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Financing in the real estate market

By Ehud Lahav

In the real estate market, there are entrepreneurs who are trying to finance building projects by implementing the Tama 38 regulation. One such company is Kubirot.

Tama 38 refers to the National Urban Plan 38. Authorized on April 14, 2005, it was based on the fear that an earthquake could destroy many of the houses built before the 1970s. Israel is located in an earthquake-prone area in the Afro-Asian geological rift, and experts believe that the occurrence of a major earthquake is just a matter of time. Consequently, the government devised a plan whereby old apartment buildings in need of structural reinforcing would be granted permission to add two floors to the existing buildings if the necessary structural changes were implemented. This meant that the costs would not be borne by the landlords but by entrepreneurs who would implement the structural changes in return for the right to build the additional floors and sell the apartments.

What started as a plan to make old buildings resistant to earthquakes has also become part of the program to increase the housing stock in the major cities. The shortage of housing in Israel is most acute in the old established cities, especially in their historic centers – the downtown areas, where there is no available land.

Adding floors to existing buildings will add four to six apartments to each of these. This will increase the housing stocks in the downtown areas and will go a long way toward alleviating housing shortages in the cities.

This is a very lucrative business for contractors, and the profit margins are large. Most of the infrastructures necessary for a block of apartments already exist. Therefore, dispensing with the need to build the necessary infrastructures from scratch lowers costs.

The new apartments are sold according to market prices, which themselves are generally influenced by building costs. These are much higher for new building projects than for Tama 38 projects, hence the profit margins for the latter are high, very high. But these entrepreneurs usually face

problems obtaining the necessary financing. Tama 38 projects are mainly micro projects. Consequently, it is not the large development companies that implement Tama 38 projects but rather small, privately owned contracting firms. At present, banks are wary of financing real estate projects in general because of strict central bank regulations. This is especially so with relatively small contracting firms, and this is where Kubirot comes into the picture. It finances these small contracting companies that otherwise would not be able to finance their Tama 38 projects.

Shalom Eshel, the managing director of Kubirot, told *The Jerusalem Post*, "The difficulty in obtaining financing for Tama 38 projects is one of the main reasons the program does not take off as it should. It is a major stumbling block. I believe that over 70 percent of Tama 38 projects are stuck because of problems with financing. At Kubirot, we are willing in principle to finance such projects, provided they have a building permit and are located in the central area of the country, such as Tel Aviv, Ramat Gan, Givatayim, Herzliya and Ra'anana."

In essence, Kubirot is a venture capital fund. In contrast to high-risk VC funds that invest in science-oriented projects, it is a low-risk fund that enables small investors with not less than NIS 300,000 to invest in real estate. The company has a fund called Kubirot 1 that raised NIS 9.5 million. The money has been invested in four Tama 38 projects. The company is completing its second fund, Kubirot 2, which is raising NIS 10 million. This money will be invested in similar projects. The company is planning a third fund, Kubirot 3.

Two of the advantages of investing in Kubirot are the hefty returns and the short lifespan of the fund, which is between one and two years.

Eshel says that investing in Kubirot is a low-risk venture.

That is true real estate investments are generally low risk. But while it is true that Tama 38 projects have very high potential profit margins, the projects themselves tend to be complicated, and many things can go wrong that will decrease earnings.

Eshel agrees that there are no investments without risks but says that the risks involved in investing in Kubirot are minimal.

"Each fund invests in a number of projects, which means that the odds are spread out. Furthermore, we do not finance any Tama 38 project before it is thoroughly checked by our experts," he explains. "Our due diligence is extensive. We check on the contractor to see if he can deliver. We examine the location and the demand for real estate in the area because the income will be derived from the sale of the new apartments that will be built on the floors added to the structure. We check the figures to see if the costs and the income are feasible, and only then do we disburse the funds. The low level of risk is attributed largely to our expertise." ■■



Restored buildings
Courtesy Kubirot

