties and renting them out proved to be a limitless, low-maintenance, and high-return investment opportunity for those that could afford to do so. Therefore, without any consequence, the real estate industry encouraged investment purchases, while apartment conditions worsened and rental prices increased, leading to polarization within the quality of living in society.

The socioeconomic disparities caused by the real estate market are further compounded by Israel’s slow building rates. The International Monetary Fund (IMF) calculated that it takes an average of 13 years to design and approve blue prints, receive all the necessary building permits, and fully construct a new housing project in Israel. This slow rate of housing construction led to an estimated total deficit of 105,000 units in 2011 and a shortage of near 149,000 in 2016. Roni Brik, President of the Israel Building Association stated, “according to the calculations of our Economic Department, by the year 2050, we will need three-million additional homes.” This picture illustrates a deficiency in meeting the demand of both

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hopeful first-time homeowners and investors alike. With such a large housing supply shortage, those in the upper class, with the financial means to quickly submit a down deposit and who are able to purchase a property at a higher price point than their competition, continue to govern the housing market; in 2015, 40% of all housing transactions were made from homeowners of at least one other property, for investment purposes.\(^7\)

In September 2017, Israel’s Ministry of Finance calculated that more than 60,000 families, in a country of just 8.5 million individuals, own three or more homes.\(^4\) The report further states that this number is not complete due to many households purchasing multiple homes under different family members’ names and through businesses, making it too hard to track. The overall concern is an irreparable socioeconomic polarization, illustrated by low-and middle-income households and young families facing closed doors to social mobility, financial stability, and to the symbolic representation of success that comes with homeownership.

**History Background**

Until the mid-1990s, Israel’s housing supply and demand had been historically balanced, with about 25,000-30,000 housing units per year being constructed and sold at reasonable prices that rose alongside inflation rates.\(^{11}\) However, with the dissolution of the Soviet Union, nearly one million immigrants, claiming to be Jewish, made a new home in Israel, increasing the country's population by 20% in the mid-1990s. In order to accommodate these new

immigrants, the Israeli government intervened in the housing market and offered
tax exemptions for landlords that owned multiple properties, to rent out their
uninhabited apartments.\textsuperscript{11} To add new homes to the market and expedite the
building process, the government also allowed more building permits to be secured
and engaged foreign construction companies to build and import ready-made
structures.\textsuperscript{12} Construction jumped from about 30,000 per year to roughly 70,000 in
the mid-1990s with 72,876 buildings being started in 1995 alone.\textsuperscript{13} Given the
increased overall population, these government-led interventions effectively kept
the housing demand and supply healthily balanced through the 1990s.

However, after the building rush of the 1990s, construction resumed the
form as it was before the wave of new citizens from the former Society Union
arrived in Israel. The government took an overall step-back from intervening in the
housing market; foreign companies stopped supplying ready-made housing and the
long bureaucratic procedure for building permits was put back in place.\textsuperscript{10} Between
2001-2009, the average number of housing starts returned to roughly the same rate
as it had been before the Russian wave with only 30,788 new units starting in 2007
and an average of roughly 32,000 new housing units per year (Figure 2).\textsuperscript{13}

By not making long-term construction adjustments to accommodate the
annual housing demand of the increased population, which had risen from around
30,000 households to over 50,000 households per year, including hopeful first-time
homebuyers and investors, the supply rate for available housing became

\textsuperscript{12} Lipshitz, G. “Country on the Move: Migration to and Within Israel, 1948-1990.” Springer Sciences
\textsuperscript{13} Benchetrit, G. “A Decade Without a Housing Policy.” Taub Center for Social Policy Studies in Israel.
January 2014.
insufficient. The Shoresh Institution for Socioeconomic Research in Israel deems this slow pace of construction as a main reason that investors began dominating the real estate market, increasing the property price point and “pushing those seeking apartments out of the housing market and into the rental market.”

Figure 2

Israel Housing Construction Starts 1990-2017

Reacting to the 2008 Global Economic Crisis

Unlike in other countries, the 2008 global economic crisis, catalyzed by the United States banking and real estate industries, did not gravely impact Israel’s economy. The country’s stock market and economic growth, concentrated in its import and export industry, declined only slightly and banks remained overall stable. Regardless of the country’s own financial stability, The Bank of Israel (BOI),

Israel’s central bank, lowered the national consumer interest rate as a way of regulating the exchange rate and protecting export agreements. The BOI also lowered the rate as an attempt to increase overall economic activity, particularly around housing. The interest rates plunged from 4.25% at the end of 2008, to 1.75% in January 2009 and further to 1% in February 2010. After a brief attempt to increase the interest rate later in 2010, the BOI lowered the interest rate even further in 2011 to .01%, “in an effort to boost economic growth while maintaining price and financial stability”. The interest rate remains at the .1% through today.

The low interest rates did catalyze property purchases, however the purchases were not distributed evenly among the country’s citizens. Rather, those in the upper class, as well as foreign nationals, quickly identified the favorable opportunity and decided to increase their investments in the real estate market. Thousands of homes were quickly purchased for investment purposes, taking available properties off the market faster than they were being built or sold back into the market. As a result, both housing and rental prices spiked (Figure 3).

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While families that could not afford to buy a home before 2008 were in theory in a better position to purchase a housing unit after the low interest rates took effect, the rate of investors overtook the rate of first-time homeowners; in major cities like Tel Aviv, apartments purchased for investment reached as high as 55% of all residential property purchases in 2009.\footnote{Global Property Guide. “Israel’s House Price Bubble Inflates Further”. \textit{Global Property Guide}. January 19, 2011. Accessed on October 15, 2017. https://www.globalpropertyguide.com/Middle-East/Israel/Price-History-Archive/Israels-house-price-bubble-inflates-further-1245.} For most of Israeli society, this meant that a greater percentage of Israel’s comparatively disadvantaged citizens paid rent to its wealthier neighbors, further increasing the socioeconomic disparity.

\textbf{Uniting Over Housing Disparity}

A growing frustration and social tension among the low and middle class, and young families due to the short housing supply, rising prices, and lack of opportunity for financial investment, exploded in the summer of 2011. Protests
occurred all over the country and semi-permanent tent villages were erected nearly overnight in over 40 different communities. These demonstrations united populations typically separated by ideology, heritage and geographic disparities: the politically-lean ing left and right, Arabs and Jews, religious and secular, “Until this summer, people had been privately ashamed of their inability to make ends meet. ‘Each person was lonely in their situation, thinking it’s my own problem.’ That had changed with the [housing] protests”.19

The emotional summer culminated in a record breaking march on September 3, 2011, where groups totaling over 400,000 people, in a country of 7.7 million at the time, gathered and paraded across the main cities of Tel Aviv, Jerusalem, and Haifa, demanding attention and action from the government. “This square is filled with the new Israelis who would die for this country, but who expect you, Mr. Prime Minister, to let us live in this country,” Itzik Shmuli, the chairman of the National Union of Students and a leader of the protest movement said from the stage at the Tel Aviv rally.20 Opinion polls reported that roughly 90% of the Israeli population (nearly six million citizens) supported the social movement and demanded housing reform from the government.20

**Government Responses**

The demonstrations of summer 2011 put housing on the main agenda in the next elections. During the 2015 elections, Kulanu (All of Us), a popular politically

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centrist party, became the main activists for addressing the country’s socioeconomic disparity as caused by the housing problem. Kulanu leaders strongly stated that their participation in the pending coalition would be uncompromisingly tied to having members of their own party running the departments that controlled housing construction and policy.\textsuperscript{21} Due to Kulanu’s centrist position, serving as an important role in uniting parties on either end of the political spectrum, party members Yoav Gallant and Moshe Kahlon, successfully assumed the respective positions of Minister of Housing and Construction and Minister of Finance.

As a part of Gallant and Kahlon’s plan to improve housing availability and affordability in Israel, and ultimately lessen the socioeconomic gap, on March 23, 2016, the Ministry of Construction and Housing released a tender for six international construction companies to each sign five-year contracts in Israel.\textsuperscript{14} Each company would be permitted to bring up to 1,000 workers into the country to assist in the design, construction, and project management of new residential buildings. The tender, which closed in June 2016, also requires training Israeli planning and construction companies on new technologies that would lower the cost and timeframe of completing projects, addressing the wider problem of industry inefficiency.\textsuperscript{22}

Over 50 companies from countries all over the world applied for the six spots, with the selected companies resulting in five from China and one from

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Portugal. "‘These companies are on a scale that we don’t have here in Israel. At a minimum they have to have turnover of $300 million and among those that won the competition there are some with turnover of a billion dollars,’ said Eshel Armoni, the Housing Ministry Director General.” The first of the six companies was set to begin work in November 2017.

While those families on the demand-side of the market are excited about the new projects, the Israeli Building Association is less supportive of the contracts “arguing that it would have been better to import more foreign construction workers”, therefore claiming that the lack of labor in the Israeli construction industry is one of the factors contributing to the housing shortage. The tender with foreign contractors meets the need not only for a larger labor force but also addresses Israel’s current deficiency in construction knowledge. By involving companies with more efficient building methodologies, rather than simply expanding the Israeli construction workforce, the industry is seeking a longer-term solution to rebalancing Israel’s housing market.

Kahlon attempted to make another long-term change to Israel’s housing industry by introducing a policy aimed at curtailing the number of properties purchased for investment. He presented a final reading of what is known as the Third Apartment Tax Bill to the Knesset, Israel’s legislative authority, during an over-night budgetary committee meeting on December 16, 2016. The bill, which passed that night, imposes an annual tax on homeowners of three pieces of real estate or more. Each homeowner’s tax amount would be 1% of each property’s
overall value, determined by the square footage, condition and neighborhood. The tax would apply only to each third and higher property and would also be capped at 18,000 shekels (roughly $5,000) per year, per unit. It was projected that this law would bring in 800 million shekel, roughly $228 million dollars, in its first year from current and new investors.

The goal of the tax is to discourage homeowners from buying multiple houses, therefore enabling greater competition in the housing market and lowering the average house purchase price. “Young couples can’t obtain housing and investors are collecting apartments and not letting others have them. That’s unfair competition”, stated Finance Minister Moshe Kahlon. Further, for those that already own three or more properties, the tax would ideally drive them to sell some of their units, relieving themselves of the tax, and boosting the supply of houses in the market. The Third Apartment Tax, approved by the Knesset at the December 23rd meeting, went into effect in January 2017, demonstrating the country’s ability to quickly apply the needed administration to charge and follow-up on the new financial imposition issued to its qualifying citizens.

Since the law’s conception in 2015, when Kahlon became Finance Minister, investment purchases, which counted for around 40% of all property purchases in

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2015, lowered to about 15% as of February 2017. Younger families, low and middle-income homeowners, along with more left-leaning political parties, rejoiced at the passing of the new law and its measurable impact; the downward real estate investor rate provided hope that a greater span of citizens would soon be able to own their own home. The OECD also backed up Kahlon’s bill in their June 2017 issue on the Israeli economy, stating that increasing government intervention on new housing projects will “serve as an engine for continued growth, which could further accelerate if tax reform steps announced by Finance Minister Moshe Kahlon are implemented”.

Although the Third Apartment Tax was approved and went into effect, immediately after the bill was voted on, the political opposition expressed their commitment to challenge the law. They organized a public walkout among Knesset members that opposed the law and initiated a petition to the High Court, the governing body that monitors legislative procedural practices, to review the bill in an attempt to cancel it. “This is one of the worst bills ever. It hurts the weakest citizens and the middle class who save every shekel to purchase apartments in order to leave them as an inheritance for their children,” stated Moshe Gafni, Member of Knesset and leader of the United Torah Judaism party. In August 2017, just eight months after the Third Apartment Tax Law was implemented, the High

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Court canceled the law, concluding that it was fashioned and presented in an inappropriate manner; the Knesset members were approached with the latest version of the bill just an hour before voting on it, which occurred in the early hours of the morning after an all-night meeting.23 “We battled the wealthy, the banks and interest groups that don't want housing prices to go down and are for young couples to stay far from buying homes,” Kahlon said. “I vow to continue fighting the investors. It does not make sense that one person will own six homes and another doesn’t even have one, and can’t dream of having one. We will continue fighting for young couples.”28

In July 2017, the Knesset also passed an amendment to the Rent and Lease Law, known as the Fair Rental Law. The amendment was the first law to set regulations for the landlord-tenant relationship, clearly designating whose responsibility it was to pay for realtor fees, city taxes, and repairs. The amendment also established a timeframe for attending to repairs and listed the minimum required conditions for an apartment to be considered livable. These conditions included working sewage and electricity, a front door that can be locked, and a separation between the restroom and the rest of the housing unit, all of which were not mandatory before the amendment.29 The Fair Rental Law was first proposed in 2013 and only approved in 2017, illustrating the long and slow process that can occur for such a high-impact policy to come to fruition.

The Fair Rental Law is considered to be a significant step in addressing the housing issue, making investing in an apartment more of a responsibility than purely a source of financial gain, and ideally reducing the desire for homeowners to become real estate investors. Additionally, “it has been proven worldwide that a regulated public and private rental market, with proper rules and encouragement of long-term rentals, is an irreplaceable key to lowering housing prices,” stated Member of Knesset Stav Shapir.\(^\text{30}\) Further, the attending members of Knesset unanimously passed the Fair Rental Law, illustrating a shift in the previously dominant belief that the government should not interfere with the housing market.

**Policy Proposal**

In order to address the increasing real estate investor population and the resulting expanding socioeconomic gap, the Third Apartment Tax could be revised and apply to new real estate investors owning of three or more properties, rather than acting as a retroactive fee. For the purpose of this paper, the policy being proposed will be called the Forward-Acting Third Apartment Tax. The goal of this proposed policy is to lower the amount of new investors entering the real estate market by 40% within two years of the policy being put into effect. This would lead to more available housing and more opportunities for first time homeowners to enter the real estate market, catalyzing a longer-term effect of helping close Israel’s socioeconomic disparity.

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Policy Authorizing Tool

Since the Third Apartment Tax was officially struck down in the summer of 2017, any new version of the bill would need to go through the entire legal process. In order to propose a new law or an amendment to an existing law in Israel, at least one Member of Knesset, must present the law to the Knesset Speaker. If the Speaker approves the proposed law for the agenda, it is then transferred to the appropriate Knesset committee, which prepares the bill for its first of ultimately three rounds of readings. Between each of the three readings, Knesset members offer feedback, giving the committee an opportunity to re-strategize the bill’s likelihood of passing. The bill is often redrafted, incorporating the feedback to maximize its chances of being passed. After the third reading, the bill is put to a vote and will pass if at least a simple majority, 61 of the 120 Knesset members, supports the bill. The High Court must also approve the bill’s procedural undertaking, ensuring that no inappropriate or stressful forces aided in its passing, as seen with the Third Apartment Tax.

In the case of the Forward-Acting Third Apartment Tax, a member of the Finance Committee should present the bill to the Knesset Speaker. Should the bill be pushed forward while Kahlon is still the Minister of Finance, he should present it. The housing issue has been a long-term agenda item of his and he is the current leader of the larger housing reform movement. A 1% tax on owned property, which would remain a condition of the Forward-Acting Third Apartment Tax, did get approved by the Knesset before being withdrawn by the High Court. Kahlon and members of his current committee therefore serve as the most qualified body to articulate the Forward-Acting Third Apartment Tax. Further, it is fitting that the
Finance Minister or a member of the Finance Committee present the bill to the Knesset Speaker because it is the Knesset's Finance Committee that prepares all laws concerning taxes such as those written for the Fair Rental Law, the Third Apartment Tax, and other previously proposed and passed bills on housing.

The Forward-Acting Third Apartment Tax, once passed, would be put into effect on the first of January of the following year, which is the start of the next financial period.

**Policy Implementation**

To ensure that the policy's expenses can be reasonably absorbed by the state budget and be incorporated into plans for implementing future taxes, incentives, and subsidies, laws of a financial nature are voted on in tandem with the state budget at the country's annual budget meeting. 31 Due to meeting delays, holidays, and multiple rounds of re-legislation, bills can take years to be officially rejected or approved and entered into law, as seen with the Fair Rental Law.

The Ministry of Housing and Construction will be responsible for drafting the proper documentation for property buyers to complete upon purchasing a housing unit, disclosing all other properties that they own. Real estate agents, lawyers, and mortgage brokers will also be required to ask their clients about their owned properties, helping provide the needed information.

The Israel Land Registry and Israel Tax Authority would share the energies and financial costs of implementing this policy. The Israel Land Registry would contribute manpower to cross-checking property ownership contracts with various

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databases, identifying which households would receive the 1% tax. This body would also determine the amount of tax owed based on the property size and how many other properties the household possesses. This includes conducting in-depth analyses into family-wide home ownership whereby contracts are placed under other family member's names. The Tax Authority would ensure that the taxes are paid.

These entities would need to invest sufficient resources into accurately identifying and following-up with the households that would need to pay the issued tax. If these measures were not taken, then the policy would not be effective in collecting tax revenue, deterring families from purchasing a third property, or increasing entrances into the housing market for low and middle-income households, and young families. Further, if these measures were not taken, then 90% of the Israeli public, which has voiced their support for housing reform, along with the OECD and IMF that urge government intervention in the current housing market, would not take the Israeli government serious in their efforts to make such a change for a more equal Israeli society.20, 24

Families that own two properties at the time the bill goes into effect will be the most targeted families to identify and monitor for purchasing further real estate units. In 2014, 34.1% of all households in Israel, roughly 830,000 households, were identified as owning two properties.8 Aside from wide-spread print and digital notification of the Forward-Acting Third Apartment Tax, these families will also receive letters in the mail informing them about the new law and what financial fees they would directly face should they purchase an additional property. Going
forward, all families that purchase a second apartment would also be notified by lawyers and via mail campaigns about the law in order to keep up with this most targeted group of potential real estate investors.

**Policy Analysis**

**Probability for Success**

The Third Apartment Tax serves as a simulated trial to the Forward-Acting Third Apartment Tax. The Third Apartment Tax, which described a nearly identical tax to the Forward-Acting Third Apartment Tax, was approved by Knesset in December 2016 and put into effect at the beginning of January 2017. This one month turn-around time illustrates that implementing such a policy is easily accomplished within the Israeli government’s technological and administrative capacity, and that it is financially feasible for the government to operate. It also illustrates that the majority of Knesset members already believe that this sort of legal stick can be effective in tailoring housing purchases by the Israeli public.

Depending on when the Forward-Acting Third Apartment Tax is passed, it will be no more than 12 months until the following January, when the next budget cycle begins and when the policy can be put into effect. Therefore, any timeline that is more than the one-month turnaround experienced with the Third Apartment Tax, can be confidently deemed as a reasonable timeframe to implement the Forward-Acting Third Apartment Tax. Further, by putting the new policy into effect quickly, there will not be a large window of time for current homeowners of two properties to purchase a third housing unit. These identified potential investors would be motivated to purchase a third home because the Forward-Acting Third Apartment
Tax is not retroactive and if they had a third property when the bill goes into effect, they would be exempt from paying the tax. Should the bill pass anytime in 2018, the tax will apply to families that purchase a third home beginning in January 2019.

From a financial standpoint, the Third Apartment Tax can also serve as a source of certainty for passing the Forward-Acting Third Apartment Tax. The Third Apartment Tax was meant to be a retroactive tax and its budget included implementation costs for identifying and following-up on homeowners that already own three or more properties.4 The Forward-Acting Third Apartment Tax is not retroactive and would be applied only to all future buyers of a third or higher property. The tax would not apply to the 60,000 households that already own three properties or more, regardless of their future housing purchases. Therefore, the cost to run such a policy will arguably be cheaper than the Third Apartment Tax, since it will only be monitoring new families upon purchase of a third unit.

Communication via mail-campaigns has historically been successful in Israel. Most recently, over the past few years, a total of 142,000 letters have been sent to homeowners suspected of tax evasion by not reporting income they receive from renting out properties that they own.32 As of October 2017, most letters have been answered and over 45,000 homeowners have made claims to previously unreported sources of rental income; tax from this newly reported income, totaling an additional 1.4 billion shekels, roughly $400 million, has since been paid to the treasury.32 This success shows that mail campaigns from the government are taken

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seriously by the Israeli public and stimulate appropriate civil responses. Assuming a similar success rate of 32% for a mail campaign, 11% of all households in Israel would reconsider purchasing an additional property due to the threat of the new tax.

Between 2015-2017, real estate investment purchases have dropped from being an average of 40% of all property purchases to being 15%, showing a 62.5% overall decrease in investment purchases. The Bank of Israel and The Ministry of Finance’s Chief Economist, Yoel Navehm, have concluded that this drop is directly correlated to the hype and passing of the Third Apartment Tax during these three years. Assuming the behaviors of potential new investors would similarly be impacted by a 1% tax in a forward-acting manner, the rate of homeowners with two properties, can also assume to drop regarding the purchase of a third unit. The Central Bureau of Statistics calculates that there is an average of 4,240 new housing investors, those that purchase a second property, per year (Figure 1). Of this group, should the Forward-Acting Third Apartment Tax also influence 62.5% of these households, 2,628 fewer households would purchase a third apartment. Therefore, a policy goal of dropping the rate of investors purchasing three apartments by only 40%, totaling 1,696 fewer households purchasing a third apartment, appears plausible.

An effective Forward-Acting Third Apartment Tax also has broader positive implications for the Israeli economy. A country with lesser socioeconomic disparity is viewed as being more politically stable, which is a desirable characteristic for its citizens and a favorable characteristic for acquiring international trade partners. Reviews on Israel’s economic equality and political stability, as measured and analyzed by renowned organizations like the World Bank, IMF, and OECD, often set the foundation for policy discussions, business recommendations, and economic predictability. It is therefore in Israel’s best interest for the government to intervene in the housing market and attempt to implement new policy, such as the Forward-Acting Third Apartment Tax, that can begin to close the gap on the country’s socioeconomic disparity and increase its global status as a country that acts towards creating equal opportunity for its citizens.

**Administrative and Financial Challenges**

“Government efforts to reduce investor purchases by raising the purchase tax are limited by the government’s inability to identify investment purchases.” The Ministry of Finance currently does not record or crosscheck homeownership within broader family units. Therefore, homes can continue to be bought and registered under various family members’ names while keeping the property and income under one household and simultaneously avoiding such an imposed tax on multiple property ownership. In order to address this issue, the Tax Authority would need to create a new system to gather information and cross-check it with the Land

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Registry database, which is the main database for property ownership. This would need to include applying extensive time and resources into seeking out information on extended family relations and change in last names due to marriage or name preference. Without this investment, any tax toward investors, which may be somewhat easy to implement, will also be easy to evade.

Economists, real-estate professionals, and those with investment properties, have vocalized that a 1% housing tax won't significantly deter those who can invest in real estate from doing so. In June 2017, Israel’s Chief Economist, published a survey on real estate investor responses, which concluded that a tax on multiple apartments would at most, lower the investment rate by 3%. Kahlon has even stated that, “for an investor with a lot of money who wants to buy an apartment, an additional 50,000 or 70,000 shekels for an apartment is really nothing compared to a young couple just starting out”. While he intended to illustrate the drastic need for housing reform, Kahlon’s statement also shows that whether it is a new relatively small tax, such as the 1% tax as illustrated in the Third Apartment Tax and Forward-Acting Third Apartment Tax, or a higher purchasing price, unless it is dramatic, investors with the means to invest will continue to do so, limiting overall competition in the housing market. Further, homeowners and those opposed to such a tax have argued that implementing the bill will only motivate landlords to continue increasing their rent prices in order to cover the new tax expense, which will lead to an even more dire situation for renters and widen the already expanding

socioeconomic gap between those that own a home and those that cannot afford one.38,39

By not addressing the homeowners that already own three or more properties in the Forward-Acting Third Apartment Tax, there is no deterrent for them to continue purchasing more units nor is there an incentive to sell already owned properties and increase the amount of available apartments in the market. This means that the behavior of the over 60,000 homeowners that already own three or more properties, will not be impacted and claims of social inequality, such as those seen in 2011, will sustain. It will also mean that closing the socioeconomic gap will solely depend on raising up those households in the lower economic quintiles and not include lowering the overall ceiling of the wealthier population to which real estate investors belong.

From a financial standpoint, the Third Apartment Tax had predicted that 800 million shekels would be collected each year from the identified 60,000 households, calculated at roughly 13,300 shekels per household.3 The Forward-Acting Third Apartment Tax would not lead to any of this income being collected since it is not retroactive. Instead, in the Forward-Acting Third Apartment Tax’s first year, the government would only collect the tax from the 2,544 households, estimated to be purchasing a third apartment. At 13,300 shekels per household, this would result in a collected total of nearly 34 million shekels in the first year of the policy’s

implementation. If 2,544 additional households were to enter the real estate investor pool every year, in its 20th year with nearly 51,000 investors paying the tax, 676 million shekels would be collected (Table 1). This number is significantly lower than the expected 800 million shekels collected in just the first year of the Third Apartment Tax.

Taking this low estimated rate of income into consideration along with the BOI’s recent survey that stated that a tax on multiple apartments would only lower investment purchases by 3%, the lack of short-term fiscal benefits may outweigh the long-term benefits of the tax. Further, applying this lesser collected income to the administrative expenses it would take to identify qualifying households, issue the tax, and follow-up with its payment, the policy may be deemed as fiscally not worthwhile to implement.4

Table 1

<table>
<thead>
<tr>
<th>Year(s) After Implementing Policy</th>
<th>Number of Households Paying Policy Tax (Estimated 2,544 per year)</th>
<th>Income Collected From Policy Tax in NIS (Estimated 13,300 per household per year)</th>
<th>Income Collected From Policy Tax in USD (3.5 NIS to 1 USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2,544</td>
<td>₪ 33,835,200</td>
<td>$ 9,667,200</td>
</tr>
<tr>
<td>5</td>
<td>12,720</td>
<td>₪ 169,176,000</td>
<td>$ 48,336,000</td>
</tr>
<tr>
<td>10</td>
<td>25,440</td>
<td>₪ 338,352,000</td>
<td>$ 96,672,000</td>
</tr>
<tr>
<td>15</td>
<td>38,160</td>
<td>₪ 507,528,000</td>
<td>$ 145,008,000</td>
</tr>
<tr>
<td>20</td>
<td>50,880</td>
<td>₪ 676,704,000</td>
<td>$ 193,344,000</td>
</tr>
</tbody>
</table>

Finally, the increasing rate of real estate investors and rising housing prices may have led to expanding inequality but it had a positive impact on government revenue. In 2008, tax revenue from real estate transactions made up 1% of the total
GDP and by 2015, it had climbed to 1.6% of total GDP; the growth is about six billion shekels, roughly $1.7 billion, in tax revenue (See Figure 4)\textsuperscript{40}. The increase in collected income was significantly felt between 2014 and 2015, before the Third Apartment Tax was conceived, when an additional 4.7 billion shekels, roughly $1.33 billion, in tax revenue was collected.\textsuperscript{39} Should the Forward-Acting Third Apartment Tax be successful, leading fewer investors to purchase multiple properties and decreasing the average property purchase price, the government's tax revenue, and the country's overall wealth, will also drop. Even with the originally anticipated 800 million shekels, Globes, Israel's leading business news source, stated that, “it looks as if in 2017, the Israel Tax Authority can only dream of the tax revenue generated by [previous housing] deals”.\textsuperscript{41} The government's current budget plans and future goals rely on this income from real estate investors and adjusting to a smaller budget could mean that social programs, security budgets, or other agendas will be cut back. This fact will dampen Forward-Acting Third Apartment Tax's ease of passing.

Figure 439

Government Tax Revenue Collected from Real Estate Transactions In Israel 2002-2015

Considering Alternative Solutions

If the rate of real estate investors skyrocketed as a result of the low interest rate, which was originally reduced to weaken the shekel and make exports more attractive to international partners, then it would seem plausible to assume that by increasing the interest rate, households would be less inclined to purchase multiple apartments because their own expenses would rise. The Bank of Israel did raise the interest rate in 2010 and 2011 from 1% to 3.5% in order to implement a “gradual process of returning the interest rate to a more ‘normal’ level.” However, the BOI dropped the interest rates after 2011 to the .1% rate that has sustained until today, demonstrating a continuing need for increased international trade relationships, “It

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appears that the Bank of Israel is a lot more worried about the appreciating shekel,” Chief Economist at Leader Capital Markets, Jonathan Katz explained in response to the BOI’s decision to lower the rate in 2011.43

In September 2017, the Bank of Israel published a survey, which concluded that the low interest rates were responsible for less than 10% of the cumulative house price increases and that one of the main problems was the lack of housing supply.44 If the low interest rate had such an insignificant impact on the housing prices and therefore on the social division caused by the housing market, then addressing the interest rate would not make a significant impact on investors entering the housing market. This study also implies that it is unlikely the BOI will raise the interest rate; instead they would support addressing the housing issue by focusing on increasing the housing supply.44

Another alternative policy towards limiting the real estate investor population is to increase the 1% tax on each property and raise the 18,000 shekel cap to an amount that will be more financially effective in halting multiple housing purchases. By increasing the fee to a more debilitating amount, the opposition’s argument, that the tax isn’t high enough to impede purchases, will not apply as heavily. However, for those homeowners who would still not be deterred from purchasing a third property, they can continue increasing their rental asking price to cover the expenses of the high tax. Further, a higher purchase tax would also


increase expenses for those trying to purchase their first home. This effect would be harmful to the low and middle class, and young families that the tax is trying to assist. Therefore, while the option of a higher tax may lower the growth rate of real estate investors, it may simultaneously hurt the population that the tax aims to help, which would defeat the overarching goal of the Forward-Acting Third Apartment Tax. Research would need to be conducted to determine if the long-term benefit of a lower investor growth rate out-weighs the impact that increased rental prices would have on the low and middle class, and young families.

**Political Analysis**

For the last 30 years, many of Israel’s markets have operated under a strong belief that the government should not intervene. This free-market mentality is an enduring reaction to the socialist ideals that Israel was founded upon and it has enabled buyers, rather than the government, to set the prices and building needs of the housing market. 45 “Real estate prices have indeed reached very high levels. But you have to bear in mind that this is a free market. Prices are a result of supply and demand. This means, among other things, that these are prices the public can sustain; otherwise, there would be no sales,” explained Roni Brik, current President of the Israel Builders Association.10 However, without government intervention, the wealthy have been able to heavily invest in the housing market, increase purchasing prices, and distort the capability of the average family to purchase a home.4, 10

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Support for Policy Advocates

Those that are pro-government intervention include members of the lower and middle class, and young families that cannot enter or compete in today’s housing market, which as of 2016 was 27.1% of the all households, amounting to roughly 660,800 households. The main stakeholders of the Forward-Acting Third Apartment Tax are those 27.1% of households that would most directly benefit from a more equal-opportunity housing market. However, as seen with the opinion polls that reported roughly 90% of the Israeli population is in support of the housing movement, the demand for government intervention on the issue far exceeds those that would be most directly impacted by the policy. With such a high percentage of the public-at large in favor of government intervention, the government of Israel is under great pressure to address the housing situation. The Forward-Acting Third Apartment Tax would be a response to this demand and would show the public that the government is listening and acting on their behalf. It would also instill confidence in the government and set the stage for a more equal future for the Israeli public.

Other supporters of government intervention in the housing market are the political parties and politicians that push for government intervention as a means for greater social equality. These parties including Yesh Atid (There is a Future), HaAvoda (Labor), Kulanu (All of Us) and others that associate themselves as more left-leaning. Leaders of these parties have charged various movements for equality and proposed new policies that involve government engagement; Kulanu leads the

current housing movement and in 2016 the Labor party pushed the passing of an amendment that sets a ceiling to executive wages. The Israeli Ministry of Finance and the Ministry of Construction and Housing, with their aggressive push towards housing reform policies, represent specific local and authoritative bodies that believe in government intervention. “In the current period, the Israeli government is really determined to solve the housing crisis through steps that aren’t easy. And I realize that these steps are painful and difficult. But if the government is serious, it needs to do these things.” stated Finance Minister, Moshe Kahlon during an interview about the government’s various responsibilities.24 Kahlon has been clear that the long-coming push for reform is about creating long-term societal change and less about satisfying short-term financial needs; the “tax is aimed at behavior. It’s not designed to collect taxes. We don’t need the money.”24

Well-regarded research and evaluative organizations, such as the IMF and the OECD, have also been vocal in their support of government intervention to lessen the impact that the current housing market has on widening Israel’s socioeconomic gap. In its March 2017 Country Report on Israel, the International Monetary Fund concluded that “housing market developments are complicated by purchases for investment purposes by high-income households” and that future housing policies need to “support fiscal and structural reforms to promote sustained and inclusive growth.”1 Additionally, after polling for their 2016 Economic Survey, the OECD states that the “rising housing prices in Israel, due to weak competition, impose a greater cost, in terms of living standards, to socioeconomically disadvantaged groups”.45 The OECD further urges the Israeli government to
intervene and use policy to influence the actions of those engaged in the housing market and prevent future financial instability that can arise due to the housing market.\textsuperscript{47}

For Moshe Kahlon, the Kulanu party, and other political bodies that have historically fought to close the socioeconomic gap that the housing market has contributed to, successfully passing and implementing the Forward-Acting Third Apartment Tax would be a victory. Given the loud support for this sort of action over the last decade by 90\% of the population, the policy would serve as a step forward in achieving social justice and offer a more controlled consumer market. With greater equality, the world will also view Israel as a more serious and stable partner for trade.\textsuperscript{35} In addition to societal benefits, passing the policy would boost Kahlon’s political clout in future elections and in current and future policy decisions; he would be seen as a political leader that can get things done.

**Potential Consequences**

The high demand from the public at-large for housing reform and the decade-long build-up of pressure on the government to address the socioeconomic disparity due to unfair housing competition puts a spotlight upon this policy. The low level of collected income due to the forward-acting nature of the policy and the BOI’s recent survey concluding that taxes on multiple properties would only decrease investments by 3\%, is a great threat to building confidence surrounding the policy’s effectiveness.\textsuperscript{4} Additionally, the low income received from the policy will undoubtedly decrease the government’s overall budget, even though Mr. Kahlon

claims that the government does not need the money.24 This fact can impede the policy’s overall passing.

If the policy passes but is not noticeably effective, as predicted by the BOI’s survey, then the support of those that make up the housing movement, 90% of the Israeli population, will diminish and the opposition will gain greater influence in the matter. Since Mr. Kahlon you are the face of the housing movement, this sort of failed effectiveness, especially after the Third Apartment Tax has already been shut down, would greatly impact your ability to gain the support of the Israeli people in future elections.

The opposition, those in favor of a free-market, has a lot of power in the real estate market and it is their strong arguments have led the socially dividing housing market to sustain for over a decade. The opposition argues that it is not the government’s place to judge and unfairly punish citizens for spending their hard-earned financial means on real estate, especially after the Bank of Israel set such a low interest rate that encourages this very behavior.4 Taxes on owning multiple properties have been described by Ohad Danos, Chairman of the Israel Real Estate Appraisers Association as “a populistic, Bolshevik-style rule.”48 This statement illustrates the strong and unwelcomed feelings against such a tax, felt by those that would need to pay the tax and/or are against general government intervention in the housing market; it describes an authoritarian act of governance and control over private ownership, personal financial growth, and freedom of choice. Those in the

opposition including economists, public figures, and homeowners have been vocal about how they would react to such an imposed tax: they would raise the prices of rent further, making the tax a burden for renters rather than a deterring factor towards their own property purchases. With this response, the housing market would continue dividing society, reversing the government’s efforts toward reform.

The political leaders against government intervention and taxes on multiple properties created a memorable response in 2017 that must be considered while attempting to pass a similar tax. Among the leaders of the opposition was Moshe Gafni of the United Torah Judaism party and Chair of the Finance Committee, illustrating that division over the law exists even within the committee that pushed the policy forward. In a coalition government system, it is important to consider how relationships may be impacted when certain issues are aggressively pushed. If a similar or even more hostile reaction would occur upon the passing of the Forward-Acting Third Apartment Tax, political relationships and the participation of the Kulanu party in future coalitions may be compromised.

**Recommendation**

The government of Israel is addressing the country’s socioeconomic gap, as it is impacted by the high level of real estate investors making home ownership difficult for the lower and middle class and young families, by contracting foreign building companies and increasing the supply of available housing. Yet with the unwavering low .1% interest rate, it is highly likely that upper class will again see the opportunity for personal financial gain and quickly purchase these newly built properties for investment purposes, as they did beginning in 2008. The Forward-
Acting Third Apartment Tax offers the possibility to slow down the rate of investors in the real estate market and begin enabling the low and middle class, and young families in Israel to purchase a home. The potential benefits of the policy outweigh its challenges and should be proposed, initiating a step towards having more available housing in the market and lessening the country's socioeconomic gap. This policy would show that you, Mr. Kahlon, are still fighting for social justice, despite setbacks such as the Third Apartment Tax cancelation. It will also reignite the public's hope for a future with more equal opportunity and financial stability.

The main obstacle in the policy's implementation is identifying the households that should receive the tax. While the country currently does not have an effective system for identifying, documenting, and tracking property purchases within a family unit, investing in and establishing such a system now will enable the government to have a better idea of its society's demographics, capabilities, and disparities. With more accurate information on household purchasing trends, the government would be able to propose and pass other housing reform policies, such as rental increase ceilings and retroactive taxing, that would advance the fight for more real estate opportunities and further social justice. Additionally, the information is worth investing in because it will also set a foundation for better policy decision-making and more effective implementation in the future, beyond the current housing crisis.

Another potential obstacle to the tax being effective is the response of increasing rental prices. While the Forward-Acting Third Apartment Tax may not be able to prevent this from happening, it is designed to lessen the amount of investors
each year that will join the tenants that may increase rental prices; 2,544 additional households, rather than 4,240 additional households per year. This would also slow down the expanding socioeconomic gap. While the policy is not retroactive and does not solve the problem of addressing all investors in the housing market, it is a step in curtailing the behavior of would-be investors.

Finally, the opposition’s financial argument of bringing in less tax income due to lower housing prices illustrates a focus on short-term budgetary accomplishments. While this may be true, you have stated, Mr. Kahlon, that the country is not in dire need of the money that would be forgone in collecting less property taxes. Your statement implies that Israeli government is currently in a financially capable place to open prospects of a more stable financial future, without debilitating its own current needs. Additionally, as seen with the OECD and IMF, lessening the socioeconomic gap, creating more financial stability, and improving Israel’s overall status as perceived by other countries, will increase its chances of having a more fruitful and stable economic future.

With the building of more houses already underway, the Forward-Acting Third Apartment Tax offers a first step towards curtailing the demand-side of the real estate market, taking a holistic approach to addressing the country’s socioeconomic disparity as impacted by investor activity.
Curriculum Vitae

Rachel Jetter-Cohen was born on December 4, 1989 and grew up in Holmdel, New Jersey. She received a dual Bachelor of Arts degree in Sociology and Business, Organization and Society from Franklin and Marshal College. She moved to Israel in 2013 and currently works for the Jewish Agency of Israel, expanding nonprofit and governmental philanthropic efforts towards Israel’s social service sector. Rachel recently purchased an apartment in Jerusalem with her husband, which set the foundation for examining the real estate investor-impact on the low and middle class, and young families in Israel. Rachel is a candidate for a Master of Arts in Public Management at Johns Hopkins University.