

Removing the Barriers to Housing Development in Israel

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KOHELET
POLICY FORUM
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Adar II 5776 – March 2016
Policy Paper no. 27



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This booklet is an abridged version of the three-volume Hebrew publication, which was published by Kohelet in November 2015.

This publication was made possible by the generous support of Mr. Albert Dov Friedberg and of the Tikvah Fund.

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Printed in Israel, Adar II 5776 – March 2016

ISBN 978-965-7674-29-1



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Introduction

Summary

Excessive government invention in the housing market makes housing in Israel much more expensive than it should be. Among the myriad artificial policies that constrain building in Israel, Kohelet researchers identified three cardinal barriers: public ownership that greatly restricts access to land; a distortionary and centrally controlled municipal taxation regime that greatly reduces the incentives of municipalities to approve new construction; and a cumbersome planning system that involves immense expense, time and uncertainty in getting approval even for building plans that completely conform to all relevant regulations

Our recommendations are to immediately make a large amount of land in urban areas available for private ownership and development; to reform the municipal revenue structure in order to give local authorities more fiscal autonomy and restore their natural incentive to encourage development; and to implement reforms that would make approval of a building permit automatic contingent on the plan meeting whatever transparent criteria the planning authorities decide upon.

Following is a brief synopsis of each article.

A. Privatization

Asher Meir and Ziv Rubin

The land regime in Israel—in which an overwhelming majority of state lands, including a significant majority of municipal lands, are owned and managed by the central government—is an anomaly compared to land regimes in other free countries. Forum Researchers Asher Meir and Ziv Rubin explain exactly why centralized administration leads to deficient development, and how, with fairly modest reforms, most of the barriers of public administration can be brought down in the area of housing.

There is an extensive literature on the best ways to allocate lands for uses which provide the best service to the citizen along axes of space (where to build), time (when to build), and use (what to build). Experience shows that the most successful regime makes full use of the various advantages of the private and public sectors. The private sector is much better in understanding the needs of its customers and in quickly gearing up to provide them with the desired product at a place and time convenient to them. The public sector is better at understanding the public interest and creating rules which ensure that entrepreneurs' pursuit of profit is done within a framework which preserves and advances the public's quality of life in terms of issues such as density, aesthetics, and appropriate mixture of uses.

The authors present new quantitative data which illustrate the inferior capabilities of public administration in building apartments according to the needs of buyers as opposed to the private sector. They show that making available to the private sector less than one percent of lands under public administration, plots in high-value regions already slated for medium-term development, could fix most of the distortion created by public administration today in the housing market.

Recommendations

The ability of the state to manage municipal lands is significantly inferior to that of the private sector. Therefore, two steps should be taken:

The entire inventory of municipal lands not designated for an explicitly public purpose should be made available to the private sector. If a private party wishes to buy such land, there will be a regular, convenient and transparent way to do so without additional conditions (either an auction or an assessment).

Out of the land reserves for housing already marked as such, lots in high-demand regions already in the “work and preparation” stage, a significant amount — at least 10,00 dunams — should be marketed immediately. The sale must be unconditional, as attaching any conditions to the sale is in itself a form of administration and should therefore be avoided by the state. The public sector may be responsible for shaping land use, but it should do so through planning and taxation policies, not leveraging ownership.

B: The Role of Local Authorities in Developing Real Estate

Sandrine Fitoussi, Itamar Yakir, Michael Sarel

Summary

The Israeli housing supply is established through a complicated process, in which many governmental and professional parties are involved. The local authorities are a central player in the process, as they can significantly affect the planning stages and marketing of lands within their jurisdiction. Additionally, they can also affect the rate of housing development in general through their control of building permits and other paperwork necessary for the approval process. Local authorities therefore have a major role to play in setting the pace of housing construction in their jurisdiction, and thus in the country as a whole.

Recently, it has been suggested that local authorities have a negative incentive to develop housing in their jurisdiction. The reason for this is the gap between the cost of adding new residents and the income generated from these same residents. By contrast, businesses, on average, generate more tax revenue than the cost of the municipal services for those businesses.

The present paper expands on the existing literature, and examines the possibility that the local governmental income structure not only causes them to be reluctant to promote housing, but also to rely on the ratio between residential and commercial built up area as a central strategic tool for making financial decisions and for informing their negotiations with the central government.

This paper also emphasizes the distortions the present income structure creates in light of the strategic interaction between local authorities, as well as its long-term consequences in geographical-spatial and socio-economic terms. We argue that local authorities are competing with each other to attract relatively wealthy “quality” populations—both in the business context and the demographical-social one.

Today, the manner in which the central government deals with this reality—for instance, signing umbrella agreements with local authorities—is ad hoc and unsystematic as well as not entirely transparent, creating the potential for additional distortions and political biases. In addition, these processes involve a heavy financial burden. This burden falls on all Israel citizens, but disproportionately on residents of the country's periphery.

Recommendations

The solution proposed in this paper focuses on the incentive given to local authorities by the central authorities in the form of a per capita grant, that is: an additional budget granted by the central government, calculated based on a simple and transparent formula: the number of residents living in the town. The grant will be conditional on the ratio of *arnona* (property tax) received from business and those received from residencies not go above a certain limit, which will be determined by the central government. This incentive will add a source of revenue to the local authorities' budget which reflects the number of people within that authority, not just the built up area. At the same time, the central government will reduce its involvement in setting *arnona* rates for businesses and residencies, allowing local authorities more freedom in determining the same.

Implementing the proposed change will advance a number of desired goals, including:

1. Reducing the distortions caused by the present taxation policy;
2. Reducing the present phenomenon of cross-subsidization and the negative incentive of local authorities to promote the building of housing in their jurisdiction;
3. Weakening the presently regressive structure of funding local authorities;
4. Reducing uncertainty and increasing the independence of local authorities regarding their own income.

C: Building Permit Process

Avichai Snir

Summary

Israel has 126 local committees authorized to grant building permits—with conditions, with exemptions or not at all. The discretion granted to the committees is unlimited and in no way transparent. The lack of uniformity in submitting requests and the handling of the same in the local committees make the receipt of a permit even more complicated. All of these lead to the possibility of committee decisions which are due to either external considerations or on the basis of personal interests. The committees' dragging out of the process and the subsequent lack of certainty about permits leads to higher apartment prices.

Amendment 101 to the Planning and Building Law aims to expedite the procurement of a building permit by enforcing a single, unified procedure in all committees, reducing the committee's degree of discretion and forcing it to be transparent. In addition, the law presents a series of supervision measures, incentives and punishments. To ensure the ultimate goal of Amendment 101 to expedite building permits is achieved, the unification of request submissions at all committees and the transparency of the same are critical. Another critical condition to expedite the process is the establishment of external testing institutes which will compete with each other for entrepreneurial dollars.

Recommendations

The reforms of Amendment 101 advance the goals of unity and transparency in receiving a building permit in all committees, in such a way that entrepreneurs know exactly what's expected of them and which prevent them from being held hostage to arbitrary or improper requests on the part of the committee. But most of these changes have not been implemented. The reforms of Amendment 101 must be expedited, and they should make full use of the Interior Minister's right to appoint external committee members.





Improving Land Allocation by Privatizing Urban Land Reserves

Asher Meir and Ziv Rubin

A. Introduction

Land is a capital good that is an essential input into almost every economic activity and is the most fundamental production resource for creating the housing supply. The judicious allocation of this resource is particularly important for two main reasons. The first is **permanence**—if the wrong building is built, it is very expensive to demolish and replace it. The second is the **salient external impacts** of land use. Certain types of land use can have a tremendous influence on the value of the surrounding land. Research has shown that certain uses, such as a transportation line, public park or residences beside desirable neighbors, can add tens of percentage points to the value of the adjacent land. Other uses, such as a waste disposal site or residences beside undesirable populations, lower the value of the adjacent land to a similar extent.

Experience has shown that the most successful method for achieving effective allocations in an urban environment is a combination of two components: **a free land market**, in which the profit incentive prompts land owners to seek out the purpose and the timing that will generate the highest yield by fulfilling the needs of the buyers who will be using the land; and **a local planning regime**, whose purpose is to mitigate the external influences and create the proper balance between the developer's incentives and the general public good.

Israel does not adhere sufficiently to this desirable division of roles. Both the land market and the planning mechanisms are overly controlled by the central government. The reality in which the ownership and management of most of the land in high-demand regions is public and centralized is an artifact of unique historical circumstances, but it has no economic justification. This situation allows bureaucratic bodies too much control over the rate and nature of economic development. Under an efficient planning regime, the State of Israel would offer to sell most of the land it owns in high-demand region, with no preconditions. Assuming private sector developers offer the state a worthwhile price for certain land, the state would retain public ownership of the land only for essential public purposes.

Table 1: Breakdown of ownership of land throughout Israel and in the jurisdictions of all the local authorities (in thousands of dunams and percentages)

	Private and local authority	JNF	State and development authority	Total
The entire country	1,486 (6.8%)	2,574 (11.7%)	17,406 (79.3%)	21,957 (100%)
Local authorities	530.3 (28.6%)	122 (6.6%)	1,201 (64.7%)	1,855 (100%)

Source: Israel Lands Authority

Note: The numbers do not total 100% because of unregulated land. The table does not include Judea and Samaria.

B. The current situation

The State of Israel owns about 80% of the regulated land in Israel, and the Jewish National Fund owns approximately an additional 10%. Until now, the Israel Lands Authority (known as the Israel Lands Administration until 2013), has been responsible for the management of all these lands. The extent of public management of *residential* land reserves, however – land that is suitable for residential construction in the foreseeable future – has been somewhat less.

Over the years there have been significant changes in the management of the land, but one principle has remained constant: Neither the Israel Lands Authority (nor the Israel Lands Administration in the past), has ever maintained a routine procedure of selling land unconditionally. With the exception of a few instances, the marketing of available state land was conducted only after the ILA planned the use of the land, and the buyer committed to developing the land in keeping with the purpose and the timing set out in the purchase contract signed with the ILA.

Another condition applied to land marketed by the ILA is that in most cases, even after the land is developed, apartments are leased and not sold. In the wake of various committees that discussed the over-involvement of the ILA, and which all supported reducing this involvement, a creeping privatization process began. Today we do not see a significant difference between the ownership rights and the rights granted to lessees by the ILA following planning and development.

The ILA is supervised by the Israel Lands Council (ILC), which has ten members and sets the policy for the ILA. Eight of the ten ILC members are government representatives, such that the ILA is essentially subordinate to the government. The allocation of land in Israel, on the individual level, is therefore subordinate to political dictates. The government's management of state lands has various goals, including increasing state revenues, developing certain regions at the expense of other regions and a desire to meet quantitative development targets.

Adv. Gideon Vitkin writes that the government's goals are not being realized. "The ILC is frequently called upon to amend its decisions, as these are not producing the desired results." An article by Kalman Geyer and Sergey Somkin also shows that the ILA's actual construction consistently falls short of the goals set by the government. In his report on the housing crisis, the state comptroller notes a large number of cases in which government decisions are not implemented by the ILA, and in some cases there was not even any ILC discussion of the government's decisions.

In the context of urban development, the role of the political echelon should be to do its utmost in determining the regulatory environment that will ensure a balance between the various needs of the public, and to steer completely clear of direct involvement in the allocation of land, such as when and how many housing units will be built on one plot of land or another.

The purpose of this section is not to claim that the ILA does not strive to fulfill the government's demands in a professional and responsible manner. In general, the ILA is considered to be a highly regarded and professional body.

Rather, we contend that:

- In the context of urban development, the role of the political echelon should be to do its utmost in determining the regulatory environment that will ensure a balance between the various needs of the public, and to steer completely clear of direct involvement in the allocation of land, such as when and how many housing units will be built on one plot of land or another.
- The appropriate political echelon for setting the individual planning regulations is usually the local authority. In setting the "rules of the game," which is clearly a government responsibility, the main entity should be the local authority and not the central government. The Israeli government, including the planning administration, should be focused on planning on the regional and national level, and not on detailed decisions regarding how many or what type of houses will be built in one local authority or another.

C. Why government ownership?

Public ownership of most state land is very rare in countries in the free world. Even though a similar system exists in China and Singapore – countries with a considerable measure of economic freedom – in western countries this system is not practiced at all.

The main reason for this situation in Israel is historical. To a great extent the land ownership system in Israel is not a matter of land nationalization, but rather of non-privatization.

Even so, various reasons have been proffered to justify this system. In their article, Eliahu Borochoy and Elia Wertzberger view public ownership of land as "an essential tool for achieving social and economic goals." These authors enumerate four types of positive explanations for a centralized ownership regime: market failures; social equality and justice; planning; and political and societal goals. We will here endeavor to show that these considerations cannot justify widespread central government ownership of undeveloped land in urban regions.

To a great extent the land ownership system in Israel is not a matter of land nationalization, but rather of non-privatization.

Heading the list of market failures are “external influences.” These influences are indeed of paramount importance in land policy, but the ability of centralized ownership to overcome them is by far inferior to that of the local authority.

These influences can and must be addressed by the planning and building laws, not through ownership. Fortunately, in practice, the ILA does not invest much energy in internalizing the external influences. The main work of addressing the external influences should be left to the planning laws, particularly those of the local authorities.

The next market failure on Borochov’s and Wertzberger’s list is “public goods.” This consideration is a valid justification for public ownership, but it does not justify the holding of massive land reserves, but rather the retention of those lands that are required for essential public needs, plus reasonable reserves, due to the difficulty in purchasing or expropriating land for future needs. Furthermore, this consideration would imply that public ownership in populated areas be mainly in the hands of the local authority, as most of the public products in a locale are only for the local population.

Later in their article, the authors touch on the problem of “uncertainty regarding the future.” The authors’ intent is apparently that uncertainty regarding the future justifies a need to ensure available land reserves in the future, because private land owners have an inherent tendency to be too hasty in developing land. This concern, however, is not in line with the prevailing opinion today that the private land speculators’ transgression is that they delay developing land. There also seems to be too much concern over the irreversibility of land use.

The second category is “social goals.” In particular, Borochov and Wertzberger view “preventing unreasonable wealth” as an essential goal; we, on the other hand, perceive no clear public interest in preventing the enrichment of Israel’s citizens. Furthermore, even if we were to acknowledge such a public goal, public ownership of land would not be the ideal tool for realizing that goal.

The third category is “national and planning goals.” This consideration could be a justification for government ownership in outlying and undeveloped regions, but not in demand areas. Furthermore, the benefits of public ownership for this purpose are to some extent offset by the artificial incentive such ownership creates to develop land specifically under government ownership, even if the land is not in the best location for development according to economic or national considerations.

One consideration that we oppose outright is “construction for new immigrants.” This seems to refer to refraining from construction now in order to ensure land reserves for future construction – for example, construction that will be necessary in order to absorb a wave of immigration. We believe that there is no justification for building less now in order to be able to build more in the future. It would be far better to increase the housing supply immediately, such that immigrants will arrive in a country with ample available housing and affordable prices right away.

Further in their article, Borochov and Wertzberger mention the supervision of land use. They write that, “when the initiative to develop is in private hands, there is a huge incentive for developers and land owners to introduce changes that will increase their profits, without considering the social cost, and there is no need to go into detail.” Further on in this article, we present the counter-argument that political pressure from developers is actually an essential component in planning considerations, alongside of course the counter-pressure from other affected parties, which is equally essential.

They also mention urban development management. This is a very important consideration, but should be left to the planning authorities, and in any case public ownership makes practically no contribution to this aspect.

In the final analysis, the considerations mentioned in Borochoy's and Wertzberger's article in favor of public ownership of land justify an effective planning and regulating system at the local and regional level; public ownership of public installations and classic public goods, such as parks; and the retention of reasonable land reserves for ensuring the availability of extensive areas for public and private initiatives that require the uniform ownership of a large area – an achievement that the expropriation laws currently in effect in Israel find difficult with respect to land that has multiple owners and small parcels. These considerations cannot justify public ownership of most of the state land and most of the urban land reserves.

We believe that Israel's system of centralized ownership is a historic anomaly which should be promptly rectified. This paper cannot judge the necessity of the land ownership regime for promoting national or demographic goals, but it can state that land ownership in populated areas is not the proper tool for promoting those goals. There is essentially no justification whatsoever for government ownership of land reserves in demand areas, beyond land required for public products whose construction is anticipated in the near future.

We believe that a system of centralized ownership in Israel is a historic anomaly which needs to be rectified promptly.

There is essentially no justification whatsoever for government ownership of land reserves in demand areas, beyond land required for public products whose construction is anticipated in the near future.

D. Empirical findings

We conducted several statistical examinations to check whether the influence of centralized land management in Israel could be quantified. The quantitative analysis produced four main findings:

- 1. The ILA's management has a significant detrimental effect on the elasticity of housing supply.**
When we examine housing starts on state lands, we find that they respond less to prices than construction starts on privately owned land, with respect to both time and region. Turning to the supply elasticity within various regions, we find that greater extent of ILA management is correlated with lower elasticity of housing supply.
- 2. Over the years many more housing units have been built on private land, even though we find that most of the inventory of urban land is managed by the state.**

Our interpretation of the first finding is simple: As claimed and explained throughout this paper, the public sector is not structured to respond quickly and efficiently to the clients' wishes, as these are expressed in apartment prices over time. To take one example, public sector construction was concentrated in low demand areas, while private sector construction was concentrated in areas with brisk demand. For example, in the ten most densely populated areas, 56% of the land was privately owned, while 68% of the construction in these areas was on privately-owned land. In the ten least populated areas, just 37% of the land was privately owned, and the ratio of construction on privately-owned land in these areas was almost the same, at 40%. In absolute terms, some 70% of public construction was in the less densely populated areas (i.e. less than median density), and less than half the construction in these areas was on privately owned land.

An interesting ramification of the first finding is that in areas with a greater presence of centralized management, prices are lower and the rate of inventory growth is actually higher. Instead of responding to the desires of the clients, as expressed in the prices, and building via tender in places in which people want to build, construction on publicly-owned land is usually wasted in lower-demand areas, which further reduces prices in these areas. It is true that average prices seem to be lower in areas with significant public management, which are usually areas with relatively low demand, but from an overall perspective this datum does not attest to successful management, but rather actually to failed management.

It is important to note that the tendency of the public sector to build specifically in outlying areas is partially due to the conscious and deliberate policy of spreading out the population for demographic reasons. A narrow economic analysis cannot refute the wisdom of this policy, but can indicate the fact that this policy has a major influence on the housing market and significantly reduces the supply of apartments in areas in which Israelis want and are determined to live.

E. The privatization proposal

Any discussion of the solution must first present a clear picture of the problem. The main problem is that most of the urban land reserves in Israel are largely isolated from market signals. Even if a developer is convinced that he can succeed in building a shopping mall, an apartment building an industrial installation or any other structure on publicly owned land and which is not being put up for tender in keeping with the developer's vision, he cannot simply buy the land and charge ahead. Ideally, he will manage to convince the ILA to put the land up for tender, but this persuasion and tender process can take years, and there is no guarantee that he will win the tender that is being held thanks to his vision and effort. Thus it would be appropriate to consider any alternative to the current system. Each of the following proposals is presented with its advantages and disadvantages.

The main problem is that most of the urban land reserves in Israel are largely isolated from market signals. Even if a developer is convinced that he can succeed in building a shopping mall, an apartment building an industrial installation or any other structure on publicly owned land and which is not being put up for tender in keeping with the developer's vision, he cannot simply buy the land and charge ahead.

1. The “little bang”

In an article published in 1997, Eckstein and Perlman proposed a “big bang” for privatizing most of the state-owned land in one giant privatization process. Privatization on such a large scale, however, is very difficult from a technical perspective and is actually unnecessary. The “little bang” that we propose entails the privatization of only the urban land reserves already in the planning stages.

In particular, we prepared an exhaustive list of all the plots classified as “ILA land reserves” and identified the plots designated primarily for housing. We chose the 50 largest residential projects (in terms of the number of housing units) in demand areas. These projects totaled over 300,000 housing units (by the ILA's calculations) on a land area of slightly over 100,000 dunams – less than 0.5% of the state-owned land, but tens of percentage points in terms of the value of that land relative to the value of the state-owned land reserves.

Such a targeted privatization would drastically reduce the distortion inherent in the government ownership of the Israeli housing market, while causing minimal harm to the government's ability to leverage its land ownership for national projects, which are not addressed in this study. The remaining distortion in the housing market will be very small, as most of the monetary value of the land is in the highest demand areas, and most of the land is not designated for development in the next few years anyway.

In light of the limited scope of the proposed privatization and the advanced state of the Israeli capital market, there is no need for any unique privatization mechanism for implementing the privatization. At present the capitalization of the publicly traded companies on the Tel Aviv Stock Exchange is about NIS 800 billion. Even assuming the most conservative estimate that buyers would be found for all the land at the proposed price, the value of the proposed privatization is about NIS 100 billion, and would be spread out over a few years. It is reasonable to assume that the potential buyers who would apply

A targeted privatization will drastically reduce the distortion inherent in the government ownership of the Israeli housing market, while causing minimal harm to the government's ability to leverage its land ownership for national projects, which are not addressed in this study. The remaining distortion in the housing market will be very small, as most of the monetary value of the land is in the highest demand areas, and most of the land is not designated for development in the next few years anyway.

for the tenders on the lands would go to the capital market for financing, and, among other things, would likely issue stocks or bonds. Ultimately, the Israeli capital market would easily be able to raise the necessary funds to finance the purchase of the lands in the “little bang,” if these were economically worthwhile.

The sale of the land to the private sector would not only benefit the land market, but would also be a boon to the capital market, by opening a new investment horizon with yield potential and risks significantly different than those of the investment instruments currently on the market.

2. Sale on demand

In order to make the publicly owned lands accessible for development, it is not necessary to sell them immediately. Rather, it would be sufficient for them to be available for purchase. In the current situation, in which the ILA decides which lots will be offered for sale and when, a developer who wants to develop a specific area must wait for that area to be offered for sale, and then he must compete in a tender with other developers. There should be an efficient and accessible marketing mechanism that makes it possible for a developer to realize his vision for state-owned land and which gives the public an appropriate return for the property. The following are two alternatives that could serve this purpose: tender and appraisal.

There should be an efficient and accessible marketing mechanism that makes it possible for a developer to realize his vision for state-owned land and which gives the public an appropriate return for the property.

Tender

The moment a developer or land dealer wants to purchase a plot of land, the ILA will have to hold a tender for that land. A similar process occurred regarding the land on which the Azrieli buildings now stand: the Azrieli group applied to the Tel Aviv Municipality to buy the compound, and the city decided that it would be appropriate to sell the land, but not via negotiations with one buyer. Rather, the city would issue a tender. This precedent could be used as a basis for a regulation that a request to buy land managed by the ILA would be an automatic trigger for (at least) that land to be put up for tender.

Appraisal

Under the current system, the state sells land via tender, but there is also a threshold price set by the ILA for the value of the land. The ILA obviously has some appraisal value for the land; this value could be used as the price for any particular plot offered for sale.

One possible drawback to this approach is that the ILA's valuation will be excessively high, due to the ILA's market power. But this danger is of limited extent. For one thing, a policy of widespread sales would itself lead to wider distribution of ownership and market power would rapidly decline. Another point is that the distortion due to monopoly profits of the government in this respect are not unambiguously problematic, as the state's revenues from selling the land would reduce the fiscal burden on the public from taxes, which are themselves distortionary.

Another way to avoid the monopoly pricing problem with an appraisal system would be to actively introduce competition into the system. One way of doing this would be by breaking up the ILA into two or more organizations, each responsible for marketing a fraction of state-owned property. This is a common remedy in anti-trust policy.

Each sale must be devoid of preconditions.

The buyers will be allowed to do as they please with the land, including nothing at all, and to sell the land at any time as they see fit, to any legal buyer, in accordance with Israeli law and subject to the planning laws and equitable taxation laws.

3. Basic principles

All three of the proposed horizons – initiated sales, sale on demand via tender and sale on demand via appraisal – require the examination of a few principles:

- Each sale must be devoid of preconditions. The buyers will be allowed to do as they please with the land, including nothing at all, and to sell the land at any time as they see fit, to any legal buyer, in accordance with Israeli law and subject to the planning laws and equitable taxation laws. The source of the distortion that exists at present is the desire of the authorities to set priorities in land allocation via ownership, and not via planning laws and transparent incentives. We will not correct this distortion if we allow the current owners – the government – to retain control even after the transfer of the land to private ownership. The development of the land must be encouraged via the planning and taxation policy, and not by setting complicated conditions for ownership.
- It is important that this process not replace a government monopoly with a private monopoly. The cumulative area of the land to be sold to a single market player should be limited to an area that will not create excessive market power.

- On the other hand, in land deals there are significant advantages to the size of the land. The parcels of land that will be sold should therefore be large enough to enable the buyers to take advantage of the benefits of the land area without having to incur the transactions costs of secondary deals.

This plan can easily be implemented in a pilot format on a relatively modest scale. Within a few years it will be possible to compare the extent of the development of land that was privatized and the development of similar land that remained under state ownership, and to weigh continued privatization based on the results.

This plan can easily be implemented in a pilot format on a relatively modest scale. Within a few years it will be possible to compare the extent of the development of land that was privatized and the development of similar land that remained under state ownership, and to weigh continued privatization based on the results.

4. The planning work already undertaken by the ILA

We propose to concentrate the initiated privatization on plots that are in the “preparation and work plan” stage. The ILA has already designated these plots for residential development and estimated the number of housing units that can be built on them.

All the architectural plans and economists’ forecasts for each plot will be handed over to the buyers. Currently, if the buyer decides that the ILA’s plans indeed reflect the best use of the land, then the purchase price will reflect the value of the plans, which the buyer will receive as part of the deal.

On the other hand, if the buyer is interested in doing something else with the land, this alternative purpose will make the land more valuable to the buyers.

F. The legal aspect

Basic Law: Israel Lands (1960) states that, “The ownership of Israel lands, being the lands in Israel of the State, the Development Authority or the Keren Kayemet Le-Israel, shall not be transferred either by sale or in any other manner.” This means that the privatization proposed in this paper would ostensibly require legislative backing. An amendment to the Israel Lands Law in 2009, however, determined that the ban in the basic law will not apply to “the transfer of ownership in state lands or development authority lands that are urban land, on the condition that all the land transferred by virtue of this clause not exceed a total of 400,000 dunams” in a given period. This ceiling was later increased to 800,000 dunams.

Since the scope of the privatization presented in this paper is about 100,000 – far less than the maximum enumerated in the law, the implementing of this privatization does not need additional legislation. A decision by the ILC would be sufficient to launch the privatization.

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G. The interface between the land market and the planning process

Among the rationales raised in the past for supporting the centralized ownership of land is a desire to prevent pressure from contractors. There is a fear of the tremendous profit from rezoning unplanned land. This reality is liable to result in landowners applying disproportionate pressure on the political echelon in order to obtain development permits, and could lead to a situation approaching corruption or even to corruption itself. When land is publicly held, the considerations for and against rezoning it will be focused on the public good.

Of course such a reality is a real possibility. When a public interest that affects many people (such as open spaces) clashes with a private interest that affects a few people, the political system has a tendency to attribute more weight to the concentrated interest, as shown by Mancur Olson and others. However, it is important to note that the lack of balance can also be in the opposite direction. If there is no influential figure who can champion the cause of the benefit from the rezoning of the land, then there is no one who will present this benefit to the political system and justify it. There are many people who do not own apartments and would benefit from the planning change, but these people are scattered all

over the country. Sometimes it would be best if the affordable housing interest of these people were to be translated into profit for the developer, to make developing the land more worthwhile.

The political system is necessary to strike the balance between development and other considerations: protecting the environment, public products, national goals (such as the distribution of the population), etc. Without private ownership, the pressure to develop is insufficiently palpable, such that the political system is insulated from the pro-development pressure while at the same time being exposed to the opposing pressure.

Under normal circumstances the planning bodies should serve as “judges,” who hear all the relevant arguments before making a decision. For this reason planning body hearings include, for example, representatives of people living adjacent to a planned development and representatives of the environmental organizations.

In the current situation, the voice advocating development is mainly from the government, which is responsible for most of the land. There is no doubt that the government has many avenues for persuasion, and the interesting and unanswered question is which sector is more capable of overcoming the existing planning barriers. We believe that bolstering the voice of the private sector will contribute to achieving balanced development and could be a welcome force in promoting genuine reform in the planning system.

In other words, in a planning regime that involves judgment in the granting of permits, the persuasion of policy makers (and the addition of initiative to their preferences) is an essential input in development. Expertise in creating this resource is required no less than expertise in planning, building, marketing, financial management and in obtaining all the other resources essential to construction. The private ownership of land will create a significant incentive to bolster persuasion to undertake projects that generate economic value.

This point was elucidated in an interview granted by Binat Schwartz, director of the planning authority at the Ministry of the Interior. When the interviewer asked about the ostensibly problematic nature of “the tremendous pressure investors exert on the planning system.” Schwartz responded that “This tension between developers and planners is a healthy tension that facilitates the development of the cities and the country as a whole.”

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H. The speculator's role

One could depict the image of the real estate speculator in Churchill's description of Russian intentions: "a riddle wrapped in a mystery inside an enigma." This enigma is the *positive* image that accompanies individual speculators, at the same time that we find *demonization* of the speculator viewed as a type.

On the one hand, there is high regard for many speculators who have contributed to the construction of the country and its towns. Yoel Moshe Salamon is the hero of a popular ballad, and towns and regions are named after developers such as Akiva Yosef Shlesinger (his name is the acronym for the town Benei Ayish) and Shmuel Holtzman (whose Hebraized name graces the Etzion bloc). On the other hand, when the word "speculator" is used, it is almost always with a negative connotation, as a description of a person who exploits the public and enriches himself at the public's expense.

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When we look closely at the lowly status of the land speculator, we reveal that he is charged with two offenses: he builds too much, thus turning the whole country into a concrete jungle; and as if that were not enough, he also dares to build too little – with malice aforethought he sits on land without building on it, in the hope that the land will appreciate in the future.

Within this enigma, however, there is another mystery. When we look closely at the lowly status of the land speculator, we reveal that he is charged with two offenses: he builds too much, thus turning the whole country into a concrete jungle; and as if that were not enough, he also dares to build too little – with malice aforethought he sits on land without building on it, in the hope that the land will appreciate in the future.

The truth is that land development and land conservation are two sides of the same coin. The best use of any resource includes the optimal time and method. If a house on a certain lot will be worth more in another five years than it is worth now, even after a calculation of the cost of the time, then it's simply worth waiting.

There is a large conceptual gap between the professional literature and the general public concerning the role of the speculator. The former views him as a vital element in balancing and regulating the market, while the latter views him as a predator and an exploiter.

Adam Smith was among the first to analyze the economic benefit of the speculator, in his case of the grain merchant. Smith explained that when a broker buys now and holds off on selling, he is gambling on there being a relative abundance now, and an anticipated shortage in the future. If he is mistaken in his assessment, he will be the first and major loser; and if he is correct, the public reaps the benefit, because the actions of the speculator will have prevented the public from exhausting the grain reserves during the period prior to a severe shortage, which would be even worse without the broker's actions.

An understanding of the benefit inherent in the grain merchant filtered down to the general public, and today the existence of commodity exchanges, with spot, futures and option prices, is recognized as a vital contribution to the ability of farmers and industry alike to stabilize revenue and manufacturing.

All these reasons for the role of the speculator being essential are equally applicable to land speculation.

Under the conditions currently prevalent in Israel, the role of the real estate intermediary is particularly important. Naturally, the real estate market is much more limited than the agricultural crop market, and even at market prices an effort is required to find buyers or sellers. By and large, real estate brokers are not only buyers and sellers, but also market players – for example, buying a plot and dividing it into parcels for one type of construction or another, depending on the broker's professional judgment regarding the proper use of the land and the best timing. If a real estate broker builds too late and price do not go up, he loses. If the prices rise, he made a wise decision to delay construction to a future date when the price of the land will be higher and the appropriate use of it will be different.

A real estate broker is an expert in discerning the right time to convert the land to some use or another, and in most cases also in identifying the specific use that is most worthwhile for the land. The profit he receives is a fair exchange for his knowledge and the capital he invested.

I. Why is the ILA not the best land broker?

One could still argue that there is no need for the privatization of land, as the ILA can manage that land for the benefit of the public coffers. The ILA is undoubtedly a real estate speculator in and of itself, in fact one of the biggest in the world. The ILA manages land worth hundreds of billions of shekels, and it undertakes all the actions typical of a real estate broker.

The purpose of this sub-section is to explain that there are four distinct reasons why, even if the declared purpose of the centralized management is focused on achieving profits, similar to a private commercial body, the performance of the public management will still be inferior in the optimal use of the land than a system of private ownership.

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Even if the declared purpose of the centralized management is focused on achieving profits, similar to a private commercial body, the performance of the public management will still be inferior in the optimal use of the land than a system of private ownership.

1. **The ILA is a public body.** The incentives of a public body are appropriate for the correct allocation of land for public use. However, since most of the land is used for private purposes, most of the ownership should also be in private hands.
2. **The ILA is a nationwide body.** The management of land on a national level has an important role in realizing certain public needs. However, the bulk of the land used by the public is in urban areas under the control of the local authorities. A national body does not have the perspective and the necessary range of planning tools for making efficient use of the land for those purposes. Thus the land that should remain under public ownership should mainly be under municipal ownership.
3. **The ILA is too large.** Every economic body has efficient dimensions, in which it maximizes the advantages of its size. However, the size advantage in the allocation of land is maximized at far smaller dimensions than those of the ILA.
4. **The ILA is a concentrated, centralized body.** In the municipal arena the ILA is not a monopoly. There is competition from the business sector, and in a few regions also from the municipal sector. However, the ILA does have very significant market power. This market power results in the land being too expensive.

An essential question in an examination of the worthwhileness of a body that manages land on a scale similar to the land reserves that the ILA manages is the question of economies of scale. Even if there are no barriers to efficiency due to the distorted incentives of a public body and a monopoly, a large commercial body is liable to be inefficient if it exceeds the efficient scope of the given market.

We examined the balance sheets of dozens of mammoth real estate companies traded in the U.S.A., England and Germany, in search of the scope of the properties "in development." Only one of these many companies reported managing land of this type in excess of \$1 billion, and only a few reported such holdings in the hundreds of millions of dollars.

J. Conclusion

In most branches of the economy we rely on the profit incentive of numerous competing private suppliers who are subject to rules of the game that are set and enforced by the public, and which are designed to align the interests of the businesses with those of the public. There is no reason for this model not to apply to land. Anyone who needs land for residential, industrial, commercial or other purposes will buy land from one private landowner from among many, and will ensure that his house, factory or store meets all the applicable planning requirements.

In Israel, however, the precise allocation of most of the land reserves in urban areas is currently in the hands of an enormous national, public, bureaucratic body, the Israel Lands Authority. This body has the proven ability to allocate land and develop real estate, but it does not have the incentives, the knowledge or the resources to efficiently allocate and develop the massive urban land reserves for which it is responsible. There is considerable evidence that the land under private ownership is being developed in a manner directed more toward the needs of Israel's citizens.

There is an urgent need for rendering tens of thousands of dunams of unplanned urban land accessible to the private sector with no conditions, such that the development of the properties will be undertaken in accordance with the ability of the owners to fulfill the public's needs, and in doing so, to find buyers in the short and long term.

It is of paramount importance that the transfer of land be unconditional. The source of the current distortion in land allocations is the subordination of economic considerations to political dictates via ownership, and if the current ownership is exploited in order to hamstring the freedom of movement of the future owners, the privatization will not manage to satisfactorily integrate profit considerations in development decisions.

The monetary scope of the necessary privatization is not prohibitively large. The privatization can be conducted based on demand for individual plots, with pricing via tender, appraisal or the Ministry of Finance's valuation, or can focus on the few tens of thousands of dunams most appropriate for development in the near future, with a market value of a few tens of millions of shekels. The Israeli capital market is capable of providing this sum, assuming economic viability. The buyers could raise capital on the existing capital market, via loans, bonds or the sale of shares in the real estate companies that would be participating in the privatization.

There is reason to believe that such a process would also have a positive impact on the planning system. The planning regime in Israel is rife with barriers. Reform in this regime is a vital necessity, as detailed in the accompanying article by Michael Sarel and his colleagues and in the article by Avichai Snir. The government has many means at its disposal for overcoming or bypassing these barriers, but to some extent it is precisely this ability that is delaying the required reform. The moment that development is dependent on a fair and transparent regime, the chances that such a regime will materialize will be greater.

We anticipate that the inventory of land in private hands in demand areas will significantly improve the ability of the Israeli real estate market to supply various land uses – apartments, factories, parks, commercial space and public buildings – in a manner best suited to the needs of Israel's citizens.





The Roles and Preferences of the Local Authorities in the Development of Residential Real Estate

Sandrine Fitoussi, Itamar Yakir, Michael Sarel

A. Introduction

In the past few years there has been a dramatic increase in apartment prices in Israel. This increase stems, among other things, from the fact that for several years in a row the pace of residential construction has not kept up with the increased demand for apartments by home buyers, who have been prompted by the low interest rates and tax distortions to invest their money in real estate. This situation is particularly pronounced in the central coastal region, where the main employment options and high quality services are located (“demand area”), and where there is relatively little room for flexibility in the growth of the housing supply.

During this time the public debate on the real estate crisis and the possibility of spearheading a solution has focused on the policy of the central government, and has barely touched on the local government’s role in this issue – the local authorities’ responsibility for the situation and the tools at their disposal (or not) for instituting change. The purpose of this paper is to outline the role of the local authorities in the current real estate crisis and to examine policy steps that can be implemented in order to influence the authorities’ approach.

The supply of residential apartments in Israel is determined via a complex process involving many government and professional elements. The local authorities are a major player in this process, as they have the ability to significantly influence the planning stages and the marketing of land in their jurisdiction, as well as the pace of residential real estate development in general, via their control over the granting of building permits and the other permits required throughout the process. The local authorities therefore play a major role in determining the pace of the construction of housing units within their boundaries, and by extension, throughout the entire country as well.

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A few articles have examined municipal wealth, its role in the current real estate crisis in Israel and its influence on the housing supply and on the prices of urban apartments in general and in demand areas in particular. Recently complaints have been voiced that the local authorities have a negative incentive to develop residential real estate in their jurisdictions. Eckstein, Tolkowsky, Eizenberg-Ben-Lulu and Sherman argue that the gap in the municipal tax rates between commercial and residential properties results in a lack of willingness – “a negative incentive” – on the part of the local authorities to promote residential construction, and induces them to restrict the housing supply for budget management reasons. These researchers believe that the local authorities’ reasoning is based on the gap between the costs they incur from the newcomers and the revenue generated by them. Businesses, on the other hand, generate revenue that (on average) exceeds the municipal expenditures required to provide them with services. Eckstein et al. suggest that a fitting solution to this problem is taxation based on land values, rather than the system in practice today, but this solution is presented in general terms only, without explaining how it would contribute to counteracting the disincentive and without examining the ramifications on other major issues such as the inequality in the local authorities’ revenue sources. The current paper expands on the existing literature, formulates a distinction based on the revenue structure of each individual local authority and discusses solutions that the central government should implement in order to change the situation.

The current paper examines the possibility that the local authorities' revenue structure causes not only their reluctance to promote residential construction, but also their reliance on the ratio between the built area intended for businesses and the built area intended for housing as a main strategic tool for making financial decisions and for guiding negotiations with the central government, at a time when a mayor is required to "show results."

The current paper examines the possibility that the local authorities' revenue structure causes not only their reluctance to promote residential construction, but also their reliance on the ratio between the built area intended for businesses and the built area intended for housing as a main strategic tool for making financial decisions and for guiding negotiations with the central government, at a time when a mayor is required to show results. We call this phenomenon "systematic cross-subsidization," and argue that this mechanism is part of the local authorities' financial-managerial strategy that is based both on limiting the supply of residential construction and on preserving high real estate prices in specific areas, in order to strengthen their attractiveness compared to neighboring areas and to affect the type of population entering the local authority. In order to depict this situation through the prism of the above-mentioned assumptions, the current paper attributes to the revenue structure two main characteristics that play a role in the mechanism described above: (1) the structural gap between the municipal rates on residential and commercial real estate; (2) the use of the built-up area as a proxy for the size of the population in the

formulation of the municipal rates. The impact of these two components is intensified by the expense structure of the local authority, which provides public goods.

In addition, our work highlights the cumulative distortions that the current revenue structure generates, in light of the strategic interaction between the local authorities and the long-term spatial-geographic and socio-economic ramifications. We contend that there is competition between the local authorities in attracting "quality" and relatively financially established populations – in both the commercial and socio-demographic spheres. Our analysis likewise examines the effect – which we believe is insufficient – of the solutions that have been implemented to date.

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We propose that an appropriate solution to the problem described above could be based on structural change aimed at: (1) correcting the distortion by narrowing the gaps between the municipal rates for residences and businesses; (2) adding a variable to the revenue formula, based on the size of the population that the local authority serves; (3) incentivizing the local authorities to make more efficient use of land – both nationally and locally. This change is proposed as an across-the-board reform, i.e. to be implemented uniformly by all local authorities, regardless of the composition of the population, preferences and political pressures, and without the need for localized intervention by the central government.

The solution proposed in this paper focuses on the incentive that the central government will give the local authorities, in the form of a per-capita grant, i.e. an additional budget allocation from the government (beyond the dedicated budgets, the budget-balancing grant and other funds already being transferred) that will be calculated on the simple and transparent basis of the number of people living in a community.

The solution proposed in this paper focuses on the incentive that the central government will give the local authorities, in the form of a per-capita grant, i.e. an additional budget allocation from the government (beyond the dedicated budgets, the budget-balancing grant and other funds already being transferred) that will be calculated on the simple and transparent basis of the number of people living in a community. The grant will be conditional on the ratio between the municipal taxes collected from the businesses and residential properties being below a certain ceiling that will be determined by the government. This incentive will add a component to the local authorities' budgets that will reflect the number of residents, and not only the size of the built area. At the same time the government will reduce its involvement in setting the municipal rates for businesses and residences and will afford the local authorities greater freedom in setting their rates.

The implementation of the proposed change will promote several desirable goals, including: (1) reducing the distortions stemming from the current taxation policy; (2) reducing the cross-subsidization and the local authorities' negative incentive to promote residential construction in their jurisdictions; (3) weakening the regressive character of the manner in which the local authorities are currently financed; and (4) increasing the certainty and independence of the head of the local authority with respect to its revenue.

Based on these conclusions, we contend that at present the manner in which the central government is coping with this reality (for example, by drafting umbrella agreements with the local authorities) is ad hoc and not systematic and is not completely transparent, such that there is an inherent potential for additional distortions and unfounded political biases. In addition, these processes entail heavy fiscal costs (including direct expenses for infrastructure development, which itself is not always economically justified, and the loss of revenue from marketing land). These costs are borne by all of Israel's citizens, but particularly – and disproportionately – by residents of outlying areas. As if this were not enough, the measures currently implemented can even encourage the local authorities to delay construction, in the hope of receiving even better incentives down the road.

B. The budget-balancing grant

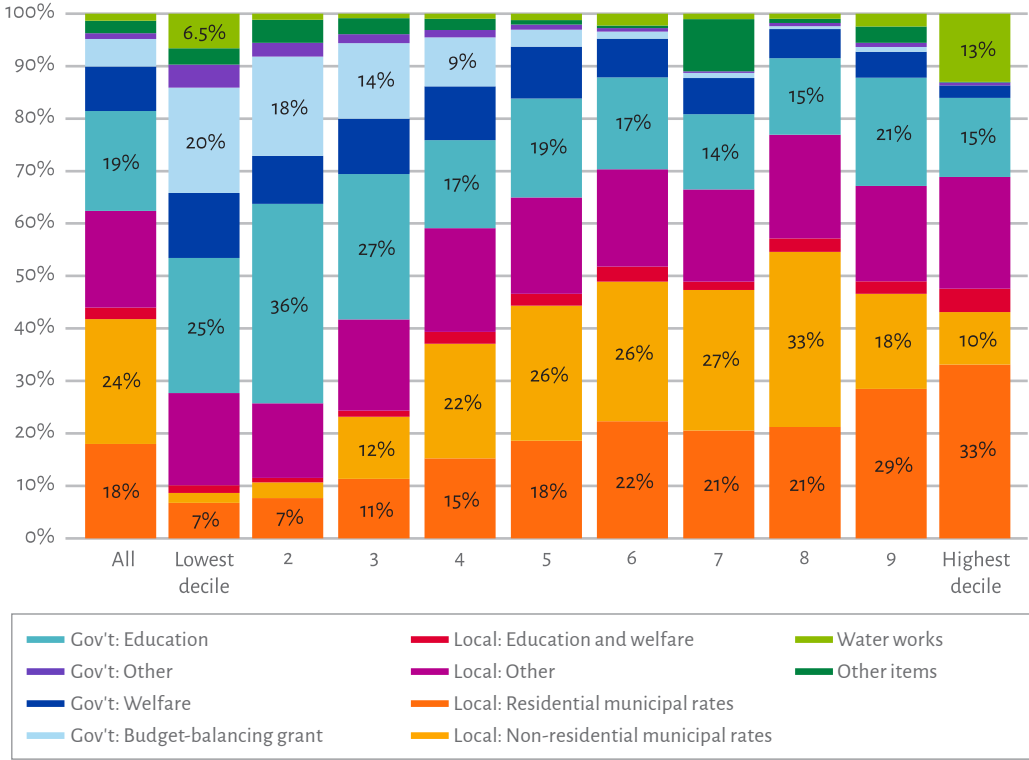
Unlike the rest of revenue in a local authority's budget, the budget-balancing grant is calculated based on the size and composition of the population, and not as a function of the built area. As such this grant is supposed to add a measure of distributive justice. By its very nature, this grant is not uniform among all the local authorities. Its purpose is to bridge the gaps that form in each local authority's budget between the potential revenue per capita and the reasonable minimum expenses, such that the local authority (and indirectly the state) can provide every resident of its jurisdiction a basic basket of services.

The revenue and expenses brought into account for the purpose of estimating the size of the budget-balancing grant are calculated in advance using a model known as the Gadish formula. This model takes several variables into account in order to adjust and refine the reasonable revenue and expenses that will serve as a basis for calculating the budget-balancing grant.

For some of the local authorities, the budget-balancing grant is of major significance: In the four lowest clusters, the budget-balancing grant is about 20% of the local authorities' regular income. In the four highest clusters, on the other hand, the budget-balancing grant is a very small proportion of the regular budget (see Figure 1).

From the local authorities' perspective, another important aspect of the budget-balancing grant is that unlike the designated government transfers, which are allocated strictly for specific purposes, the budget-balancing grant gives the local authorities greater flexibility in funding the basket of services that is most relevant to their residents' needs and preferences.

Figure 1: The main revenue components for the local authorities, by socioeconomic cluster – adjusted advantages based on overall income (in the regular budget, data for 2013)



Source: Central Bureau of Statistics, Local Authorities (2013)
www.cbs.gov.il/webpub/pub/text_page.html?publ=58&CYear=2013&CMonth=1

The limitations of the budget-balancing grant

One reason that the budget-balancing grant cannot fully bridge the forecasted gap is the budgeting policy practiced by the Finance Ministry with respect to the local authorities. Whether for budgetary constraint reasons or ostensibly in order to incentivize the local authorities to become more efficient, the finance minister actually transfers only 80%-90% of the budget-balancing grants – as calculated using the Gadish model – to the local authorities. Thus there is a gap between the “model” grant and the actual grant.

The budget-balancing grant enables the local authorities to avoid deficits and to avoid downsizing. In this respect the grant can reduce the negative incentive for the mayor to attract new residents, as the grant loosens the budgetary constraints and “compensates” the local authority’s coffers for the residents whose cost to the local authority are greater than the revenue they generate. Still, in effect, the accepted practice concerning the transfer of the budget-balancing grant not only fails to reduce the negative incentive, it can actually increase it, for two reasons:

- First, the Gadish formula not only sets a *lower* limit on the revenue per capita for the purpose of calculating the grant (in order to establish a revenue level that will not be below the true potential income); it also sets an *upper* limit on the theoretical expense. Thus even though a local authority's revenue per capita according to the model is higher than the authority's potential revenue in light of the character of its residents, the expense for the purpose of calculating the grant effectively represents not the full unique needs of the authority, but rather only the minimum level of the provision of those needs.
- Second, the sum of the budget-balancing grant actually transferred is, as noted, liable to fall short of the gap between the annual income and expense figures. This gap increases the local authority's disincentive to absorb economically weak residents. This scenario strengthens the local authority's resolve to reduce the shortfall between the anticipated grant and the actual gap, in one of two ways: the harder way - collecting more from the low-income population; or reducing the authority's dependency on the grant by reducing the characteristics of the local authority that could increase this dependency relative to the actual budget gap, i.e. by preventing the entry of low-income populations.

C. The duality of municipal rates

The main difference between municipal rates and other real estate taxes lies in the applicability of the municipal rates and their influence on micro-economic variables. Municipal rates apply to all properties based on their size, i.e., to all residents, whereas the other real estate taxes apply mainly to properties that are non-exclusive, i.e. whose owners own additional properties or when a property's value exceeds a certain sum, regardless of its size.

Municipal rates are not merely a user fee paid in return for the use of a service, as the benefit from the services provided to the residents is also reflected in the value of the property itself. At the same time, however, municipal rates are not just a value-based capital tax, like property taxes in the US and many other countries.

The duality of municipal rates is also expressed in their use as a practical tool from the perspective of the local authorities' budget management. Each local authority's main revenue comes from its residents, in the form of municipal rates – directly, from the residential property tax, and indirectly, from the property tax on businesses (the cost of goods and services consumed by the residents includes the businesses' overhead expenses, which include the municipal rates). An understanding of the nature of the municipal rates requires a distinction between their two main roles: (1) a tax and (2) a payment for services. In accordance with this perspective, the division between the two aspects of the municipal rates is also a division of the local authority's revenue in practice, i.e. a certain percentage of the municipal rates reflects payment for services and the remainder is a tax.

Municipal rates for businesses are primarily a tax, with the aspect of payment for services being secondary. Ultimately the value of services provided to businesses is significantly smaller than the sum collected from them via the municipal rates. A minor aspect of this tax is the correction of negative externalities resulting from the existence of the business (noise, pollution and the creation of an area devoid of people after closing hours).

Municipal residential rates, as opposed to the rates for businesses, are based mainly on the cost of the municipal services. Still, it is important to note that the formula for calculating the municipal residential rates is not completely consistent with the definition of a payment for services, as the rate is calculated primarily based on apartment size (with a secondary component of location within the local authority), rather than on the number and of residents in the apartment, who are receiving the services. In this aspect the municipal rates are closer to being a tax than a payment for services, and the tax characteristic is even more pronounced when one considers the progressive-distributive nature of the collection of municipal rates, which includes various discounts based on the size and income level of each household.

D. The role of the local authorities in developing residential real estate

The local authorities play a major role in the sequence of events in the realization of a housing development, and have substantial influence on the various stages in this process:

- The authorities' influence is reflected first of all in the zoning of land use in general, through their involvement in the drafting of urban plans.
- Later, the authorities are involved in the formulation and planning of the infrastructure that serve as a prerequisite for the construction of a residential neighborhood.
- Finally, the authorities can control the quality and the rate of the bureaucratic processes under way concurrently with the development of the land and the construction, and thereby regulate the contractors' demand for land in the authority's jurisdiction: an authority that prolongs the planning, permit approval and construction processes will tend to decrease the desire of developers to build in that authority.

The local authorities deal with several players who are associated with five stages in this process:

- The land stage – the location, marketing, leasing and sale of land by the Israel Lands Administration, the Construction Ministry and private land owners;
- The planning stage – the zoning and division of the land into plots by the planning authority and the various levels of planning committees;

- The development stage – the allocation of requisite resources by the Ministry of Transportation, the Ministry for Environmental Protection and other ministries (often represented by the Finance Ministry and the Construction and Housing Ministry), for building the various infrastructures in the land slated for construction, as a precondition or in parallel with the construction on the land;
- The execution stage – the actual construction by contactors, including the financing stage, by the financing sector or the government sector;
- The purchasing, leasing and occupation stage – a stage that exists concurrently with the activities of the other four stages, and includes the locating of the desired residential and commercial owners/tenants or the presentation of the future construction to them, and the completion of transactions with them.

E. The socioeconomic effect of the taxation policy on the municipal level and the aggregate level

The above discussion reveals that there are distortions in the land tax system, on both the local and the national level, that are linked to the revenue mechanisms of the local authorities and cause a structural over-demand and under-supply of residential real estate, particularly in demand areas. An efficient policy solution must therefore include a mechanism that will correct the existing distortions, and in particular offer alternatives that will affect the structure of the revenue mechanisms by narrowing the gaps and adding a component to the local authorities' revenue mechanisms that will take into account the size of the population and not only the size of the built area. The purpose of this section is to highlight the chain of consequences that stem from the local authorities' revenue structure and to examine the hypotheses described below:

- **The substantial reliance on localized grants from the state**, in order to finance the service component of the local authorities' expenses and to balance the authorities' budgets, reduces the independence of the local government, increases the non-egalitarian competition between the authorities and prevents the correction of the structural distortions created in the allocation of land on the local and aggregate level.

- The effect of the rates gap.** The initial assumption in this paper is that the welfare of the residents is affected over time by the level of expenditure per resident, and for this reason the level of expenditure is an approximation of the potential level of the residents' welfare. The authority's source of funding for its expenses is the independent revenue obtained primarily from residential and commercial property taxes (calculated based on the size of buildings) and from revenue from central government sources (mainly dedicated allocations for education and welfare, as well as from non-dedicated allocations, particularly the budget-balancing grant, which is dependent on a complex calculation based mainly on the size and composition of the authority's population). The gap between the residential and commercial property taxes affects the local authorities' behavior, turning the authority's decision regarding the number of residents in its jurisdiction into an endogenous variable in the equation for maximizing the residents' welfare. Thus the local authority can influence its revenue capability by setting the ratio between the area allocated for residential construction and the area allocated for commercial construction (assuming a population density level that cannot be influenced in the short term) and thereby restrict the housing supply and influence prices in the authority's jurisdiction. The authorities therefore use the ratio of these areas as a tool for setting the marginal revenue required for covering marginal expenses when the authority provides public goods to a new residential neighborhood. Thus the structure of the authority's revenue mechanism, which is based on a discriminatory municipal rate and on relating to the residential area as an approximation of the number of people who use the municipal services, creates
- inbuilt distortions. These distortions cause a shortage in the supply of residential real estate, particularly in demand areas. Thus, when examining the policy tools for rectifying the situation, a solution should be sought that will compensate for those components, and particularly a solution that will facilitate the reduction of the discrimination in the municipal rates, and which will give greater weight to the size of the population to which the authority is required to provide services.
- The gap between the marginal revenue and the marginal expenditure.** Considering the authorities' revenue structure, there is a gap between the marginal revenue and the marginal expenditure per resident (or per new neighborhood). The structure of the local authority's revenue mechanism is based on the use of the built-up area as an approximation of the number of municipal service users, but as the literature describes, the formulas for calculating the current local land tax, based on this variable use causes distortions in the allocation of resources. In this context, the local authorities refrain from reducing the average actual revenue per resident and from dependency on the budget-balancing grant. In order to avoid harming the rates of municipal tax collection in practice, the authorities prefer to attract populations with higher incomes, who tend to pay higher rates of municipal tax, and even populations with surplus payment ability, for additional services beyond those included in the basket of municipal services, such as extra-curricular education. In accordance with this preference, the housing supply in demand areas will be designated for these populations, based on plans for more expensive, upscale real estate products or larger apartments.

- **The marginal revenue mechanism and the systematic cross-subsidization on the local level.** Considering the discriminatory municipal tax rate and the inbuilt gap between marginal revenue and marginal expenditure per resident, from the authority's perspective there is an optimal ratio between the number of residents and the number of businesses (or alternatively between the areas designated for them), that enables the equalizing of the average marginal revenue and the marginal expenditure via a cross-subsidization mechanism. Thus the decision whether or not to add a new residential neighborhood to a city is influenced by the ability of the relative number of businesses to "subsidize" the new residents. The cross-subsidization between the businesses and the residents and the optimal relative value determine the willingness of local authorities to act on expanding or limiting the housing supply. Authorities that have a broader revenue base from businesses can provide their residents with a higher level of services. Thus authorities with a higher ratio between the revenue from commercial municipal rates and the revenue from residential municipal rates have higher expenditures per resident.
- **The cross-subsidization on the national level.** The ability to subsidize residents (or new residential neighborhoods) by drawing additional businesses exists mainly in authorities that can attract businesses and industry in a sufficient proportion relative to the number of residents. In other words, the cross-subsidy mechanism does not operate uniformly in all regions. Alongside the local subsidy mechanism there is also a mechanism for "cross-subsidy on the national level," that widens the gaps between the services provided to residents of the various local authorities, and in particular increases the gaps in the prices of housing between various locales and contributes to the rise in prices in demand areas. This mechanism develops because in cities with more wealth, the blocking of new residential construction in their jurisdiction indirectly increases apartment prices and the allure of living there as opposed to other cities. Theoretically, this situation could further strengthen these cities' ability to attract socio-economically stronger populations, and in their wake also to charge higher municipal rates and achieve higher collection percentages. Thus the cross-subsidy between businesses and residents in a given city is similar and comparable in poor cities and rich cities, when all the other variables are fixed (see Figure 2).

Figure 2: “Cross-Subsidy” – A vicious cycle that reinforces the inequality between cities



- **Arbitrariness, inequality and other distortions.** The negative incentive to develop residential real estate results in a significant delay in increasing the housing supply in demand areas and contributes to the rise in apartment prices. This negative incentive also encourages a government policy (aimed at overcoming the negative incentive by granting positive incentives) that is confusing and inconsistent, and which grants disproportionate power to the strong local authorities, particularly those that have significant land reserves. This policy sets arbitrary and non-optimal priorities for the timing of large-scale infrastructure projects, in

order to obtain the willingness and consent of the local authorities for the accelerated development of the residential real estate in their boundaries. The disincentive for increasing the number of residents in the local authority is also liable to induce these authorities to attempt to delay urban renewal projects. Since most of the local authorities rely on cross-subsidy between businesses and residents, in which the former subsidize the latter, the key to the residents' welfare in the various local authorities is extremely arbitrary and unequal. Local authorities that happen to have employment hubs and businesses can provide residents

with particularly high-quality services and discourage an influx of new residents, in order to preserve the ratio between residents and businesses. From the national perspective, the fact that municipal rates are largely dictated by the central government and calculated based on property size causes the municipal rate to be a particularly regressive tax. When the municipal rate is examined as a proportion of the property value, it becomes obvious that this proportion is actually lowest in the strongest local authorities, while the cost of the municipal services – at least the basic ones – are not significantly more expensive in the stronger locales. In this fashion, the weaker local authorities are subsidizing the stronger ones.

- **The counterweight: positive incentives for attracting new residents.** In addition to the many negative incentives that affect decisions in the local authorities, there are a significant number of positive incentives that promote the willingness and tendency of local authority mayors to absorb and even attract new residents to their communities. In quite a few cases these incentives offset the effects of the negative incentives and even outweigh them, to the point of prompting local authorities to actively encourage the influx of newcomers, even without the involvement and persuasion of the central government (although usually this refers to strong populations and the central government plans its use of some of these incentives).

F. Policy goals

The discussion of the appropriate solutions to the systematic cross-subsidy of local authorities must take into consideration the desired socioeconomic goals, in general, and the residential real estate goals in particular. In this context the question arises as to whether the central government is striving to reduce the geographic and socioeconomic gaps or would rather maintain the high prices, as exemplified by the policy in Britain. On the one hand, perhaps the government's policy in this sphere should aim to increase the number of apartment owners, particularly among young couples. On the other hand, one could argue that interest rates are sufficiently low to promote the purchase of apartments for personal use, such that demand should be allowed to inflate prices in this context. Another direction is the influence of the mix of apartment owners and the active intervention to change it (for example, the restriction of the ratio of investors relative to the ratio of young couples who own apartments, or relative to the general population of apartment owners).

We believe that the goal of the government's policy concerning apartments should be derived from the ultimate goals of the socioeconomic policy in the broader context – increasing growth and reducing inequality. It is noteworthy that some of the policy measures taken in the past in the housing sphere actually tend to harm growth and increase inequality. This is due, among other things, to the tax distortions that cause inefficiency in the allocation of the public's savings and of the banking system's credit (an excessive incentive to invest in real estate relative to real and financial investments, other things being equal); to the over-taxation of labor and capital (as a direct result of real estate tax benefits); and to the subsidization of residential apartment purchases (compared to rental and saving in the capital market), whose main beneficiaries are people with high equity (the buyers or their parents) and rela-

tively high income earners (who can afford mortgage payments). With this in mind we propose that the correction of the distortions created in the local tax system (such as the disincentive for residential construction) and the development of fundamental change in the structure of the local authorities' revenue can contribute to the solution of the localized problem of the slow development of residential real estate and can promote the more efficient and egalitarian allocation of resources on the macro-economic level of overall socioeconomic policy.

Steps taken by the government to reduce the negative incentive

The negative incentive overshadowing the decisions of the local authorities has not gone unnoticed by representatives of the central government. Indeed, in recent years the government has instituted numerous measures aimed at weakening the negative incentive (or for some other purpose, but which also had an impact on the negative incentive). The following are four of these measures.

- **Development grant.** Since July 2008, the Ministry of Construction and Housing has been granting subsidies to the local authorities to finance infrastructure “for public initiative construction.” Infrastructure includes laying water pipelines, paving roads and other preparation work required for the construction of neighborhoods. The grants, which are awarded only to communities designated Priority Region A and which meet additional prerequisites, make it easier for the local authorities (and to a certain extent the building contractors) to attract home buyers, by covering part the high one-off costs (to the residents), and by easing the reluctance of the local authorities to tackle the budgetary and financing processes that such expenditures entail (the collection of infrastructure fees and levies is burdensome for the local authorities, whether due to the lengthy duration of the collection process or due to their reluctance to excessively – and contrary to promises – increase the cost

of the apartments in new neighborhoods). Even so, the infrastructure grant has a limited effect on bridging the revenue gaps in the regular budget, which over time become a major challenge to some local authorities.

- **Umbrella agreements.** Agreements signed between the government and the local authorities during 2014 aim to promote a similar idea: They “promise the commitment of the state, the government ministries and the local authority in demand areas, even before the establishment of the new neighborhoods, and the full involvement of the local authority in the issuing of building permits, quickly and within a reasonable period of time from the submission of an application, in accordance with the urban building plan regulations...the state, via the relevant ministries, will make preliminary funding available in advance for the required infrastructure components: the underlying infrastructure... the accompanying infrastructure...compulsory public buildings...[and] public institutions.” Under this program, the government transfers preliminary financing to the local authorities for the necessary infrastructure components – infrastructure and public institutions – when new residential building permits are issued in demand areas. The rationale behind these agreements is that the government, via subsidizing part of the marginal cost incurred by the new neighborhood, removes the barriers impeding the addition of new residential neighborhoods. Still, at this stage, the umbrella agreements are designed to finance large-scale infrastructure projects mainly in demand areas, and are therefore expected to further widen the gaps between wealthy and poor local authorities. Moreover, the drawback of the umbrella agreements lies in the vagueness of whether they were signed only following a professional process of locating available land in high-demand areas. In this respect, the processes that led to the signing of the agreements could

be described as non-transparent and very non-egalitarian from the perspective of the optimal political process. Furthermore, the local authorities' have turned the umbrella agreements into a common and main means of increasing pressure on the central government. Thus these agreements are actually liable to spur the local authorities to delay developing residential real estate in their jurisdiction, in order to be eligible for additional benefits and grants from the government. The umbrella agreements include, for example, financing for infrastructure projects such as the Apollonia Interchange in Herzliya, or the financing of infrastructure whose cost exceeds NIS 1 billion in Rosh Ha'ayin and Rishon Letzion. These examples reflect: (1) the preference accorded to the development of infrastructure in demand areas – beyond the need and the priorities – relative to the outlying areas, for example; (2) the fact that ultimately every ad hoc solution is actually liable to contribute to the widening of the gaps, such that a structural solution is required that will prevent the cyclical process described above. Finally, the umbrella agreements have the potential for political bias (lack of transparency in the criteria), for arbitrariness (granting a big advantage to locales that have available land), and for changing the balance of power in negotiations between the central government and the local government (“spoiling” local authorities that become accustomed to generous and excessive budgets as a prerequisite for cooperating in housing developments). This solution does not address the structural distortions described above, and is therefore insufficient in our opinion.

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- Housing incentive.** Ostensibly the most effective solution proposed by the government in order to counter the local authorities' negative incentive is the housing incentive, which creates "an incentive mechanism for the local authorities to grant building permits." Under this plan the government committed to granting the local authorities NIS 10,000 for every additional housing unit whose construction the local authority approves in its jurisdiction beyond the annual average that the local authority approved in 2010-2012, as long as the authority meets two conditions: (1) The number of housing units approved in the given year is at least 200; (2) There has been a significant increase in the number of housing units the authority approved in the given year (an increase of at least 10% over the annual average in 2010-2012). The implementation of these grants was planned for 2014-2016, with a total grant ceiling of 12,000 housing units in all the eligible local authorities. The housing incentive really does compensate a local authority for the high marginal cost – relative to the revenue, particularly considering the timing of municipal rate collection – stemming from adding a new resident or a new neighborhood, but the impact of this incentive on the local authorities behavior has yet to be observed. There is no doubt that this solution could spur the granting of building permits in the short term in some of the local authorities, but will probably only result in a change in the timing of the local authorities' promotion of residential construction (in 2014-2016, at the expense of later years). In addition, similar to the other incentives, this one will encourage the local authorities to refrain from promoting residential construction "for free" – without a substantial contribution from the central government. Thus these incentives are ultimately liable to strengthen the negative incentive.
- The recommendations of the Barzilay Commission for choosing a municipal taxation rate system for Israel.** At the beginning of 2007 the interior minister appointed a commission headed by Adv. Ehud Barzilay, to examine the Israeli municipal rate system. Even though the commission's recommendations have still not been implemented, we will present a brief summary of them. The recommendations of the commission indicate the need for structural changes to the system, based on two possible alternatives:

 - The first alternative** is based on the idea of replacing the municipal rate with an indirect tax, i.e. the addition of 2.0-2.5% to the VAT in exchange for the cancellation of the municipal rate. The VAT supplement that would be collected by the central government would be transferred to the local authorities based on a uniform formula that would cancel the differences in collection percentages and reduce the inequality between the local authorities on a national level. This alternative would facilitate the management of each local authority's budget based on a uniform basket of services, resulting in minimal differences between the various communities, something that will not necessarily allow room for the expression of the various needs of the different populations and their choices, as expressed in the municipal elections.
 - The second alternative** focuses on a change in the structure of the municipal rate, to a tax calculated based on the property value, similar to the calculation method in most western countries. A solution of this type has burdensome operational ramifications, as it requires a complex appraisal system at the municipal level. Furthermore, a solution of this type is liable to drastically increase the inequality that exists today between the financial resources of the local authorities, due to the vast differences in property values in the various population centers throughout the country.

In conclusion, the distortions described above – which stem mainly from the local authorities' revenue structure, and particularly the structure of the municipal rates – causes over-demand and under-supply of residential real estate, mainly in demand areas. An effective alternative policy is required to correct the existing distortions, and especially to offer changes that will affect the authorities' revenue structure, by resolving the distortions and adding a component connected to the size of the population in the local authority. Furthermore, since the distortions are structural, any localized solution that does not take into account the source of the problems, but rather addresses only the symptoms, will not only not solve the problem, but is even likely to increase the inequality and have a severe impact on demand and prices, and fuel the vicious cycle of the cross-subsidy on the national level. This point is demonstrated in our explanation of the umbrella agreements, above, that were recently proposed by the government in order to reduce the negative incentive for building residential neighborhoods.

G. Policy recommendations

In the current situation, the wealth of a local authority is mainly a function of the size of the built-up area. The taxation policy set by the central government includes three significant components: the gap between the municipal rates for commercial and residential properties; the control over the rate per square meter and the permissible annual increase; and finally the use of the built-up area as a proxy for the size of the population in the municipal rate formula. These have created a situation in which the local authorities are forced to implement systematic cross-subsidy. This subsidy method is based on the local authorities' use of the ratio between the municipal rates collected from businesses and the amount collected from the residents as a strategic tool in budget management.

We propose a policy alternative that has the potential to promote several desired goals, including: (1) the resolution of the distortions stemming from the current taxation policy; (2) the reduction of the cross-subsidy and the negative incentive for the local authorities to promote residential construction; (3) the weakening of the regressive character of the current financing of the local authorities; and (4) the increased certainty and independence of the local authority's mayor concerning the authority's revenues.

This alternative is based on an incentive that will be given to the local authorities by the central government in the form of a per-capita grant, i.e. a budgetary supplement to be transferred by the government (in addition to the dedicated budgets, the budget-balancing grant and the other funds already being transferred) that will be calculated based on simple and transparent basis of the number of people living in a community. The grant will be conditional on the ratio between the municipal taxes collected from the businesses and residential properties being below a certain ceiling that will be determined by the government. This incentive will add a component to the local authorities' revenue that will reflect the number of residents, and not just the built area. At the same time, the government will reduce its involvement in setting the municipal rates for commercial and residential properties and will allow the local authorities greater freedom in setting these rates.

The increased freedom of every local authority to decide for itself (or at least to have significant involvement in the decision) regarding this policy will increase the fiscal autonomy of local government in Israel, which is currently very limited. In many local authorities, meeting the required ratio between the commercial and residential rates will require an increase in the residential rates or a decrease in the commercial rates, or a combination of the two. Every local authority will be given the option, subject to the restrictions that will be determined, to decide for itself how it wants to meet the ratio. Furthermore, a local authority will also be able to choose not to meet the ratio, but the consequence of that choice will be the waiving of eligibility for the capitation grant.

Although this policy paper recommends the broadening of the local authorities' fiscal autonomy (which is currently extremely limited), this paper does not examine the optimal scope of that autonomy and the desired rate of its expansion. One radical option is to offer the local authorities complete and immediate autonomy. Alternatively, their autonomy could be gradually expanded, with the central government's guidance and close examination of the process and its ramifications, including learning from mistakes and implementing corrective measures.

When the government discusses the maximum ratio between the municipal rate revenues (the ratio that will make the local authority eligible for the "poll grant"), it should ensure the fostering of a situation in which: (1) the current need for cross-subsidy will be obviated; (2) the total revenues of the local authority (including the per-capita grant), on the countrywide macro level, will be similar to the total revenues today.

The budgetary cost of the proposed change will be financed by the central government via increased indirect taxes (for example, a change in the VAT). There is usually public opposition to increased indirect taxes, because they are perceived as less progressive than direct taxes. In this case, however, increasing the indirect taxes is designed to fund a process of a highly progressive nature, such that it is reasonable to assume that the overall effect will be a reduction in the inequality. An alternative source for the budgetary cost of the poll grant is a reduction in the tax benefits for investments in real estate. These two sources could, of course, be combined.



Delays in Obtaining Building Permits from Local Building Committees

Avichai Snir

The economic theory of public choice and empirical research show that the more leeway public officials have in making decisions during the decision making process, the greater their ability to demand economic rent in exchange for their decisions. Furthermore, in such cases it serves the interests of the public officials to extend the decision-making period and to limit their ability to track the decision-making process, in order to prevent criticism of their decisions.

Testimony from real estate developers and public officials indicate that this scenario is indeed characteristic of the local committees that are required to approve building plans. Ideally, the examination process of permit applications should be undertaken by the various local committees in accordance with uniformly structured procedures, but the reports reveal that in practice, there are large discrepancies in the practices of the various local committees involved in this process. The time required for a local committee to approve similar building plans also varies significantly.

In many cases, the differences in the duration of the approval process can be months or even years, even when the applications are for building permits of a similar nature. Quite often this duration depends on the connections between the developer and the officials on the local committee.

There is also a lack of transparency concerning the manner in which the decision-making process for building permits is conducted, and the officials and local committee members have tremendous influence on both the scheduling of the discussion of a building permit application and on the decision itself.

In many cases, the differences in the duration of the approval process can be months or even years, even when the applications are for building permits of a similar nature. Quite often this duration depends on the connections between the developer and the officials on the local committee, as the developers often have to keep in touch with the officials: to clarify the status of the application and whether the committee's engineer has submitted his conclusions to the building committee, and to verify that the building committee is planning to discuss his permit at an upcoming meeting.

There is also a lack of transparency concerning the manner in which the decision-making process for building permits is conducted, and the officials and local committee members have tremendous influence on both the scheduling of the discussion of a building permit application and on the decision itself.

Even after a local committee has discussed and approved a building permit application in principle, there are often substantial differences between the additional documents and amendments that developers are required to submit in order to obtain the final approval and the desired permit. These differences can also result in months-long delays in the issuing of the permit, because the additional requirements dictate the number of consultants that the developer must hire (and then submit their opinions) in order to obtain the permit and the number of official bodies that must also issue their approval before the permit is granted.

All these delays and differences drastically increase the developers' costs and sometimes cause deep uncertainty concerning the date on which developers will be able to commence construction and the costs they will have to bear until construction starts. This uncertainty is factored into the price that developers demand from apartment buyers. The uncertainty also sometimes deters developers from building in locales in which they are unfamiliar with the local officials and the members of the local committee.

As a result, developers who have connections with certain local committee members sometimes have more market power than expected, considering that the process for obtaining building permits is identical for all developers. In locales in which well-connected developers benefit from priority in receiving permits, this market power usually results in these developers being the only ones who apply for tenders. Similarly, well-connected developers sometimes know which building plans the local committee is interested in promoting, such that the developers participate in those tenders in which the rights to building plans that the committee is interested in promoting are being sold.

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Tenders that the committee is not interested in advancing, on the other hand, often fail due to lack of applications, because the well-connected developers prefer to avoid risking investing in such tenders, even when the government and the Israel Lands Authority have an interest in promoting them. This is what happened, for example, with the *Mekhir l'Mishtaken* affordable housing projects that the Housing Ministry has been trying to promote for the past few years. Most of the tenders for those projects failed.

According to the economic literature, in such situations there are also concerns that the well-connected developers will try to influence the committee members and the public officials in charge of approving projects in order to delay the approval of applications or to alter the requirements in tenders held for the sale of building rights. If such manipulations are indeed occurring, they are likely to be one of the reasons that in instances in which *Mekhir l'Mishtaken* tenders did succeed, the developers who acquired the rights were granted conditions that enabled them to sell the apartments without significantly lowering the prices, even though the projects were designed to result in the sale of the apartments at prices averaging 20% lower than the market prices.

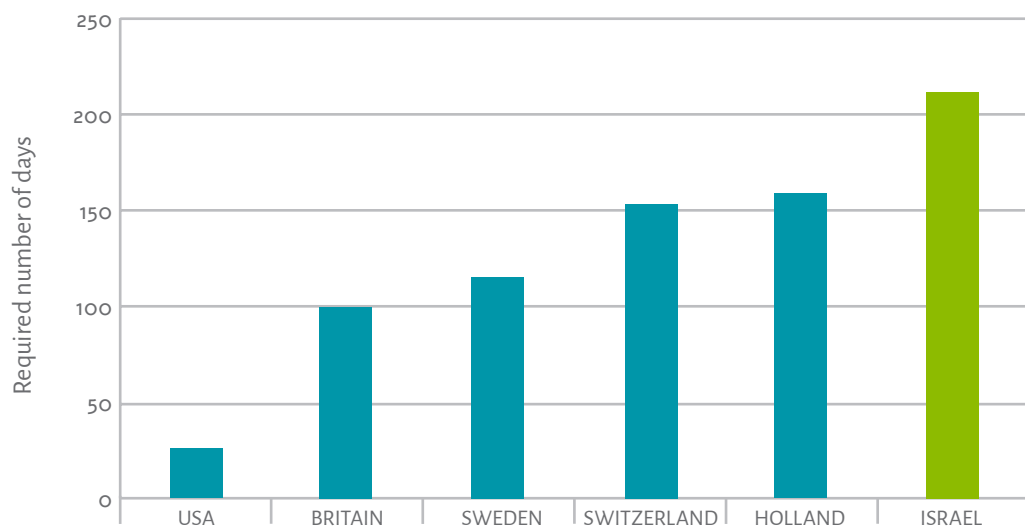
This article will examine the current situation in the local planning and building committees and the manner in which this situation affects the costs to developers. We will also examine the implications of **Amendment 101 to the Planning and Building Law, 5725-1965**, which was passed in 2014, and is part of the Binat Schwartz reform, which was designed to remove many of the barriers in the building committees. Even though the language of the reform is explicitly aimed at overcoming many of the problems with the current situation, there are concerns that it will be implemented in a manner that will actually make matters worse in many cases. The situation that is supposed to exist following the implementation of Amendment 101 will be examined versus the theoretical solutions designed to resolve problems such as those faced by local committees in Israel.

The average time required for obtaining building permits in Israel and the vast discrepancies in the time required for the approval of similar plans apparently indicates a lack of efficiency in many parts of the process. A plan that is submitted in compliance with the terms set down in the information booklet should be submitted to the local committee within a month or two, such that the wait until the approval of such a plan, even with reservations, should be a maximum of two or three months. In practice, the time required in most cases is over a year, and in many cases could be up to two years or more.

In addition, even after the application has been approved, with reservations, developers have no way of estimating the number of approvals and corrections they could be required to submit, despite the significant influence the type of approval has on the length of time required to obtain the permit, as the reservations vary from one committee to another and from one application to another. Obtaining a certificate from the Fire Department, for example, is a procedure that takes a few months. The result is that Israel is one of the countries in which the wait for building permit is among the longest in the developed world, as displayed in Figure 1, which is based on data from the World Bank's Doing Business 2013 report.

The time required in Israel is three times that required even in countries such as Switzerland and Holland, which have a complex permit procedure, and more than twice that of England – a country considered as one in which the laws governing land development are particularly demanding.

Figure 1: Average time required for obtaining a simple building permit



Based on: World Bank, Doing Business 2013 (2013)

The figure shows the length of time required for obtaining a permit for the simplest type of building in various countries. The time required in Israel is three times that required even in countries such as Switzerland and Holland, which have a complex permit procedure, and more than twice that of England – a country considered as one in which the laws governing land development are particularly demanding. Furthermore, in Switzerland, for example, the time required is relatively long because the plans are publicized and considerable time is allocated for the neighbors to submit their reservations.

The main reasons for the long wait for a permit in Israel is apparently the broad discretion in the hands of the officials, the municipal engineer, the urban planning committees and their chairpersons, as well as the lack of transparency of the process and the differences in the demands of the various committees.

With respect to all the procedures that are dependent on the authorities in Switzerland, the wait for the permit is relatively short.

The main reasons for the long wait for a permit in Israel is apparently the broad discretion in the hands of the officials, the municipal engineer, the urban planning committees and their chairpersons, as well as the lack of transparency of the process and the differences in the demands of the various committees. Some of the local committees also lack manpower and resources. In certain locales, for example, a developer can be required to transport the municipal engineer to the planned building site as a condition for the engineer examining the application, because the engineer does not have a vehicle in which to reach the site on his own.

One aspect of the lack of transparency in the process is that developers have no way of knowing the stage their application has reached on its way to the committee. They have no way of knowing, for example, whether or not their application has been relayed to the committee engineer; whether or not the engineer has examined the application and transferred it for discussion by the committee or if the application is still in the office of the clerk who accepted it. This is because the clerk is under practically no obligation to forward the application to the next person involved in the process. Many developers are wary of complaining about this situation, because the clerk could respond by disqualifying an application for a technicality that could normally be resolved at the amendments stage, after the conditional granting of the permit. The clerks also have a certain measure of authority to set the conditions for a project. A clerk can decide, for example, that an underground compound adjacent to a commercial zone can be used solely for storage purposes, or alternatively the clerk could approve the use of the compound for auxiliary purposes. In the latter case, the person who rents or purchases the commercial space can decide the use of the underground space, and build washrooms or an employees' lounge or work room there, for example (such as a smoking room or a goldsmith's room under a jewelry store) or part of a kitchen. In the former case, the space can be used only for storage. The difference in the value of the property, from the perspective of the developer who is building the structure, can be millions of shekels, but quite often clerks give different permits for similar projects based on their exclusive discretion. In certain cases, such decisions can lead to significant delays in construction processes, because the developers appeal to the courts and appeal committees in order to change the clerks' decisions.

The authority to decide some of the conditions that developers will be awarded and the duration until an application is discussed by the committee grants the clerks considerable power. For this reason developers must maintain good relations with the clerks, in order for the developers to obtain good conditions when they submit permit applications.

Another unknown factor for developers, in addition to the conduct of the clerks, is the position of the committee's civil engineer, even though he has a decisive influence on the committee's decision. The engineer can give almost any recommendation that is suitable to him, and the committee members usually accept his professional opinion without question.

There is also a lack of transparency in the committee's discussions. In principle, every committee must publish the minutes of every meeting, in order to enable developers to know the reasons for the decisions that are made. Even so, in order to allow decision makers freedom in the discussions, the committee members have the right not to record the minutes of detailed discussions. Furthermore, some of the local committees publish abridged minutes or do not publish them at all.

Even though infrastructure fees are supposed to be set using a uniform formula, in practice, the calculation of area subject to infrastructure fees is dependent on the committee engineer's decision, as is the amount to be paid. Anecdotal accounts indicate that sometimes there are discrepancies of millions of shekels between the sums developers are asked to pay for similar projects in the same city.

Thus the local committee members can make decisions based on their personal preferences. Since the committees are largely controlled by the chairperson, who is the mayor or his representative, the result is that the position of the chairperson often determines the approval or denial of an application. This lack of transparency also limits the ability of the developers to appeal the conditions that the committee has set for granting the permits, even when it seems that the conditions are not based on professional considerations – for example, when a developer is required to submit a certificate from the Fire Department, when there are no professional grounds for such a requirement, and obtaining the certificate could delay the construction of the project by at least a few months.

The power of the committee members and the committee engineers also affects their ability to set the level of the fees that the developers will be required to pay. These are mainly infrastructure fees and land improvement levies. Even though infrastructure fees are supposed to be set using a uniform formula, in practice, the calculation of area subject to infrastructure fees is dependent on the committee engineer's decision, as is the amount to be paid. Anecdotal accounts indicate that sometimes there are discrepancies of millions of shekels between the sums developers are asked to pay for similar projects in the same city. The local committee similarly has almost complete freedom in setting the level of the land improvement fees. Thus projects are often delayed because the developers file appeals and try to negotiate with the committees in order to lower these fees. In other cases, mainly when a fee is charged only for the areas approved for additional construction, the developers prefer to pay the high fees in order to avoid delaying construction, and pass this cost on to the end buyers.

The extensive leeway enjoyed by the clerks, committee engineers, committee members and committee chairpersons compels developers to constantly act in order to ensure that the permit applications they submit will be advanced from one stage to the next. In many cases this means that the developer or his agent makes regular visits to the local authority offices, to check with the clerks regarding the progress of the application, and to try to find ways to speed up the process. Often the reason for a delay turns out to be technical – for example, that some of the forms had to be submitted in more copies, because the photocopy machine at the committee's malfunctioned, or that they have to deliver certain forms in hard copy, rather than as e-mail attachments. A developer who does not visit the authority's offices in such cases is liable to wait a long time for the permit or could have his application denied for technical reasons, because the application did not even reach the discussion stage with local building committee.

Developers also usually try to maintain a good relationship with the municipal engineers and the committee members, particularly the committee chair, in order to improve the chances that the committee will approve applications. Testimonies from the field indeed indicate that developers with connections usually obtain permits more easily than other developers. Many developers therefore also often employ special workers whose duties include keeping in touch with the local committees. These employees are usually people with reputations of having connections with the local committees, and for an appropriate sum, they can persuade the clerks to keep the process moving quickly until applications are approved.

As noted above, developers often prefer to steer clear of local committees with which they are not familiar, as the length of time required for obtaining a building permit could erode the profits from the planned project. In such cases the competition in tenders over plots declines, such that there is an advantage for the developers who are already operating in that locale. These developers thus garner market power beyond the market power they would have in competitive conditions, because their ability to purchase additional land enables them to manage the construction in a manner that increases their profits both from future projects and from the projects under way when the additional land is acquired.

Solutions based on literature and the ramifications of implementing Binat Schwartz's reform in the current format (Amendment 101)

The situation described in the preceding sections is documented in the literature as a situation that encourages corruption, in that it presents an opening to public employees and public representatives to exploit their power for personal gain. This is because due to the lack of supervision of the clerks and public representatives, they can do things that can strengthen their status without paying a significant price.

The situation described in the preceding sections is documented in the literature as a situation that encourages corruption, in that it presents an opening to public employees and public representatives to exploit their power for personal gain.

In Israel, this is expressed, among other ways, in that many mayors and municipal workers, including municipal engineers, become embroiled in criminal affairs involving bribery. In 2013 the mayors of Jerusalem, Bat Yam, Ramat Gan, Upper Nazareth and nearly 40 other locales were either accused or convicted of offenses connected with building permits. In other words, 15% of the heads of local authorities in Israel were suspected of criminal offenses. In most of the cases, the suspicions were related to building permits. It is reasonable to assume that this phenomenon is much more widespread; if the risk of being caught and having to pay fines or serve prison terms were greater, the number of suspects would presumably be much lower, because the mayors would not behave in a manner that could be interpreted as illegal.

The prevalence of the phenomenon in which mayors are willing to make decisions regarding building permits is expressed in the fact that the conduct of the municipal building committees, which are chaired by either the mayor or his representative, depends largely on the character of the mayor himself, and on the character of the municipal engineer, who is appointed by the mayor. When the mayor is interested in the committee conducting itself with relative transparency, the committee functions in a manner that enables developers to follow the processing of the building permit applications they submit. Still, even the local committees that function in a relatively transparent manner, much of their proceedings are concealed from the developers and these latter have to invest energies in promoting their plans. In any event, in most of the committees, the processes are not transparent and developers need some influential ability to obtain their permits.

In many cases certain developers receive permits and variances despite many objections from the public, while other developers are delayed for long periods, even though they submitted similar plans to those that were approved for other developers.

There are also large discrepancies in the duration of the approval process.

The result is that in many cases certain developers receive permits and variances despite many objections from the public, while other developers are delayed for long periods, even though they submitted similar plans to those that were approved for other developers. There are also large discrepancies in the duration of the approval process. Even in a municipality in which the process is well-known and ostensibly orderly, such as Tel Aviv, developers have reported that even though most of the applications for building permits take 12 to 18 months, some permits were granted within just one month. A large rental housing project, for example, that the municipality was interested in promoting in order to garner positive media coverage, was approved within a month, while similar-sized condominium projects submitted by the same architect were delayed nearly a year and half before being approved.

Another result of the lack of transparency is that it is practically impossible to oversee the conduct of the committees. In many cases, for example, developers who submit applications for building permits do not receive official confirmation of the date the application was filed, making it impossible to trace the beginning of the processing of the application. It is also impossible to know the reasons for the extended duration of the process or the order in which the applications will be presented for discussion at each local planning and building committee meeting. Even requests by the Central Bureau of Statistics for data from the local committees are stymied, even though refusal to provide the bureau with information is theoretically a criminal offence.

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All these factors have a considerable effect on apartment prices in Israel. Developers who have invested in land purchases must pay financing costs. If a developer has to wait 12-18 months before commencing construction, these costs can be in the millions of shekels. In addition, since developers have no way of knowing how long they will have to wait for a building permit, they also have no way of knowing what conditions in the field will be when they start building and marketing their projects.

Since there can be significant changes in the year or two in the interest rates, the GDP, unemployment, the number of buildings under construction by other developers in the same region, etc. developers are taking a substantial risk, as they must pay for the land and the permit fees in advance. These costs are passed on to the apartment buyers, and in many cases constitute 10%-15% of the price.

The additional cost of this risk factor affects demand in the construction market. These days many developers prefer to work on large-scale renovation and expansion projects (such as Urban Plan 38) than on housing start projects. One of the main reasons is that in these combination projects the property owners receive apartments in the future project, such that if the project is less profitable than anticipated, the property owners' apartments will be worth less than estimated when the project contract was signed. This means that in Urban Plan 38 and similar projects the developers are sharing the risk with the property owners. For this reason many developers prefer these projects, even though they usually yield lower profits and add fewer new apartments to the market than new housing complexes on land that developers purchase from land owners or from the ILA.

The risk factor also deters developers from investing in regions in which the developers are unfamiliar with the local committee members and procedures. Many developers, especially small and medium-sized ones, operate only in a limited number of cities – usually only one or two. Many developers also refrain from investing in Tel Aviv, for example, because meeting the local committee's demands entails costs that make developing projects not worthwhile. As a result, the competition in the market is much smaller than one might expect, based on the number of developers, because each city has only a limited number of small developers and a few large developers who build most of the projects in the city.

A possible solution based on the public choice literature.

The solution proposed in the literature in such cases is to reduce the discretion of the clerks and increase the transparency of the process. Assuming that the current structure of a national committee, district committees and local committees for managing construction and development in Israel is to be retained, the building permit application process at the local committee level could be improved as follows:

1. The procedure must be identical in all locales. In order to verify that the procedure is being practiced identically, a computerized national system could be created for inputting the permit applications. This system would facilitate the tracking and reviewing of the conduct of each local committee. Thus developers would know in advance which documents to prepare for submitting with their applications and how to submit them, even if the developers have no experience working with a particular local committee.

The procedure must be identical in all locales. In order to verify that the procedure is being practiced identically, a computerized national system could be created for inputting the permit applications. This system would facilitate the tracking and reviewing of the conduct of each local committee.

2. Second, the process would have to be transparent with respect to the progress of the processing of the application. From the moment the application is filed, it will appear in the system and every developer will be able to see if his application has passed an initial review, been checked by the committee engineer, been scheduled for discussion by the committee, etc. This transparency will enable a developer who discovers, for example, that his application is stuck at some stage or other to check the cause of the delay. Ideally, a developer will also be able to know which clerks are responsible for handling his application at each stage, and contact them directly if there is a delay.

The transparency must also extend to a committee's decisions. The building committee will have to attach an explanation to every application that is denied. Thus a developer will be able to know if his application was not approved for pertinent reasons or for reasons that might be worth filing an appeal against the decision.

3. Third, every local committee would be allowed to publish a list of additional conditions that must be met before the committee will grant a building permit. These conditions will have to be determined in accordance with clear standards, such that an application that meets the standards will, in principle, also meet the conditions. These standards could, for example, be an expression of the local committee's aspirations for sustainable development, for apartments within a certain size range, to have a specific type of urban appearance, etc.
4. Fourth, in cases in which the committee has the authority to grant variances, the committee will publicize the conditions for receiving variances, as long as the public does not object. Thus every request for variances will be examined in accordance with standards that the committee will have issued in advance, and in accordance with the public's approval.
5. The only criteria that the application must meet in order to be approved are the compliance of the technical specifications in the application with the requirements of the building code; with the instructions in the information file for each project; and with the conditions published by the committee, as long as there was no request for variances and the developer's plans do not deviate from the previously approved plans. The compliance of the application with all these requirements can be verified by an approved external institute, which will examine the technical specifications and confirm them. Thus developers can be assured that their applications will be examined within a short time and that all the projects will be examined in a uniform and fair manner. The idea for these checks to be undertaken by an external institute is also consistent with the format proposed as part of the Binat Schwartz reform.

The only criteria that the application must meet in order to be approved are the compliance of the technical specifications in the application with the requirements of the building code; with the instructions in the information file for each project; and with the conditions published by the committee, as long as there was no request for variances and the developer's plans do not deviate from the previously approved plans. The compliance of the application with all these requirements can be verified by an approved external institute.

6. The committee will also publicize in advance the requirements for any additional documents that may need to be submitted, such as a certificate from the Fire Department, the Home Front Command, the telephone company or the electric company. For example, every building over a certain height and every project exceeding a certain number of housing units might be required to provide the Fire Department's approval of the plans.

If all these conditions are met, in most normal cases it will be possible to issue a building permit within a relatively short time span, because the developer will want to submit the plans to the examining institute, and after receiving the verification that the plans meet the criteria he will forward the confirmations to the committee and wait for the final decision. The committee will have to become involved in decisions and exercise its discretion only when an application deviates from the regular applications or when an application for a variance meets the committee's requirements but there is public opposition to it.

If applications are processed in this fashion, most of the decisions will be technical, such that the committee members and the clerks will have no reason to expect that they can profit from payments in exchange for intervening in the process. From the outset, this type of process will also remove any incentive for the developers to be in touch with the clerks and the building committee members, because such contacts will not be able to shorten the duration until the approval is granted, and will usually not be able to affect the nature of the decisions.

The committee members and the clerks will also have no reason to expect payments because when processes are transparent and the reasons for every decision are explained, the clerks and committee members will not be able to change a decision concerning an application that meets the requirements without the developer submitting an appeal. In that case, the appeal process will reveal that the committee denied an application for a building permit even though

the application met the requirements, and this will not only lead to the reversal of the decision, but will harm the standing of the clerks and committee members. In order for this harm to be significant, there should be a review mechanism that has authority, and which can punish committee members and revoke the rights of committees that do not meet the requirements.

Conclusion

The discussion in this chapter shows that the process for obtaining building permits is delayed for lengthy periods of time by the local building committees. This delay can often be a year or two even when a developer does not request variances or changes in the predetermined conditions.

The main reasons for these delays are apparently the lack of transparency of the process of handling the application and the extensive power that the clerks and local committee members have in accepting or denying building permit applications at whim.

From the developers' perspective, the uncertainty regarding the duration and result of the process of clarifying their applications have a significant impact on their willingness to buy land and try to build housing units in various locales. Many developers prefer to avoid buying land in areas under the jurisdiction of building committees with whose members they have no connections, because applications could get stuck for extended periods of time while the developers incur the financing costs of the purchased land without any way of generating cash flow, since the planned apartments can be sold only after the permits have been issued. The result is a decline in competition and higher apartment prices for consumers. In many cases the cost of the uncertainty and the lengthy building permit approval process, which is passed on to the apartment buyers, has been estimated at 10%-15% of the price.

The solution to the current situation, as proposed in the economic literature, is based on increasing the transparency and reducing the ability of the clerks and committee members to influence the handling and the outcome of the building permit application process, by defining requirements from the outset, such that the local committees will be compelled to approve every plan that meets those requirements.

The Binat Schwartz reform was designed to achieve these two goals, along with the simplification of the processes required in order to obtain permits. Still, the manner in which the reform was implemented, as part of Amendment 101 to the Building Law, is liable to miss these goals. At worst, it could even lead to increasing the authority of the clerks and local building committee members and increase their influence on the results of clarifying the building permit applications submitted to them, without significantly increasing the oversight and the transparency, which are necessary in order to increase efficiency.

KOHELET POLICY FORUM

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ISBN 978-965-7674-29-1



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