

# **HOUSING REFORMS**

IMPLEMENTATION CHALLENGES AND OPPORTUNITIES  
IN HOUSING POLICY AND PRACTICE IN THE UNECE REGION

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# EXECUTIVE SUMMARY

## 1 OBJECTIVES

The purpose of this study is to highlight the achievements and challenges in the implementation of national housing policies in countries with economies in transition. It provides a comparative review of housing policy reforms in the context of transition to democracy and market-based economy in 27 countries in the region. Given the immense diversity of housing conditions and policy responses, the comparative analysis focuses on four policy instruments essential for well functioning housing systems—regulatory, institutional, financial/fiscal and land administration policies. The implementation of these instruments is then related to the ability of housing systems to deliver better housing quality, to maintain stable levels of production and to provide affordable housing and choice. The analysis draws on most up-to-date research, comparative evaluations on the topic carried out by major international organizations and research institutes, the *UNECE Country Profiles on the Housing Sector and Land Administration Reviews*, as well as country specific assessments of housing policy reforms.<sup>1</sup>

Within this context the study has the following specific objectives:

- To evaluate progress in housing reforms in the countries under review focusing on regulatory, fiscal/financial and land management instruments;
- To review the performance of housing systems in terms of quality, investment, new production, affordability and choice;
- To provide strategic recommendations for priority actions and housing policy instruments that may be adopted to respond to significant challenges in the region.

Particular emphasis is given to the diversity of policy responses and performance challenges across the region, recognizing the impact of interrelated economic, social and political factors on national housing systems. The following country groupings are used—

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<sup>1</sup> UNECE has developed country profiles for the housing sector in fifteen countries including Azerbaijan (2010), Kyrgyzstan (2010), Belarus (2008), Georgia (2007), Serbia and Montenegro (2006), Russia (2004), Armenia (2004), Albania (2002), Republic of Moldova (2002), Romania (2001), Lithuania (2000), Slovakia (1999), Poland (1998) and Bulgaria (1996).

Eastern Europe, the Caucasus and Central Asia (EECCA), South-East Europe (SEE) and new European Union (EU) member states.<sup>2</sup>

The comparative study focuses on seven important housing policy domains critical for the efficient performance of housing systems and the design of well targeted, fiscally and socially responsible policies. The domains reviewed are: i) strengthening political support for housing reforms; ii) establishing reliable and effective housing institutions; iii) developing effective land administration and land management; iv) mobilizing housing finance and fiscal support; v) facilitating improvement in housing quality; vi) sustaining housing investment and production; and vii) enabling access to affordable housing and tenure choice.

## **2 STRENGTHENING POLITICAL SUPPORT FOR HOUSING REFORMS**

The common challenge of establishing a market system needs to be understood in the context of the important economic, political and social differences between the countries of the region at the outset of transition. These substantial differences have an impact on countries' housing systems with significant manifestations related to housing quality, tenure structure, output levels and affordability. Notwithstanding these differences, it is widely documented that housing under socialism was a political priority and considerable budget resources, investment and state institutions were deployed to address persistent housing shortages. At the start of the transition, housing lost this privileged status leading to massive withdrawal of the State from housing investment and direct provision of housing services.

Reform efforts during the 1990s have emphasized the importance of housing markets, privatization and private sector provision. The direction of change during this first phase of the reform process in all countries is similar, although significant variations exist in the speed of privatization and deregulation of the housing sector. Housing reforms introduced fiscally conservative housing policies, devolution of responsibilities to the local level and promoted homeownership. Housing subsidies were drastically reduced to less than 1% of

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<sup>2</sup> UNECE uses the following categories: Eastern Europe, the Caucasus and Central Asia (Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine and Uzbekistan); South East Europe (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Montenegro, Romania, Serbia, The former Yugoslav Republic of Macedonia, and Turkey), and new EU member states (Estonia, Latvia, Lithuania, the Czech Republic, Slovakia, Poland, Slovenia).

GDP and housing production left to private institutions with housing output by the private sector reaching 80%. While such reforms had a long-term impact on the supply side, the privatisation of housing through 'right to buy' policies dramatically transformed housing markets with long-term consequences for housing demand. Homeownership rates exceeded 90% across the region with the exception of a few countries such as Russia, Latvia, Ukraine and Poland.

*Risking oversimplification, the most significant policy efforts during the second phase of housing reforms, initiated in the early 2000, relate to measures implemented in the following areas: i) decentralisation and devolution in housing policy; ii) improvements in the legal and institutional framework; iii) reforms of housing finance and iv) new housing subsidy programs and rent reforms.* The development of a new legal framework has become the cornerstone of the reform process. Increasingly, new laws and regulations (e.g. Housing Acts, Constitutions, Civil Codes) and their enforcement have shaped housing policy, influencing in turn subsequent institutional changes and new institutional formation. Notwithstanding differences, the legal framework defining property rights, condominium management and mortgage lending was developed and implemented more efficiently in the new EU member states. Across EECCA and SEE countries privatization of state/public housing often proceeded without legislation on condominium management (e.g. Armenia, Belarus, Georgia, and Albania). Similarly, Poland rapidly adopted the legal structure for mortgage lending in the 1990s, while Russia, Ukraine, Montenegro implemented such reforms as recently as 2004.

In some EECCA countries, as the country profiles point out, housing reforms have been delayed by policy instability and poor governance. The sharp decline in living standards has caused great stress, undermined confidence in housing reforms resulting in deteriorating housing standards and informality (e.g. in Armenia, Georgia, Azerbaijan, Kyrgyzstan). In SEE the public sector both at the central and local levels has attempted legislative reforms, albeit with limited success. National housing strategies, action plans, and programmes, have often been sidetracked by political/electoral changes and budget deficits (e.g. Moldova, Albania and Serbia).

*Notwithstanding the significant differences among SEE and EECCA countries, there are several common challenges.* First, the legal framework has failed to catch up with dynamic

housing market developments. Frequent changes in existing legislation and/or introduction of sophisticated new legislation create a fair amount of uncertainty and may be counter-productive, at least in the short term. Second, incomplete legislation without specific provisions, often delegating responsibilities to the local government level, in view of administrative and fiscal constraints, may not be an effective way to implement housing reforms. Third, the effectiveness of rule enforcement, particularly in the context of rapid legal transition, is a significant challenge in terms of capacity for implementation, consistency and credibility. **In this context, strengthening political support for consistent housing reforms is important as well as a focus on the development of effective legislation to support reliable housing institutions.**

### **3 ESTABLISHING RELIABLE AND EFFECTIVE HOUSING INSTITUTIONS**

Since the development of housing institutions is determined by path-dependency, it is not surprising that the institutional change has failed to catch up with a more dynamic market driven process. For example, transforming the State role in housing requires more than its withdrawal from directing housing production and finance. It is crucial that the State is supportive of markets by providing a transparent and effective legal system and sound investment climate to improve housing market performance. Due to the social importance of housing, it also critical that the State facilitates the operation of a socially efficient housing system that enhances housing quality and affordability to alleviate the social costs of transition.

*In this regard, the housing profiles point to significant institutional constraints at the central level. Responsibility for housing policy is typically given to the ministries that do not control a large range of policy instruments to achieve real change. Furthermore, staff at the central level is often limited to a handful of policy officials who rarely have the capacity to monitor existing programs and cope with the demanding tasks of constant amendments to the legal framework. Cutbacks to public spending have had a detrimental impact on the ability of central government institutions to retain qualified staff leading to a significant 'loss of institutional memory' (Armenia, Georgia, Serbia) and elimination of national housing agencies (Moldova and Albania). Frequent changes in governance, particularly during the first phase of transition, has led to different and often conflicting priorities, 'stop-and-go'*

*housing programs and little effort to create strong and sustainable housing institutions at the central level.*

*At the local level, the reform process in the region has emphasized decentralization, deregulation and local autonomy.* In the new fiscal reality local authorities are seen as 'crisis managers' charged with a lot of responsibilities related to the provision of infrastructure and housing services, but without the corresponding resources to address those problems. Local governments are highly dependent on central government transfers and have limited possibility to raise funds through local taxes and fees, particularly in EECCA countries where property taxes are negligible. Reliance on donor funded projects, (e.g. in Serbia, Bosnia and Herzegovina, Azerbaijan and Kyrgyzstan) makes the need for sustainable local funding more important. Furthermore, in most EECCA countries municipal maintenance departments (ZhEKs) maintain privatised housing at regulated costs well below the required levels to improve its quality. State-set maintenance tariffs in Georgia, Armenia, Belarus, Russia, Azerbaijan and Kyrgyzstan cover only 20-40% of the costs and barely address emergency repairs.

Although the second phase of housing reforms, initiated in 2000, has attempted to address the institutional and regulatory 'vacuum' of the early 1990s, progress across EECCA and SEE countries has been uneven with respect to the extent and quality of legal provisions. *The comparative analysis identifies the most important challenges for the effective operation of housing institutions in the region as: i) lack of adequate institutional capacity of public institutions; ii) lack of effective institutional cooperation leading to bureaucratic structures, corruption, and red tape; iii) lack of adequate resources at the local level to fulfil housing mandates; iv) lack of well established, transparent and efficient private sector institutions in housing.* The quality and reliability of institutions is a critical dimension of the transition in housing governance, particularly with respect to private institutions. Housing markets do not function well if they are not competitive or if corporate governance of the housebuilding industry is poor. **Managing the transition in the governance of housing should therefore be about redefining the State as opposed to simply minimising it, and about improving the quality of public and private institutions and ensuring that they work well together.**

#### **4 DEVELOPING EFFECTIVE LAND ADMINISTRATION AND LAND MANAGEMENT SYSTEMS**

In many ways, the development of land management institutions that support housing markets and enhance private investment has been at the heart of the transition in housing governance. *The system of land management across the region has undergone a series of changes through land privatization, restitution, legal reforms, and improvement of land registration and cadastre systems.* In Russia, for example, over 50 million people and legal entities have acquired private ownership of land and 129 million hectares of land, comparable to the area of Western Europe, has become privately owned just within 4 years. Notwithstanding the scale of this rapid transformation, private ownership over urban land in EECCA countries was non-existent and the delayed transfer by the State often resulted in shortages, illegal occupation of public land and informal development.

In the context of land reforms and land privatisation, some countries have developed complete and accurate systems of property registration since the mid-1990s, while in others the process has been delayed by a decade. In Lithuania, Moldova, Romania and Bulgaria, for example, a high level of sophistication of the registration systems has resulted in integrated cadastral and property rights registration. *While most new EU member states have improved the efficiency of their registration systems, EECCA and SEE countries still experience a multitude of problems: (i) incomplete land registration systems; (ii) ineffective control due to inadequate institutional capacities; and (iii) lack of transparency in land restitution and privatization.* Furthermore, the coverage in the cadastre is often limited (e.g. in Montenegro, Serbia, Bosnia and Herzegovina up to 60%) and the information on illegally constructed buildings is not incorporated. In some countries where the scale of this construction (e.g. Serbia, Albania, Azerbaijan and Georgia) is so prevalent, affecting more than half of the new construction, the incomplete state of the cadastre constrains formal development and affects the cost of land with clear property title.

*In addition to the constraints created by the lack of complete land registration system, local governments face the challenge of regulating development in the absence of a new generation of regulatory master plans and clear legal and technical frameworks.* Montenegro and Georgia, for example, lack updated urban plans for over 60% of the territory and the situation in Azerbaijan and Kyrgyzstan is even more challenging. Frequent changes in the normative and legal basis, new construction laws, standards and

norms and the lack of normative standards for enforcement is a significant constraint for the small and often underfunded departments that deal with building and occupancy permits. Furthermore, complex and less transparent systems for construction permits and licenses contribute to delays and abuse and inadvertently lead to informal housing. **In this context, policy reforms to establish effective and sustainable land management systems, particularly in countries with high share of informal development, need to urgently address the fragmented character of the planning, housing and land reforms.**

## **5 MOBILIZING HOUSING FINANCE AND TARGETED FISCAL SUPPORT**

Different types of housing finance systems exist in the region—contractual system, commercial bank model, mortgage bank model, and the secondary mortgage bank model. The volume of mortgage lending across different countries indicates a positive relationship between progress in housing reforms and competitiveness in the banking sector. Estonia and Latvia stand out with mortgage debt exceeding 30% of GDP, and growth rates are indeed impressive for Albania, Serbia and Ukraine (over 85%), albeit from a very low base. Notwithstanding these positive developments, mortgage lending is largely confined to the more affluent groups, who can finance significant down payments and show evidence of regular incomes.

The housing profiles point out to significant differences in the extent of mortgage/housing lending in the countries reviewed. Given the more demanding institutional and operational requirements, it is understandable that the development of primary mortgage markets has been lagging behind in EECCA and SEE. First, countries that have addressed the barriers in the banking sector in general have better functioning housing finance systems. Second, development of mortgage markets is also dependent on effective institutions regulating property rights, cadastre registration and foreclosure. Third, demand factors affect the growth of housing loans such as growth in incomes, saving capacity as well as subsidies and tax treatment of interest payments also explain cross-country differences in mortgage lending.

The secondary mortgage market does not exist in most countries and the main limitations to its development are the depth of financial markets and the lack of institutional investors.

In several countries (e.g. Russia, Kazakhstan, Azerbaijan, Belarus), State agencies have stepped in to overcome the absence of long-term sources of finance. *Competition in the provision of financing for housing, particularly in those countries with more advanced systems, has driven the introduction of new mortgage products and better financing conditions. Typically over the last decade, repayment terms have been lengthened, loan-to-value ratios have increased, and interest rates have fallen, all of which improve affordability.* These changes have played a significant role in supporting the growth of mortgage lending in the most dynamic markets, often in capital cities.

*Fiscal policies in the housing sector use a mix of policy instruments. The mix is complicated to evaluate since there is no systematic assessment of different government programs (central or local) in terms of their efficiency (costs), targeting and effectiveness (outreach).* In most countries housing subsidies, excluding war reconstruction and refugee related programmes, are less than 1% of GDP. Most of the support aims at homeowners providing a combination of public provision and demand-based assistance (grants, interest subsidies and tax incentives). Romania, Hungary, Poland, Russia, Slovakia and the Czech Republic have the most comprehensive housing programs, while in Bulgaria and The former Yugoslav Republic of Macedonia housing has almost disappeared from the policy agenda in the last fifteen years. Other countries such as Albania, Republic of Moldova, Azerbaijan, Belarus and Georgia, to name a few, are grappling with major economic difficulties, which reduce fiscal support to a limited set of policy measures with inefficient targeting.

*The 'trial and error' approach to different subsidy schemes has been plagued by populist policies and inability to establish sound and transparent fiscal policies.* Hungary, Estonia, Lithuania and Poland, for example, have experimented with a variety of demand- and supply-side subsidies to increase housing investment with constant adjustments in the level of subsidy, interest rates and loan amounts. Similarly, a large number of countries have grants and subsidies for homeowners with a mix of programs assisting war reconstruction (Bosnia and Herzegovina, Croatia, Georgia, Azerbaijan) and subsidies to purchase or renovate housing through contract saving schemes (Slovakia, the Czech Republic, Romania). Tax incentives for homeowners are applied in Romania, Poland, Hungary, Russia and Croatia.

In summary, housing and banking sector reforms in the second phase of transition have improved the availability of long-term financing for housing and the diversity of mortgage products. *Still in many countries across the region Governments continue to identify the lack of housing finance as a main constraint for efficient operation of housing markets and State housing institutions act as a substitute for market-based finance.* Mortgage lending is subsidized in most countries through soft loans, deductibility of interest payments, grants and a myriad of housing programs tied to new housing construction. These subsidies, relatively more generous at the start, have been adjusted over time in an attempt to catch up with market dynamics while maintaining a more sustainable system of housing finance. **In this context, Governments across the region need to address the lack of financial transparency in housing policy and fiscal sustainability and improve the targeting of existing housing programmes. The majority of subsidies are regressive in nature, supporting access to homeownership, while little government funding is directed to public rental housing, means-tested support or assistance of low income households.**

## **5 FACILITATING IMPROVEMENT IN HOUSING QUALITY**

The transition process towards market-based housing systems has exacerbated the initial differences in housing conditions across the region leading to deterioration of housing infrastructure and growth of substandard housing in most EECCA and SEE countries. War-related conflicts in the Balkans, Georgia and Azerbaijan have resulted in a housing crisis, massive need for reconstruction and demanding provision for refugees and IDPs exceeding the ability of governments to cope with such challenges. Almost 7 million have become refugees or internally displaced (IDPs). *These are indeed the new faces of urban poverty associated with housing deprivation and social exclusion.* People often inhabit tent camps and temporary housing in unsafe and impoverished areas with limited connections to water and sewer on the outskirts of cities such as Podgorica, Belgrade, Baku, Sarajevo and Tbilisi. *Countries in the region experiencing informal settlement growth are grappling with the same set of systemic problems related to lack of access to affordable housing, inefficient planning and land management systems as well as growing urban poverty, though in very different national contexts.*

*Beyond growing poverty and informality, an important challenge for housing quality in region is related to the growing share of unsafe and substandard housing due to systematic disinvestment and deferral of maintenance as well as lack of improvements and energy efficiency retrofits in multi-family housing. About 10% of the urban population in the new EU member countries lives in substandard conditions without access to basic services and/or in overcrowded dwellings, while in EECCA countries more than half of the urban population lives in such conditions (56% in Tajikistan, 52% in Kyrgyzstan and 51% in Uzbekistan). Elsewhere in the region these rates are 30% for the Republic of Moldova and 19% for Romania, Bosnia and Herzegovina and Croatia. The question of housing deficits has become less relevant to market realities; in fact a lot of countries have a significant housing surplus. Some EECCA countries, however, have experienced delayed urbanisation since the start of the transition, which added to much stronger population growth rates, has created acute housing shortages. In Tajikistan population growth from 1998 to 2005 was 16.5%, while the growth in the housing stock was only 9%. Similarly in Kyrgyzstan, Bishkek with 200,000 migrants from rural areas, reportedly experiences acute housing shortages. In Dushanbe, the capital of Tajikistan, the city's population has reached close to 1 million due to rapid migration creating a potential deficit of 100,000 dwellings.*

*With respect to basic housing quality, the available data indicate modest improvements in the share of housing serviced with piped water and sewer since the 1990s. However, the situation in EECCA countries is particularly problematic in countries such as Moldova, Georgia and Uzbekistan with services available in one third of the stock. In SEE, Albania and Bosnia and Herzegovina stand out with over half of the housing lacking piped water. Patterns of significant urban-rural inequality in access to basic water and sanitation persistently define problematic housing quality in most countries. Due to fiscal constraints, local governments have failed to invest in technical infrastructure, resulting in deterioration in water supply and central heating networks, lower quality and interruption in services. Substantial problems are known to exist in the water supply in Albania, the Republic of Moldova, Georgia, Kyrgyzstan and Ukraine, while sanitation is particularly problematic in Belarus, Georgia and Russia.*

*The housing profiles consistently point out to one of the most significant challenges associated with the deteriorating quality of privatised multi-apartment housing. Inadequate*

*investment in maintenance as well as deferred capital repairs have aggravated the technical problems with leaking roofs, obsolete installations, elevators and poor wall insulation.* Panel technologies, which featured prominently in Russia, Lithuania, Bulgaria, Republic of Moldova, Romania, Georgia, Kyrgyzstan Tajikistan and Azerbaijan, resulted in large scale developments with demanding requirements for their housing management. Multi-apartment panel blocks account for nearly half of the urban housing stock in Armenia, Bulgaria, Romania, the Czech Republic and Moldova and for 67% in Georgia. The energy efficiency of the stock is very low and with the deregulation of energy costs and the elimination of subsidies, households were faced with disproportionately high costs for heating, crowding out the ability to invest in other housing related costs. The improvement is constrained by the lack of effective organisational and financial framework. Condominium associations exist in less than 20% of privatised housing and both management functions and ownership of common areas in EECCA countries are still vested with municipalities. Furthermore, the financing of rehabilitation requires specially designed credit lines and some incentives (tax exemptions, rebates, etc) to facilitate the process. Very few countries have launched national programs to assist this process (e.g. Latvia, Lithuania, Hungary, the Czech Republic and Slovakia) with limited impact. **Within this context, the development of systematic programs to improve housing quality, infrastructure provision and management of multi-apartment housing should be a strategic priority across the region. Governments in EECCA and SEE should effectively mobilize national and international support to provide sustainable housing solutions to refugees and other vulnerable groups residing in substandard and informal housing.**

## **7 SUSTAINING HOUSING INVESTMENT AND PRODUCTION**

Competition and penetration of the market in the housing provision system have facilitated the development of a more diversified structure with speculative and informal housing becoming dominant as opposed to State-funded and State-built housing. Due to privatisation small firms and individual households now account for over 85% of the total output. *These rapid shifts on the supply side have resulted in better quality and more diversity of the final product. As might be expected, market agents, largely profit motivated, respond to effective demand rather than need. As a result, low-income and socially marginalised households face increasing housing problems manifested in their inability to afford*

*adequate housing and increasingly house themselves through informal housing solutions.* Speculative housebuilding has grown in importance, accounting for more than half of the output in the urban markets of the new EU member states and in SEE. Equity financing and remittances are the dominant source of funding both for multi-family and single-family housing, particularly in countries with underdeveloped markets for construction finance.

Available time series data on new housing construction indicate different subregional patterns. Housing construction has collapsed in the early 1990s reaching historically low level due to withdrawal of State funding. It has shown signs of recovery in the second phase of the transition, particularly in the new EU member states and SEE, reflecting macroeconomic stability, rising consumer confidence and availability of mortgage credit. The level of new production is around half of the level in the 1990's, but in a number of SEE countries the large share of informal housing development is excluded from these statistics. The impact of the turbulent economic and social transition on housing output across the EECCA countries is equally significant. In Azerbaijan output in 2002 was 50% of the 1993 level, in Kazakhstan - 23%, in Ukraine-35% and in Georgia-40%, partly fuelled by some government programs.

*Despite differences in the housing systems in the region, Governments in most countries have adopted and continue to apply, even in times of strict public expenditure constraints, a number of instruments to provide a continuum of affordable housing options ranging from non-market (emergency shelters, social housing) to market based options (entry level private rental housing and affordable homeownership).* Central, local governments and international donors provide financial support to increase the provision of affordable housing, but the output is rather limited (less than 2% annually) compared to need. The housing profiles feature a number of experimental projects and programmes launched during the second phase of the housing reforms. The projects in Serbia, Montenegro, Romania, Russia, Belarus and Azerbaijan illustrates the diversity with respect to three important characteristics: i) *target groups* - ranging from vulnerable households, refugees, seniors to young households and middle class homeowners; ii) *options along the housing continuum* - from shelters, assisted housing to social rental housing and affordable homeownership; and iii) *level of public subsidy* - from extensively subsidised projects to projects operating with means tested and shallow subsidies.

*In the context of fiscal austerity, it is not surprising that very little new social housing has been provided in the region. Poland is a notable exception with a vibrant limited-profit housing sector since 1995, accounting for 5-7% of the housing output and relying heavily on preferential loans and subsidized access to land. In several countries (Poland, the Czech Republic, Romania and Slovakia) social housing accounts for less than 10% of housing completions in the last 5 years, while in most other countries (Albania, Macedonia, Hungary) new small scale social housing programs for marginalised groups have been initiated since 2002.*

In summary, given the recession in new construction during the last two decades, a large cut back in residential capital has occurred. Housing production capacity in the region has remained limited due to a shortage of affordable housing construction finance and shortages of serviced land with clear title and planning permit. The market-based system is delivering better quality with more variety and choice for consumers, but at a price that excludes most households from access to it. *As a result, the previous shortage of housing has been replaced by a shortage of affordable housing. Despite a growing need for affordable rental housing, policy action focusing on building a continuum of housing for a variety of needs has been extremely limited.* **Future policy reforms need to implement policy measures that increase the supply of new affordable housing, particularly for socially disadvantaged groups.**

## **8 ENABLING ACCESS TO AFFORDABLE HOUSING AND TENURE CHOICE**

*Affordability of housing remains the fastest-growing and most pervasive housing challenge in the region. Housing costs have increased with significant implications for access to adequate and affordable housing, particularly for vulnerable groups.* Data on household expenditure—housing, water, electricity and gas—show that housing costs account for more than one fifth of total household expenditure in the new EU member states. The highest share is reported for Slovakia (28%), followed by the Czech Republic (23.5 %), which is 3 to 4 times higher than housing costs in Belarus, Azerbaijan or the Republic of Moldova. Not surprisingly, housing costs are much higher for those at risk of poverty, reaching 40% in the Czech Republic and 49% in Slovakia. While the data for SEE and EECCA countries are limited, the housing sector has been sheltered from price adjustments due to high levels of poverty and housing shortages for IDPs and other vulnerable groups. Utilities are still heavily subsidised as well as maintenance through

regulated management fees in multi-apartment housing. Despite such implicit subsidies in the sector, homeowners find it increasingly difficult to pay the cost of housing services which systematically erodes the quality of the housing stock.

Available data also highlights some important differences with respect to affordability and choice. First, a large segment of homeowners lives in mortgage free housing. In Latvia, Lithuania and Slovakia this share is higher than 80%. Housing represents a large proportion of household wealth as house prices have risen faster than earnings. Second, mortgage debt has also risen sharply in relation to household income, especially in Estonia and Hungary, where homeowners with mortgages are close to 15% of the population. Third, a smaller share of the population lives in subsidised or market rent accommodation, with the Czech Republic, Latvia and Poland having 11-30% of the people living in rent free housing. In a number of SEE countries, public rental housing (less than 3%) tends to function as a safety net for poor households with zero rent.

*Tenure choice is important for long-term housing market stability and access to adequate and affordable housing. Most countries in the region have a polarised tenure structure with excessively high share of owner occupation and a small and residual sector of publicly owned housing with a social purpose.* Homeownership has grown steadily in most countries, particularly as a result of privatization policies. Social or non-profit rental housing is owned by local governments or social housing providers. Its share is significant in several countries (Poland, the Czech Republic, Ukraine and Russia) but is declining gradually through continuing transfers to sitting tenants. In most transition countries, social housing is not really defined in the legislation; however, public rental housing gradually assumes this function. In EECCA countries, where *social housing* is less than 2%, local governments are left with the worst stock in a poor state of repair and with the poorest tenants.

Households, particularly in EECCA and SEE countries, have limited resources to sustain their homeownership status acquired through privatisation or during state socialism under a universal subsidy regime. With few alternative options, new households may be pushed into owner occupation when financially stretched. Tenure choices are much broader in Poland, the Czech Republic, Ukraine and Russia thanks to a tenure structure offering a continuum of housing opportunities ranging from social to private renting to

homeownership. By contrast, in most other countries the rental option is severely curtailed, although an informal private rental market exists (e.g. Albania, Georgia, Serbia). The opportunity for a decent rental home in the private rental sector is non-existent, with the exception of countries where its share has increased due to restitution (The Czech Republic and Latvia). However, over time rent deregulation has made it less affordable.

**Within this context, Governments need to consider a major shift in housing policies to address growing affordability problems of the urban poor and socially vulnerable groups through an appropriate and targeted subsidy system. Such policies should emphasize strategic approaches to the provision of affordable rental housing to enhance tenure choice and the provision of means-tested demand assistance.**

## **9 RECOMMENDATIONS FOR A STRATEGIC POLICY FRAMEWORK AND ACTION**

A resilient and sustainable housing system in the region can contribute to economic growth, prosperity and poverty alleviation. Improvement of housing conditions and quality has undeniable positive welfare effects for households and local communities. Since housing accounts for a growing share of investment, wealth and finance, when managed effectively it can be an important source of financial stability and economic resilience. Given the durability of housing and its capital intensive nature, resilience means stability of investment and growth in the system as well as sheltering the sector from extreme economic and political shocks. Perhaps equally important is the ability of the housing systems to ensure improvement in housing quality, affordability and tenure choice. Such outcomes depend on sustained political commitment to efficient and equitable housing policies as well as long-term strategic programs to assist access to affordable housing.

The study reviewed achievements and challenges of housing policy reforms in seven domains critical for the efficient performance of housing systems and the design of well targeted (effective) and sustainable (fiscally and socially responsible) policies. On the basis of comparative, evidence based research the study suggests that better policy environment and the use of well designed policy instruments—regulatory, fiscal, financial and land management—can facilitate better performance of the housing system. More importantly, the research indicates that certain policy instruments, introduced in more advanced reformers, can improve housing quality, affordability and tenure choice in a

more effective manner. Important policy recommendations address the most significant challenges in the region—the growing shortage of affordable housing, deterioration of the existing multi-apartment stock and the proliferation of informal settlements. While different countries may chose a different mix of policy instruments, the study advances a framework for strategic housing policy intervention in seven priority areas presented in the matrix below. Specific policy tools for implementation associated with each of the seven clusters are presented in Boxes 4, 9, 12, 17, 23, 27 and 29.

### STRATEGIC HOUSING POLICY FRAMEWORK

STRATEGIC RECOMMENDATIONS	PRIORITY ACTIONS FOR IMPLEMENTATION
<b>STRENGTHENING POLITICAL SUPPORT FOR HOUSING REFORMS</b>	
<p><b>1: Strengthen political support and develop effective legislation to resolve persistent housing problems.</b></p>	<p>Housing needs to be a political priority due to the scale of the present problems and the social and economic significance of the housing sector. Reforms need to be addressed in an integrated way through systematic changes in the legal, institutional and financial framework. Governments should focus on more strategic interventions, streamline housing priorities, rationalize the legal framework and reinforce implementation in order to promote a more sustainable housing policy that facilitates investment and improvements in housing quality and ensures access to affordable housing. The focus of legal reforms in EECCA needs to shift towards the strengthening of the consistency of legislation and towards establishment of adequate capacity for enforcement, particularly in areas of condominium management and mortgage lending.</p>
<b>ESTABLISHING RELIABLE AND EFFECTIVE HOUSING INSTITUTIONS</b>	
<p><b>2: Strengthen central and local government institutions in housing policy and improve governance in the sector</b></p>	<p>Governments in the region should urgently address the problems caused by weak housing institutions and ineffective housing governance. They should strengthen the mandate and capacities of the central and local government institutions in housing policy, and should improve institutional coordination, mobilization of funds for housing program implementation and enforcement. In EECCA countries governments should work to improve the quality and the efficiency of private sector housing institutions, including market intermediaries and non-government institutions, to improve the functioning of housing systems at the national and local levels.</p>
<b>DEVELOPING EFFECTIVE LAND ADMINISTRATION AND LAND MANAGEMENT SYSTEMS</b>	
<p><b>3: Address effectively the problem of informal housing through integrated planning, housing and land administration reforms</b></p>	<p>Governments in all EECCA and SEE countries should focus on strengthening the efficiency of land administration system and on the systematic integration of planning, housing and land reforms to address the problem of informal housing. Efforts should target the completion of nationally unified land registration databases, the efficient operation of land registry offices according to international standards and the simplification of procedures for registering land and real estate. Sustainable solutions for informal settlements need to become a priority at the local, national and international level.</p>

<b>MOBILIZING HOUSING FINANCE AND TARGETED FISCAL SUPPORT</b>	
<b>4: Establish an efficient system of housing finance and innovative fiscal and financial instruments to support access to affordable housing</b>	Governments in the region should focus on establishing an efficient housing finance system and on the design of innovative fiscal and financial instruments to support access to affordable housing. These instruments, although different in SEE and EECCA countries, need to be resilient to political and economic instability, sustainable over the long term, and well targeted. Priority should be given to adequate fiscal support to low income households experiencing affordability problems and homelessness.
<b>FACILITATING IMPROVEMENT IN HOUSING QUALITY</b>	
<b>5 Develop systematic programs to improve housing quality, infrastructure provision and management of multi-apartment housing</b>	Governments in all countries should focus on developing systematic programs to improve housing quality and distributional efficiency. Considering the wide differences in terms of housing quality, these programs should set country specific priorities and target two policy domains—improvement of housing infrastructure and multi-family housing through energy efficiency retrofits. Efforts should be placed on designing a mix of policy instruments—regulatory, financial and fiscal—to mobilise private and community sector response to achieve tangible results. In addition, Governments in EECCA and SEE should effectively mobilize national and international support to provide sustainable housing solutions to refugees and other vulnerable groups residing in substandard and informal housing.
<b>SUSTAINING HOUSING INVESTMENT AND PRODUCTION</b>	
<b>6: Implement policy measures that increase the supply of new affordable housing, particularly for socially disadvantaged groups</b>	Governments in the EECCA and SEE countries should implement policy instruments that enable more efficient access to construction finance and serviced land for new housing construction. Policy action focusing on legislative and financial opportunities to build a continuum of affordable housing such as public and non-profit rental with targeted government support should receive a priority. In low income countries, sites and services options should be systematically explored, mobilizing self-help, microfinance and remittances for affordable housing solutions.
<b>ENABLING ACCESS TO AFFORDABLE HOUSING AND TENURE CHOICE</b>	
<b>7. Address the shortage of affordable housing by efficient and effective systems of fiscal and financial support</b>	Governments in all EECCA and SEE countries need to consider a major shift in housing policies to address affordability constraints of the urban poor and socially vulnerable groups through an appropriate and targeted subsidy system. Such policies should emphasize strategic approaches to the provision of affordable rental housing to enhance tenure choice and the provision of means-tested demand assistance. Other important priorities refer to improved targeting of affordable housing programmes and cost recovery principles in the rental sector.

# 1 OBJECTIVES AND APPROACH

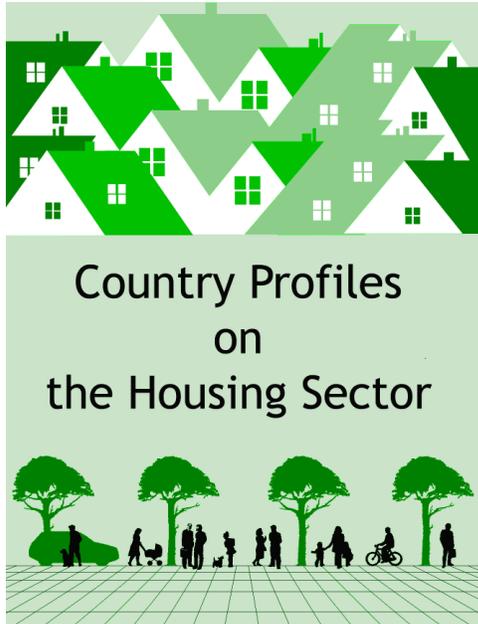
The purpose of this study is to highlight clearly the achievements and challenges in the implementation of national housing policies in countries with economies in transition. It provides a comparative review of housing policy reforms in the context of transition to democracy and market-based economy in 27 countries in the region. Given the immense diversity of housing conditions and policy responses, the comparative analysis focuses on four policy instruments essential for well functioning housing systems—regulatory, institutional, financial/fiscal and land administration policies. The implementation of these instruments is then related to the ability of housing systems to deliver better housing quality, to maintain stable levels of production and to provide affordable housing and choice (Angel, 2000; Boelhouwer and Heijden, 1992). This analytical framework, consistent with the framework applied in the UNECE housing profiles, also defines the structure and the approach of the study (see Box 1).

The study is intended to address major policy challenges in the development of appropriate regulatory, fiscal and financial instruments to enable the operation of housing markets and access to affordable housing. Although the assessment draws on individual housing profiles carried out by UNECE, it provides a valuable comparative perspective of progress and challenges affecting housing policy and practice in the region. As such, it aims to assist policy development and to identify lessons from good practices that can be instrumental in establishing a more efficient and equitable housing policy at the national and regional level. Within this context the study has the following specific objectives:

- To evaluate progress in housing reforms in the countries under review focusing on regulatory, fiscal/financial and land management instruments;
- To review the performance of housing systems in terms of quality, investment, new production, affordability and choice;
- To provide strategic recommendations for priority actions and housing policy instruments that may be adopted to respond to significant challenges in the region.

Particular emphasis is given to the diversity of policy responses and performance challenges across the region, recognizing the dynamic nature of interrelated economic, social and political aspects of the transition.

### Box 1 United Nations Economic Commission for Europe (UNECE) Housing Profiles



The country profiles on the housing sector are intended to assist the Governments of countries with economies in transition in improving the performance of their housing sector while promoting sustainable development. They analyse trends and policy developments, and make an overall assessment of the political, economic and social framework of the sector in the process of reform. This work was initiated by the United Nations Economic Commission for Europe (UNECE) and its Committee on Human Settlements in the early 1990s in response to requests from its member States. The studies are carried out by international teams of experts in cooperation with governmental bodies, nongovernmental organizations, local authorities and the private sector. Through a process of broad consultations, the experts carry out a comprehensive analysis of the housing sector,

draw conclusions and make recommendations to help policy makers develop strategies and programmes.

The country profiles apply a consistent framework for analysis that explores legal, financial and institutional frameworks affecting national housing systems. The framework also includes a critical reflection on important trends and issues affecting the provision of new housing and the quality and tenure of the existing housing stock. In some of the profiles, with economic and social transition well advanced and framework conditions for the housing sector in place, the analysis has focused on specific cross-sectoral issues such as land management and urban planning and/or social housing for vulnerable groups and refugees.

UNECE has developed country profiles for the housing sector in fifteen countries including Azerbaijan (2010), Kyrgyzstan (2010), Belarus (2008), Georgia (2007), Serbia and Montenegro (2006), Russia (2004), Armenia (2004), Albania (2002), Republic of Moldova (2002), Romania (2001), Lithuania (2000), Slovakia (1999), Poland (1998) and Bulgaria (1996).

The profiles are widely disseminated to all concerned stakeholders – policy makers and legislators, government officials, academics, NGOs and other national stakeholders, as well as international organizations, including lender and donor organizations, technical assistance agencies, or private sector investors.

*Source: ECE 2003a, 2005, 2008*

The study is prepared for the first *Housing Forum: Europe & Central Asia* organised in Budapest in April 2011. It is expected to inform the policy discussions at the forum and to contribute to the development of a *Vision for Housing in Europe and Central Asia*. Its methodology is based on content analysis of housing policies, quantitative time series data and evidence from publicly available government reports, academic publications and housing market assessments. The analysis draws on comparative evaluations on the topic carried out by major international organizations and research institutes, the *UNECE Country Profiles on the Housing Sector and Land Administration Reviews*, as well as country specific assessments of housing policy reforms. It incorporates statistics and housing indicators from officially published sources of information and international databases. Where possible, housing challenges and policy responses are reviewed on a subregional basis using three clusters consistent with UNECE terminology: (i) new EU member states; (ii) South East Europe (SEE); and (iii) Eastern Europe, Caucasus and Central Europe (EECCA). The study is illustrated by concrete examples of housing policy implementation across the region in order to capture different challenges and achievements to date.

Recognizing the complexities of interrelated factors affecting housing systems across the region as well as the diversity of policy responses, the study focuses on seven priority domains:

- Strengthening political support for housing reforms
- Establishing reliable and effective housing institutions
- Developing effective land administration and land management systems
- Mobilizing housing finance and fiscal support
- Facilitating improvement in housing quality
- Sustaining housing investment and production
- Enabling access to affordable housing and tenure choice.

On the basis of comparative, evidence based research the study provides recommendations to governments that focus on the role of effective legal framework, stronger housing institutions, robust system of housing finance and efficient land management for the development of sustainable housing policy solutions. The recommendations propose a mix of policy instruments—regulatory, fiscal, financial and land management—organised in seven priority clusters.

## 2. STRENGTHENING POLITICAL SUPPORT FOR HOUSING REFORMS

### 2.1 PROGRESS ACHIEVED AND PROBLEMS ENCOUNTERED

#### *Housing Reforms on the Political Agenda*

Following the political changes in 1989, various reform initiatives were carried out in the region to transform the housing sector. Housing reforms were motivated by pressures to reduce budget deficits and to move away from macro regulation and direct subsidisation of housing supply to a market-oriented housing sector (ECE, 1997). The common challenge of establishing a market system needs to be understood in the context of the important economic, political and social differences between the countries of the region at the outset of transition. These substantial differences have an impact on countries' housing systems with significant manifestations related to housing quality, tenure structure, output levels and affordability. Notwithstanding these differences, it is widely documented that housing under socialism was a political priority and considerable budget resources, investment and state institutions were deployed to address persistent housing shortages. At the start of the transition, housing lost this privileged status leading to massive withdrawal of the State from housing investment and direct provision of housing services.

Recognising that different points of departure had a considerable impact on choices and reform strategies, evaluations of housing policy in transition have acknowledged two uniform trends: i) housing policy has taken a back seat on the political agenda; ii) a residual housing policy, often targeting specific housing measures and/or groups, has been introduced (Hegedus et al, 1996; Struyk, 2000). *The transition imperatives of structural reforms, private sector growth, and fiscal deficits naturally crowded out efforts to maintain housing as an important element of the welfare state.*

In general terms all countries in the region focused their housing policy reforms on strengthening market forces and reducing State intervention in the housing system. Those policies in the first phase of the transition, starting in 1990s, promoted deregulation of housing markets, increased the role of private sector institutions and reduced public expenditure. The reforms also involved the privatisation of public assets – public housing and state construction enterprises. The practical implementation of the reforms across

countries, mirrored in their macroeconomic performance and prolonged recessions, resulted in collapsing housing output, runaway house price inflation and rapid growth in homeownership (ECE, 1997). The elimination of extensive and universal housing subsidies was particularly successful in reducing the public deficit. Most Eastern European countries were spending over 5% of their GDP on housing with another 5% allocated to subsidise utility costs. These figures were even higher in the former Soviet Union. Under the new regime of fiscal austerity, housing subsidies across countries in the region were reduced to less than 1% of GDP in most of the cases (Tsenkova, 2008). Led by public expenditure considerations, housing policy makers rapidly deregulated the housing provision system leaving the supply of housing services to the new market institutions with housing output by the private sector increasing to 80% of total output. While such reforms had a long-term impact on the supply side, the privatisation of housing through 'right to buy' policies dramatically transformed housing markets with long-term consequences for housing demand.

The privatisation of public housing in Eastern Europe involved the transfer of more than 3 million homes just within the first four years of the transition. This was in effect a huge off-budget subsidy as apartments were transferred to sitting tenants for free, in exchange for vouchers or for symbolical payment. In countries where privatization was delayed (Estonia, Latvia, Slovakia, the Czech Republic and Poland), it was completed in the second phase of the transition reforms initiated at the end of the 1990s and/or left at the discretion of municipalities. Across EECCA countries privatization was the flagship of housing reforms with much more significant impact due to limited private ownership over housing. *Levels of homeownership across the region exceed 80%, creating nations of homeowners over a very short period of time.* In fact, some of the poorest countries exceed 95% (see Figure1). The second phase of housing reforms, from 2000 to 2010, is far from uniform. While housing is still not a political priority, different policy choices are directly related to the economic restructuring and the wider context of social and political change. In general terms housing reforms have proceeded through 'trial and error', focusing on addressing housing market problems rather than strategic intervention (ECE, 2010a; Tsenkova, 2003). There have been limited attempts to launch more strategic interventions. All countries have housing action plans, strategies and a myriad of 'stop-

and-go' housing programs, but implementation is limited and the commitment inadequate (ECE, 2008; Leckie, 2002; World Bank, 2002).<sup>3</sup>

*Risking oversimplification, the most significant reform measures during the second phase relate to: i) decentralisation and devolution in housing policy; ii) development of adequate legal and institutional framework; iii) reform of housing finance and iv) new subsidy programs and rent reforms.* Despite the economic and social hardships, it is interesting to note that there has not been a popular backlash against the housing policy reforms, even in countries where independence brought to the fore unresolved ethnic tensions, conflicts and war. Rather, the choices have been driven by efforts to sustain the liberalisation of housing markets and to ensure supportive legal and institutional environment. The devolution of housing responsibilities to the local government level also contributed to the loss of political support for comprehensive housing policy from national governments. This coupled with rapid decentralization of local governments and their fiscal dependence on central government transfers, has pushed housing even further down on the political priority list. Local governments, particularly outside of capital cities, have limited ability to mobilise funds for capital intensive housing programs. Furthermore, capacity constraints, frequent political changes and unfunded mandates related to delivery of social services and housing for the most vulnerable have become significant constraints for housing policy implementation at the local level.

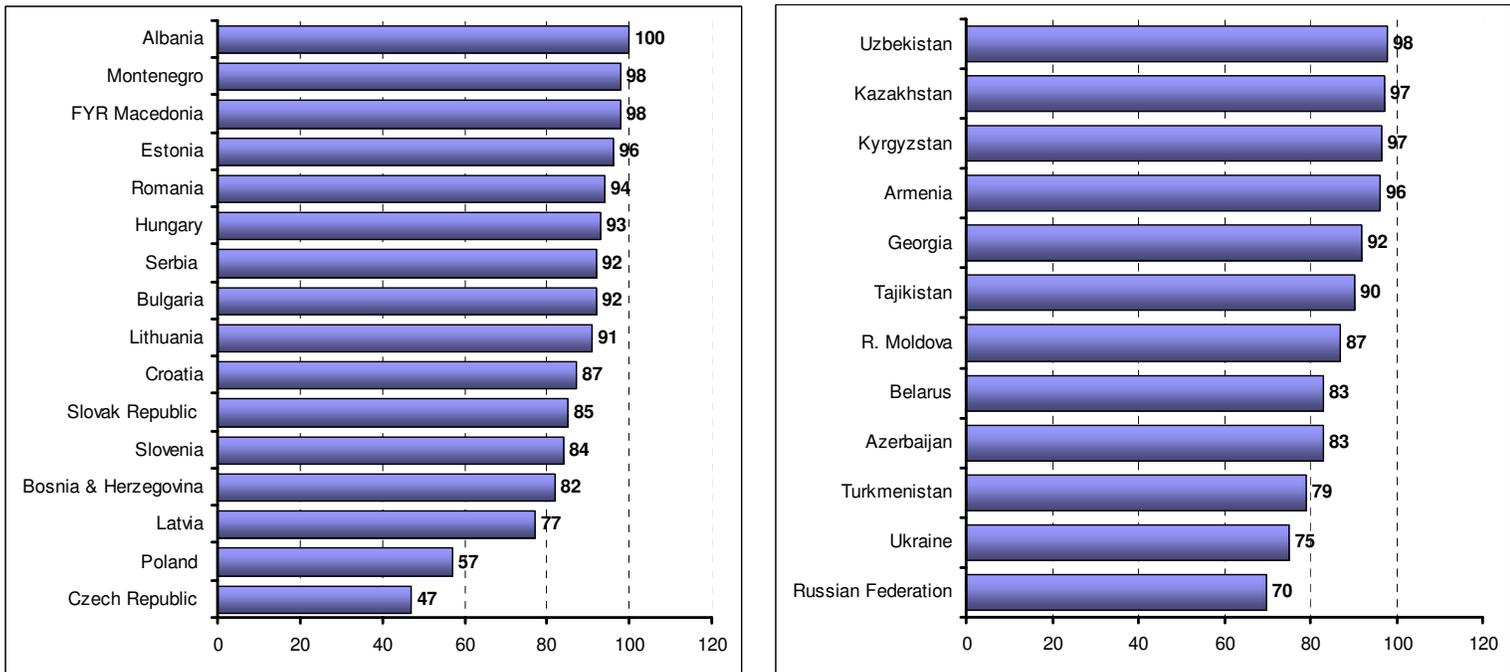
Over the past decade, with respect to the development of an efficient legal and institutional framework for housing, two broad patterns have emerged. In more advanced countries, sustained macroeconomic stabilisation, consistent effort to provide an adequate legal framework and economic growth have laid the basis for the gradual development of the institutions that are necessary to support housing markets. This development has been shaped by both internal political and economic pressure for consistency in housing reforms on the one hand, and the strong incentives and guidance of European integration, on the other (EBRD, 2009). In the less advanced countries, progress in liberalisation and macroeconomic stabilisation has been slow and uneven. Moreover, the legal framework has been developed with considerable delays and its implementation has been

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<sup>3</sup> The Republic of Moldova developed its *Housing Strategy* in 1998, but it was never implemented. Croatia's attempt to get its Housing Strategy approved failed due to changes in government and Serbia's efforts to build consensus on social housing issues and further reforms has been jeopardised by political instability.

jeopardised by continuing structural weaknesses of the financial sector and limited capacity of state institutions to implement and enforce the legislation. In some EECCA countries housing reforms have been delayed by policy instability and poor governance (ECE, 2005; 2010a; World Bank, 2002). The sharp declines in living standards that have occurred have caused great stress and have undermined confidence in housing reforms resulting in massive illegal construction and informal housing development (ECE, 2004; 2007). In SEE the public sector both at the central and local level due to its limited capacity has attempted legislative reforms, albeit with limited success. National strategies, action plans, and programmes, have often been sidetracked by political/electoral changes and budget deficits (Tsenkova, 2005).

**Figure 1: Homeownership in the region, 2006**



Source: Tsenkova, 2008

### ***Development of Legal Frameworks for Housing Reforms***

Development of the legal framework is the cornerstone of the second phase in housing policy reforms. Efforts have centered on three important areas: property rights, management of condominiums, and mortgage/foreclosure.

**Property rights**

Across the region, private property rights in housing and real estate are adequately protected. In most countries such rights are secured in the Constitution (e.g. Albania, Bulgaria, Croatia, Moldova, Former Yugoslav Republic of Macedonia, and Romania). In EECCA countries title and ownership rights are still unclear and although the legislation exists as pointed out in several ECE Housing Profiles, its implementation has been inadequate (ECE, 2007; 2010a,b). Some countries (e.g. Romania, Russia, Serbia, and Moldova) have opted for introduction of a comprehensive new legislation that deals specifically with housing, as the example from Russia in Box 2 indicates. Such *Housing Acts* regulate different aspects of the acquisition, ownership, possession and use of immovable property as well as define housing relations, rights and obligations of the owners and maintenance of apartment buildings (ECE, 2003; 2005). Others have chosen a more incremental approach of modifying existing legislation and/or regulating housing aspects in the general Civil Code provisions (e.g. Albania, Armenia, Georgia). In the new EU member states a stronger legal tradition and higher levels of homeownership under state socialism have made it possible to reconstruct existing legal institutions and regulatory instruments (Giovarelli and Bledsoe, 2001).

**Management of condominiums**

Another critical area of the legal framework relates to housing privatisation and the management of multi-family housing. The forerunners in privatization (Moldova, Lithuania, Albania) were among the first countries to introduce legislation in 1991. In other countries specialized legislation was approved in the mid-1990s with legal acts governing the basic provisions for the management of common properties introduced often a decade later.<sup>4</sup> In most of the cases the legal response was reactive rather than proactive with the Czech Republic being a notable exception. In this case the establishment of condominiums was a requirement for the transfer of the building and individual privatization of apartments was not allowed. In EECCA countries very few have an adequate legal basis for condominium management (ECE 2007; 2010a). In fact, even if the legislation exists (e.g. Belarus and the Republic of Moldova), the enforcement is inadequate. Due to legal and organizational problems the formation of institutional entities such as associations of homeowners or condominiums has been very slow and in most countries the market for maintenance and management is dominated by municipal

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<sup>4</sup> In Bosnia and Herzegovina the *Law on Privatisation of Apartments with Existing Tenure Rights* was passed in November 1997, supplemented by the *Law on the Housing Fund* (2001). In Montenegro the *Law on Floor Property* of 1995, provided the basis for privatisation, but its substantial revisions in 2004 defining maintenance responsibilities of apartment owners in a more explicit manner (ECE, 2006a).

companies. The legislation has failed to impose in reality an obligation on residents to take responsibility for buildings and common areas, which in practice leads to further deterioration of the stock. Further, municipal maintenance and management companies have shown surprising resilience, maintaining the old style organisational and financial practices of 'low fee, no service' (Gruis et al, 2009). The issues are even more complicated in housing with mixed ownership and in cases of restitution (Latvia, Estonia and the Czech Republic).

#### **Box 2 The New Housing Code of Russia**

The *Law on the Fundamentals of Federal Housing Policy* of 1992 established a regulatory framework for the owner-occupied as well as the rental sector in Russia. It introduced the possibility of establishing homeowners' associations, clarified property rights, strengthened the possibilities for mortgage lending, introduced housing allowances, established the foundations for a programme to increase rents, provided for improved maintenance of State housing by introducing competitive procurement procedures and reduced tenant rights by permitting eviction from municipal flats for the non-payment of rent. This basic legislation was supplemented in the following years by a number of legislative acts and reforms to strengthen and redefine some of its principles.

The establishment of a new *Housing Code* since 2005 is a further step towards solving the housing problems in an integrated way. This package of 25 laws brings the norms governing the relationships in the housing sphere in accordance with the *Constitution*, the *Civil Code* and other federal laws. This includes the delimitation of housing responsibilities between the Federation, the "subject of the Federation" and local governments, and the establishment of how housing legislation and other legal acts relate to one another in practice. It addresses unresolved issues regarding the future of free privatization of housing, the targeting of social welfare payments covering housing and utility charges, the termination of owner's rights under specific circumstances (e.g. non-repayment of a mortgage) and the legal protection of tenants, including family members.

*Source: ECE, 2005*

**Housing loans and mortgages** The hallmark difference between housing finance systems in socialist and market economies is the role the public sector plays in ownership and control of housing finance. The speed with which the required legal and institutional structure has been established in this area has varied significantly. Poland rapidly adopted the legal structure for mortgage lending in the 1990s and introduced sophisticated products such as dual-indexed mortgages.<sup>5</sup> Russia implemented many of these reforms as

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<sup>5</sup> In Bulgaria the *Property Law* and in Romania the *Mortgage Law* (1999) allow licensed banks and other financial institutions to make loans secured by real property. The *Mortgage Law* has provisions for loans to be secured by future (to-be constructed) property (Merrill et al., 2003).

recently as 2004, while Ukraine, Montenegro and the Republic of Moldova passed legislation authorizing mortgages in 2003-2005. The absence of the appropriate legal reforms required for a well-functioning mortgage market is due to a market structure evolving faster than the legislative process. Such delays substantially have hindered the emergence of a housing finance system in EECCA and SEE countries, where mortgage lending was non-existent till 2005. Legislation articulating the conditions for soft loans and eligibility requirements (e.g. in Russia, Croatia, Serbia and Kyrgyzstan) was often provided in the interim (see Box 3).<sup>6</sup>

### **Box 3 Evolution of Legal Framework for Mortgage Lending in Kyrgyzstan**

The development of the mortgage market in Kyrgyzstan started in 1999, when the *Law on Mortgages* was adopted. The Law establishes a legal framework not only for mortgage lending, but also for loan and saving schemes. The Law also allows municipalities to create agencies for the development of mortgage lending and issue housing certificates — securities, which could be accumulated and exchanged for housing. A separate chapter of the Law is devoted to the creation of a State mortgage agency responsible for the development of the mortgage market and provision of a refinancing vehicle through issuing mortgage-backed securities with a State guarantee. Unfortunately, all these initiatives were not realized until 2002 due to a lack of finance. The initial legislation was amended in 2002 and replaced by the *Law on Pledge* adopted by Government Decree in March 2005.

*Source: ECE, 2010a*

In Azerbaijan a Mortgage Fund was established in 2005 on the basis of a draft regulation in line with the Presidential decree on development of the mortgage market. It makes mortgages available to certain groups with 4% interest, substantially below market rates (ECE, 2010b). Furthermore, the development of mortgage markets is also dependent on adequate legislation on property rights, cadastres, and property valuation. Such legislation, as well as effective foreclosure procedures, also emerged a decade later in this part of the region (ECE, 2008; 2010a).

In the new EU member countries, legal harmonization was an important driver for advancing the legal and institutional requirements of a housing finance system. For example, mortgage lending was introduced in Slovenia in 1997, and was operational in

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<sup>6</sup> Croatia, for example, approved several laws in this regard – *Law on Building Society Savings and State Subsidies for Building Societies*, *Law on the Fund for Long-term Financing of Housing Construction with State Subvention* and *Law on State Subsidised Housing Construction*.

Estonia and Latvia in 2000. Before mortgages took off in the new EU member states, loans for home purchases were unsecured, had a private guarantor or were covered by joint finance. The terms and conditions for this type of loan were less favourable than for mortgage financing, which became the dominant type of housing loan once it is available (Hegedus and Stuyk, 2006). In the interim phase, many countries introduced special legislation on subsidised housing loans, often committing governments to long-standing subsidy arrangements to cover the interest rate difference (e.g. Slovakia, Hungary, and Poland). For example, the *Law on Provision of Dwellings for Citizens* in Lithuania specified the conditions for access to subsidised loans for housing construction. While state support was provided to less than 1,000 households per year, the waiting list of eligible households included over 104,000 (ECE, 2000).

## **2.2 CHALLENGES AND OPPORTUNITIES AHEAD**

Housing has lost its political priority on the political agenda and reform efforts have emphasized the importance of housing markets, privatization and private sector provision. The direction of change in all countries is similar, although significant variations exist. *Housing reforms have proceeded with 'trial and error' promoting residual housing policies, devolution of responsibilities to the local level and experimentation with housing programs promoting homeownership. The development of a new legal framework has become the cornerstone of the reform process.* Increasingly, new laws and regulations and their enforcement have shaped housing policy, influencing in turn subsequent institutional changes and new institutional formation. Although the second phase of housing reforms initiated in 2000 is attempting to address the institutional and regulatory 'vacuum' of the early 1990s, progress across countries has been uneven. Developments have focused on adoption of legislation governing the privatization of housing, property rights, condominium ownership, mortgage finance, property registration and foreclosure. Yet, beyond these basic steps, the variation is considerable, both in the extent and quality of legal provisions.

Notwithstanding the significant differences among countries, there are several common problems. First, the legal framework has failed to catch up with dynamic housing market developments. Frequent changes in existing legislation and/or introduction of sophisticated new legislation create a fair amount of uncertainty and may be counter-productive, at least in the short term. Second, incomplete legislation without specific provisions, often delegating responsibilities to the local government level, in view of

administrative and fiscal constraints, may not be an effective way to implement housing reforms. Moreover, if enforcement cannot be guaranteed, the credibility of the new rules may be undermined. Third, the effectiveness of rule enforcement, particularly in the context of rapid legal transition, is a significant challenge in terms of capacity for implementation, consistency and credibility. In many countries the lack of credibility of the law has led to significant evasion, arbitrariness and less transparent enforcement mechanisms.

**Box 4 Recommendation 1: Strengthen political support and develop effective legislation to resolve persistent housing problems.**

Housing needs to be a political priority due to the scale of the present problems and the social and economic significance of the housing sector. Problems within the sector therefore need to be addressed in an integrated and all-encompassing way, by taking into account socio-economic considerations as well as legal, institutional and financial framework conditions. Governments in all countries should strengthen their political support to resolving persistent housing problems. They should focus on more strategic interventions, streamline housing priorities, rationalize the legal framework and reinforce implementation in order to promote a more sustainable housing policy that facilitates investment and improvements in housing quality and ensures access to affordable housing. The focus of legal reforms in EECCA needs to shift towards the strengthening of the consistency and coherence of supporting legislation and towards establishment of adequate capacity for implementation and enforcement, particularly in areas of condominium management, mortgage lending and property rights.

While it is difficult to recommend specific measures that need to be implemented across different countries with distinct legal traditions, UNECE housing profiles provide important policy recommendations (see ECE 2005; 2007; 2010 a,b).

A solid legal basis is an essential part of such an approach and a precondition for addressing the current problems in the housing sector. It is important to address inconsistencies in different legal acts and to provide a solid and comprehensive legal basis for all housing policies and programmes as well as a transparent legal framework for market-based institutions. This includes specialised legislation on maintenance and management of multi-family housing, on mortgage lending as well as on eligibility for supply- and demand-side assistance in housing.

Housing policies cannot, however, stop with the development of the legal framework but have to be effectively and efficiently implemented. A functioning institutional framework needs to be in place to facilitate implementation and to resolve the uncertainties regarding institutional responsibilities. In the implementation of housing legislation priority should be given to enforcement of legal frameworks that:

- (a) Allow effective mobilisation of necessary public financing;
- (b) Facilitate the establishment of functioning management and maintenance systems;
- (c) Develop a system of housing support for socially weak households;
- (d) Support well functioning housing finance.

## **3 ESTABLISHING RELIABLE AND EFFECTIVE HOUSING INSTITUTIONS**

### **3.1 PROGRESS ACHIEVED AND PROBLEMS ENCOUNTERED**

#### ***Institutional Reforms and the Changing Governance of Housing***

The transition has marked an important institutional change from government to governance in housing. The process is at different stages with some countries still maintaining a strong primary function of public institutions in the delivery of housing, while others have shifted to a more inclusive government approach in housing policy. The new governance in housing goes beyond the formal authority and procedures to incorporate practices and performance by different institutions and entities that interact with government. These represent a variety of stakeholders from public and private sector involved in implementing public policies and programs in the housing sector. Fiscal austerity and economic uncertainty have affected the operation of central and local governments in the region and their ability to formulate and effectively implement housing policies. The central governments overall are playing an enabling role in housing with major responsibilities centred on legislative reforms. By contrast, local governments have acquired important responsibilities related to new housing programs and management of existing public housing.

Since the development of housing institutions is determined by path-dependency, it is not surprising that the institutional change is inherently slow and an imbalance has arisen between the creation of markets and the establishment of appropriate supporting institutions. Further, the types of institutions that matter differ during the various stages of the process. For example, transforming the State role in housing requires more than its withdrawal from directing housing production and finance. It is also crucial that the State is supportive of markets by providing a transparent and effective legal system and sound investment climate to improve economic performance. Due to the special nature of housing, it is also important that the State facilitates a socially efficient provision system, enhancing housing quality and affordability to alleviate the social costs of transition and structural change.

At the central level, the responsibility for housing policy is typically given to the ministries responsible for public works, construction and spatial planning, such as the Ministry of

Urban Development in Armenia, the Ministry of Environment, Transport and Telecommunications in Albania (ECE, 2003a; 2004). The need for coordination among the departments dealing with the different aspects of the housing sector as well as with other line ministries – Social Welfare, Finance, Local Government, and Justice – presents a complicated task, as the is the case of Russia, Serbia and Belarus (see ECE 2005; 2006a; 2008). Financial ministries have the decisive role in housing policy and determine the allocation of resources for the sector, either in the state budget process or through the transfers to local governments. In other words, the “housing ministries” typically do not control a large range of policy instruments and are often dependant on other Ministries to achieve real change (ECE 2002, 2007, 2010b). Furthermore, the staff at the central level is often limited to a handful of policy officials who rarely have the capacity to monitor existing programs and cope with the demanding tasks of constant amendments to the legal framework. Often due to frequent changes in governments, the expertise in housing has been lost with people reallocated to other departments. For example, in Serbia a major institutional reform of the public sector was implemented in 2000 with many subsequent changes reducing the staff responsible for housing policy in the Ministry of Capital Investment to 3 persons in 2005 (ECE, 2006a). Cutbacks to public spending have had a detrimental impact on the ability of central government institutions to retain qualified staff leading to a significant ‘loss of institutional memory’ on lessons learnt. In Russia, for example, there was no housing ministry or parliamentary committee at the federal level to provide transparent coordination within and between all levels of government essential for the implementation of housing reforms (ECE, 2005). The political instability and frequent changes in governance, particularly during the first phase of transition, led to different and often conflicting priorities, ‘stop-and-go’ housing programs and little effort to create strong and sustainable housing institutions at the central level (ECE, 2002; Tsenkova, 2009). In Albania the National Housing Agency (NHA), abolished in 2009, has built almost 10,372 apartments for ‘homeless households’ registered with local authorities. NHA sold the apartments with a contract for a lump-sum payment with a 30% discount covered by the state budget and/or provided 25-year interest free loans. The Agency in Moldova was abolished in 2007 (Box 5).

### Box 5: The Role of National Housing Agencies



New national housing agencies have been established in several countries to facilitate the implementation of housing policies and/or deal with specific housing problems. In some countries housing privatization agencies have been reinvented in a new role (Latvia, Lithuania). In **Albania, Croatia, Republic of Moldova and Romania** these agencies act as housing developers using budget resources, public land and donor funding to solve urgent housing problems (e.g. completion of unfinished housing,

compensation of tenants in housing subject to restitution, etc.). Although the mandate of these national housing agencies was much broader including institutional support to condominium associations and development of new mechanisms for affordable housing, most of the current operations have focused on new housing construction.

In **Romania** the National Housing Agency was set up in 1999. This is an off-budget government institution designed to manage government subsidised housing programs (ECE, 2001). In the *National Strategy for Housing* for 2001-2004 the government housing policy aimed at (1) mitigating the ratio between the market price of housing and the average family income; (2) facilitating access to the market for specific categories, especially young individuals and families; (3) providing incentives for private investment in housing; (4) enhancing the role of the National Housing Agency as a developer and a housing lending institution.

*Source: ECE, 2001; 2003a; Tsenkova, 2005*

**At the local level**, the reform process in the region has emphasized decentralization, deregulation and local autonomy. In the new fiscal reality local authorities are seen as ‘crisis managers’ charged with a lot of responsibilities related to the provision of infrastructure and housing services, but without the corresponding resources to address those problems. Local governments are highly dependent on central government transfers and have limited possibility to raise funds through local taxes and fees, particularly in EECCA countries where property taxes are negligible and even do not exist. Reliance on donor funded projects, particularly in Serbia, Bosnia and Herzegovina, Azerbaijan and Kyrgyzstan makes the need for sustainable local funding more important. Thus, the central government has shifted the conflicts in housing development to the local level. In addition to decentralization, the degree of local government fragmentation has raised serious

questions related to institutional capacity, coordination and the lack of economies of scale in the management of public utilities (ECE, 1997; 2001).

The extensive functions of local governments include making decisions on development programs, urban planning, as well as the investment in maintenance and development of infrastructure, schools and hospitals. Municipal enterprises also provide infrastructure and services related to water, sewer, waste management and public transport, but with less financial and human resources. All of these tasks have extremely important implications for the housing sector and the inadequate service delivery adversely affects housing quality (ECE 2005, 2008, 2010a). Just like the central level, the local government administration has experienced constant cutbacks, problems with staff recruitment, political interference and significant loss of human resources.<sup>7</sup> It is not surprising that at the local level, and in smaller municipalities, the local bureaucracy is often criticized for its slow and inefficient responses to the needs of businesses, private institutions and/or citizens' groups, red tape and alleged corruption.

Housing is typically a responsibility which is shared between the central and local governments with the central level focusing primarily on legal issues and the provision of housing subsidies, while local governments have major responsibilities for implementation of these programs as well as for housing the poor and disadvantaged. However, the privatization has left little, if any, public housing to respond to such needs. The residualisation of the public rental sector, coupled with a reluctance to implement systemic rent reforms, has led to poor quality of housing services. Despite different coping mechanisms, arrears in the sector are wide spread and a lack of payment discipline, common (Lux, 2003; Tsenkova, 2009). In most EECCA countries municipal maintenance firms maintain privatised housing at regulated costs well below the required levels to improve the quality of multi-apartment housing. State-set maintenance tariffs in Azerbaijan and Kyrgyzstan are too low, so privatized apartment buildings continue to deteriorate. The current institutional framework requires both maintenance and structural repairs to be

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<sup>7</sup> In a number of EECCA countries water and waste-water services are operated as a vertically integrated natural monopoly by a government ministry through national or regional subsidiaries or by municipal departments. There is no, or little, financial autonomy and/or management capacity at municipal level. Heavily subsidised tariffs still exist, along with a high degree of cross-subsidisation. There is a low level of cash collection. Central or regional government controls tariffs and investment levels (ECE 2007, 2008, 2010b).

provided by the State through its Housing and Communal Services Departments (ZhEKs). Without adequate financing, ZhEKs cannot provide routine maintenance, but instead provide a form of catastrophic insurance (World Bank, 2006). Without central or local government subsidies, and poor collection of regular maintenance charges from owners, housing maintenance is significantly under funded (see Box 6); in some countries the tariffs cover only 20-40 percent of the costs and barely cover emergency repairs (Gruis et al, 2009).

**Box 6: Problematic Management of Multi-apartment Housing in Armenia**

Following the give away privatization of housing, which resulted in rates of homeownership exceeding 98%, the government adopted a *Law on Condominiums* in 1996. However, reforms in housing and communal services remain incomplete with only 40% of the apartments organised in condominium associations and less than 20% of those associations being active by 2002. In the early transition years, privatization of apartments created a new group of owners, who acquired the benefits of apartment ownership without fully assuming the responsibilities. Local government set maintenance tariffs are too low (22 dams/sq m), and are not augmented with other funds, so apartment buildings continue to accumulate a large backlog of repairs. Maintenance and structural repairs are provided by the Housing and Communal Services Departments (ZhEKs) whose ownership was transferred to municipalities. Most ZhEKs are poorly equipped and the service is of low quality due to lack of funding and competition in the market for maintenance and management. A newly introduced programme in 2002 is providing State assistance to owners for repairs in apartment buildings, provided that they match the funds.

*Source: ECE, 2004*

Although some countries have moved forward to strengthen municipal governance and the management of local public utilities as one of the key institutional reforms in the housing sector, the old management structures have been surprisingly resilient. Efforts to introduce new fiscal discipline and new forms of corporate governance have been limited, particularly in EECCA countries, where social hardships and high poverty rates have made price adjustments difficult. First, the sector is inefficient due to its limited managerial independence as far as service policies, operations and pricing is concerned. Second, prices charged for services historically have been low relative to the cost of supply. Efforts to adjust prices in line with inflation and costs have been made on an *ad hoc* basis with

limited effect (see ECE, 2004; 2005 and 2010b for in-depth discussion on these issues affecting Armenia, Russia and Azerbaijan). Third, the funding gap in investment capital has led to postponing replacement, deferring maintenance, reducing services, and finally options for concessions and contracting out (Tsenkova, 2010).

### ***The Growth and Diversity of Housing Market Institutions***

Many private institutions are involved in the production, allocation and consumption of housing. The most significant ones in the process are: the developers, the landowners (private and public); the financial institutions; the housing industry and market intermediaries. *These new roles and responsibilities are associated with the new governance in housing, creating a dynamic and diverse mosaic of private and non-profit institutions and professional organisations.* New actors have emerged – speculative housebuilders, real estate agents, private building firms and maintenance companies. Former participants have received new roles and responsibilities (see ECE, 2005; 2007; 2010b for description of such trends provided in the institutional section of country profiles). Decentralisation and privatisation in the production and distribution of building materials occurred rapidly in most of the countries, while the construction sector has been relatively slow to adjust, particularly in countries where the industrial privatisation has been delayed due to the influence of the *nomenclatura* or by political and economic instability. The deregulation of land and housing finance markets, has resulted in a growing number of institutions and market intermediaries since the mid-2000s. In EECCA and SEE countries the lack of well-established regulatory institutions has contributed to the inefficiency and immaturity of these markets (ECE 2008, 2010a, Merrill et al, 2003). Manifestations of institutional weakness include: lack of transparency in corporate business practices, tax evasion, abuse of deficiencies in the legal system, unsound business practices, including asset-stripping and poor corporate governance.

On the supply side the nature of the **housing industry** and the diversity of promotion and production of housing have become important determinants of housing investment and growth. State construction enterprises in the region have disappeared in the early 1990s and the ‘municipal developer’ or social housing enterprise has ceased to exist in most countries. The private building industry has established a considerable market presence.

Most of the firms are small, with less than 50 employees, currently holding more than 70 percent of the total construction industry assets (ECE, 2000; 2001; 2004). In Armenia, for example, close to 1,000 companies exist with 40% of those involved in housing construction. The size of the companies is reportedly volatile, but most tend to build 3-5 dwellings per year in Yerevan (ECE, 2004). Private housebuilders have become the new agents in the homeownership market with a strategic role in the provision of new housing. They manage the entire development process from identification of the site, through planning negotiations, land provision, supply of building materials and equipment, labour contracts, marketing, financing and the sale of dwellings. Some housebuilding firms have started by spinning off from state construction enterprises, others – as a new business venture with foreign investment capital (ECE, 2005; 2006a; 2010b).

#### **Box 7 Private Housebuilding in Serbia**



Housing construction in Serbia, unlike the maintenance sector where public firms dominate, is entirely private. Private provision played a significant role prior to the transition process, accounting for 72% in 1989. Housebuilders use traditional methods and the on-site labour is often part of the grey economy as construction companies avoid the 75% turnover tax. Construction loans are expensive, so most of the housing is pre-sold and financed through cash payments and savings from the economic migrants abroad. Mortgages cover about 1% of total housing investments. The average construction cost is €325 per sq m, while the sale price is two to three times higher. Thus an average income household with annual income of €3,200 will need 22 annual salaries to purchase a modest 65 sq m apartment.

New housing has higher quality and is connected to basic infrastructure and central heating. Some of the main constraints for private housebuilders relate to the lack of affordable construction finance and serviced land.

Source: ECE, 2006a

The existence of a large number of small firms in the housebuilding sector reflects the ease of entry into the industry, the fragmented nature of the development process, the demand for small traditionally built housing, and the lack of economies of scale (Tsenkova,

2010b). Large builders play a more prominent role in selected large urban markets, including the capital cities. Those companies use their own resources for construction finance, and in some cases have established investment and development subsidiaries with foreign capital (see ECE, 2002; 2005; 2010a).

*Despite this rapid growth of private housing institutions, studies have pointed out the lack of transparency in the business operation of the sector. As private housebuilders target mostly the elite market, little capacity is being developed to provide affordable housing. Some inefficiencies within the industry, coupled with lack of construction finance and bureaucratic procedures, have contributed to higher prices (ECE, 2002; Puzanov, 2009). Informality, contract enforcement issues and cash payments have plagued new construction in EECCA and SEE countries for two decades (see Box 7). Equity financing from potential homeowners, often resulted in failed 'pyramid schemes' where the lack of protection for consumers allowed deposits to be channelled in other business ventures (Tsenkova, 2000). The use of casual labour, poor supervision standards and lack of building code enforcement was often attributed to the operation of largely uncharted housebuilding industry (ECE, 2007). Furthermore, illegal construction has become prevalent in some countries, often absorbing revenue from the grey economy.*

**Non-government organisations** (NGOs) in most of the countries in the region are at an early stage of development and require support to act as effective intermediaries between the public sector and civil society. They are generally limited in capacity and reliant on international donors for funding, but have pioneered a lot of innovative projects as the example in Box 8 indicates. Representative bodies of owners or tenants at the national or local level are few, though there has been some attempt to involve NGOs in the development of national housing policies. There are very few institutions dealing with housing research, surveys, data collection and policy evaluation. The early years of transition have seen the formation of special interest groups, such as Associations of Private Landlords in countries with restitution of nationalised housing, or some charitable groups catering for special needs housing clients (elderly, people with disabilities, etc.).

### **Box 8 Nineteenth century idea for a twenty-first century solution in Kyrgyzstan**

*Habitat for Humanity in Kyrgyzstan* is a local affiliate of Habitat for Humanity International, a non-profit organization dealing with housing issues working in the country since 1999. The organization is governed by a Board of Directors, consisting of eight local volunteers. The Board selects families to support with construction of simple and affordable houses. Individuals and corporate donors provide funding and construction materials for building Habitat houses while volunteers provide most of the labour. Partner families themselves also contribute to building their own houses and the houses of others. The Government provided its initial support by granting a plot of land for the construction of the first phase of this project, which started in 2000 and resulted in 20 houses allocated to people in 2002.

The size of each of the dwellings is around 45 sq m including a bathroom (toilets are located offsite). The walls were built with a newly developed product of pressed cane reed, which provides good heat insulation at low cost. The total construction costs were as low as €7,000 per unit, financed with a loan from Habitat for Humanity with interest that only covered inflation with a 15-year maturity. Monthly capital repayment is €35 per family. Title for the dwellings will be transferred to the tenants only after full repayment of the loan.

For its innovative concept of a “nineteenth century idea for a twenty-first century solution” the project won an award in the Development Marketplace Global Competition 2006 of the World Bank. Presently, the Habitat Kyrgyzstan Foundation is facing difficulties in repeating this successful model due to lack of land and finance.

Source: ECE, 2010a

## **3.2 CHALLENGES AND OPPORTUNITIES AHEAD**

While all countries in the transition region continue to face challenges in establishing the institutional framework of a well functioning housing system, these vary widely in nature and magnitude. The future reform path requires a commitment to new governance in housing that emphasizes the quality of institutions and redefines the role of the state. *In summary, the most important challenges for the effective operation of housing institutions in the region are: i) lack of adequate institutional capacity of public institutions; ii) lack of effective institutional cooperation leading to bureaucratic structures, corruption, and red tape; iii) lack of adequate resources at the local level to fulfil housing mandates; iv) lack of well established, transparent and efficient private sector institutions in housing.*

Given the significant differences in the region, different pathways of institutional transition affecting the diversity and operation of private and non-government institutions in the housing sector have emerged. The quality of institutions has emerged as a critical

dimension of the transition in housing governance. State institutions with similar objectives – regulatory, fiscal, and financial - can have vastly different impacts in terms of their effectiveness. The effectiveness of institutions depends on technical capacity, coordination, and political structure promoting transparency and accountability. The quality dimension is also important with respect to private institutions. Housing markets do not function well if they are not competitive or if corporate governance of the housebuilding industry is poor, which depends on the effectiveness of supporting state institutions, legal frameworks and enforcement authorities. The transition in the governance of housing should therefore be about redefining the State as opposed to simply minimising it, and about improving the quality of state and private institutions and ensuring that they work well together.

### **Box 9: Recommendation 2: Strengthen central and local government institutions in housing policy and improve governance in the sector**

Governments in the region should urgently address the problems caused by weak housing institutions and ineffective housing governance. They should strengthen the mandate and capacities of the central and local government institutions in housing policy, and should improve institutional coordination, mobilization of funds for housing program implementation and enforcement. In EECCA countries governments should work to improve the quality and the efficiency of private sector housing institutions, including market intermediaries and non-government institutions, to improve the functioning of housing systems at the national and local levels. Practical recommendations on institutional development to effectively address the housing challenges in different countries from UNECE country profiles are summarised below.

#### **Central level**

The roles and responsibilities for housing policy at the central level need to be consolidated, preferably within one government institution. The main responsibilities should entail:

- (a) Developing a comprehensive national housing policy framework;
- (b) Establishing the necessary legal and financial frameworks for effective implementation, supervision and enforcement;
- (c) Defining the roles of all major stakeholders in the implementation of the housing policy;
- (d) Developing a social support system and ensuring its funding. This includes ensuring that local governments have sufficient sources of revenue to fulfil the social obligations assigned to them;
- (e) Monitoring and analysing the implementation of the national housing policy.

#### **Local government level**

Local governments are the principal responsible institutions for implementing housing policy. Their main responsibilities should include:

- (a) Developing municipal housing programmes in accordance with national and regional policies and guidelines;
- (b) Implementing programmes for social housing support using national and local funds;
- (c) Improving land-use and urban development planning to ensure supply of land for housing and infrastructure services;
- (d) Developing action plans for upgrading and regenerating the local housing stock;
- (e) Ensuring the efficient management, operation, repair and renovation of the municipally owned housing stock in cooperation with the private sector.

For local governments to execute their tasks effectively, their resource base would need to be strengthened. It is therefore recommended that central government should:

- (a) Extend proper national funding to local governments and regulate its disbursement in line with clearly identified targets (e.g. social housing benefits, investment thresholds);
- (b) Provide municipalities with sources of budgetary funding, most importantly from real estate tax;
- (c) Encourage municipalities to generate additional funds locally through user fees and more efficient contracting of services.

To enable municipalities to carry out their tasks more efficiently, the following is recommended:

- (a) Encourage the establishment of contractual bases for the work of municipal housing enterprises and utility companies.
- (b) Establish a transparent system of subsidies on the basis of social need in municipal housing and introduce cost recovery principles in the rental sector;
- (c) Encourage municipalities in establishing a transparent procedure of regulation and financial auditing in order to promote a competitive market for maintenance services.

Implementation of housing sector reforms will require extensive capacity-building at all levels of government, in particular at the local level in strategic planning, project management, participatory approaches, fund-raising and budgeting as well as the contracting-out of public services, including tendering, quality and price evaluation, etc.

## 4 DEVELOPING EFFECTIVE LAND ADMINISTRATION AND LAND MANAGEMENT

### 4.1 PROGRESS ACHIEVED AND PROBLEMS ENCOUNTERED

#### *Constraints in the Land Management and Registration System*

While progress in deregulation of housing markets and privatisation has been the hallmark of the first decade of transition, the supporting administrative and legal institutions responsible for land management and administration have also undergone major changes. Together with legal and institutional developments related to land cadastre and valuation, reforms have facilitated the establishment of a modern land administration system with different level of success in implementation. Some countries have complete, current, and accurate systems of property registration records since the mid-1990s, in others the process has been delayed by a decade. In Lithuania, Moldova, Romania and Bulgaria, for example, a high level of sophistication of the registration systems has resulted in high level of integration with other land information available to the public and private institutions alike. In many cases the new land administration systems were challenged by the legacy of previous systems in place and required consolidation of cadastral and property rights registration.<sup>8</sup> In other cases, sound land registration systems, such as those in Poland and Hungary, were fundamentally challenged by a huge task of digital modernization, lack of staff and funding to cope with a large volume of transactions.<sup>9</sup> While most new EU member states have improved the efficiency of their registration systems, other countries still experience a multitude of problems: (i) incomplete land registration

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<sup>8</sup> Romania, due to its history of being divided between the Austro-Hungarian and Ottoman empires, has two different registration systems - the Land Book and the "inscription-transcription" system. The 1996 *Law on Cadastre and Real Estate* introduced the use of the Land Book system throughout Romania, managed by 170 offices. A potential problem is that the land book offices have little capacity to gather information; they rely on the local units of the National Office of Cadastre, Geodesy, and Cartography that also carry out a number of cadastre-related activities (ECE, 2001).

<sup>9</sup> Hungary's land registration system faced challenges due to the vast increase in the number of new parcels through the *Land Compensation* program. The average time lag time between possession of land and issuance of titles was about 18 months. In Poland the registration system is fundamentally sound, but extremely slow, which led to 30-40% of land in Poland being unregistered. When a transaction with unregistered land begins, the process takes from a few months in the countryside to as much as two years in Warsaw (Giovarelli and Bledsoe, 2001).

systems; (ii) ineffective control due to inadequate institutional capacities; and (iii) lack of transparency in land restitution and privatization.

**Land administration reforms** across the region had different points of departure. Poland and Hungary maintained private land ownership during socialism, while other countries (Russia and Former Yugoslav Republic) nationalised urban land. Where restitution of land was implemented (Latvia, Estonia, Bulgaria), the process was plagued with difficulties created by incomplete legislation, lack of records and competing claims. In parallel with the land privatization and restitution process, land registration has progressed significantly in most countries with the exception of the Balkans where massive displacement has created insurmountable challenges for the land administration system.<sup>10</sup> *Overall, the process across the region is also constrained by land privatization, unclear property rights and inefficient land administration systems. The scale of land tenure transformation has been very dramatic, particularly in EECCA countries where private ownership over urban land was non-existent.*

In Georgia state land was transferred into municipal ownership with some delays initiating a rather *ad hoc* process of privatization.<sup>11</sup> In the Russian Federation over 50 million people and legal entities have acquired private ownership of land and 129 million hectares of land, comparable to the area of Western Europe, has become privately owned just within 4 years (ECE, 2002). In Armenia the process was equally dramatic transferring 90% of the land in private ownership by 1993 and creating over 370,000 small farms in a very egalitarian way. The situation with urban land was more complicated delaying the process of mapping, registration of land rights at the municipal level till 2003. Meanwhile illegal occupation of land mushroomed with over 320,000 buildings, mostly for housing purposes outside of the formal housing market (ECE, 2004). While Poland had less work to do on privatization than many of its neighbours, it still had to privatize the large state farms that

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<sup>10</sup> Post-war resettlement and repatriation challenges have been inhibited by difficulties facing those who remain a minority within their previous home area. In Croatia, fewer than half of the Serbs had been able to return to their pre-war homes by 1999, while in Bosnia and Herzegovina only 100,000 of 1.76 million were successful. Housing commissions facilitating the return of minorities to their property have been characterized as sluggish and ineffective.

<sup>11</sup> The privatization of urban land began in 1998 in accordance with *the Law on Disposal*. Urban land was transferred by decisions of municipalities without any competition, transparency or publicity. This transfer has proceeded without the proper demarcation of land plots or reference to either urban master plans or territorial zoning plans (ECE, 2007).

occupied one-fifth of Poland's arable land (approximately 3.7 million hectares) during state socialism.

*In addition to a dynamic process of land ownership transformation, the supply of land for housing is often constrained by the lack of effective land-use planning to guide development.* Twenty years later, evidence suggests that most urban markets have become more fragmented, reflecting differential opportunities for development and profit. Land barter deals, very common at the start of the transition, have lost their attractiveness, but land prices in the capital cities and growth centers have increased. The myriad of ownership arrangements has created significant barriers for the efficient operation of urban land markets contributing to the growth in land prices. In some EECCA countries urban land is auctioned by municipalities, reportedly under procedures that are not very transparent.<sup>12</sup> *The supply of serviced residential land is also constrained by local governments' lack of capacity to finance necessary infrastructure.* Typically, cash-constrained municipalities shift infrastructure costs to the developer. These developments are accompanied by the occupation of agricultural land in the urban periphery and **the growth of informal settlements** where the combination of inefficient administrative systems and urban poverty has created 'informal cities' with hundreds of thousands of new residents in Albania, Georgia, Azerbaijan, Kyrgyzstan, Tajikistan, and Serbia (Tsenkova et al, 2009).

Although most governments have accelerated **the development of modern cadastre systems**, the coverage is often limited (e.g. in Montenegro up to 60%) and the information on illegally constructed buildings is not incorporated. In some countries where the scale of this construction (e.g. Serbia, Albania, Azerbaijan and Georgia) is so prevalent, the incomplete state of the cadastre constrains formal development and affects the cost of land with clear property title. In response to these challenges, Serbia and Bosnia and Herzegovina have allowed registration of illegally constructed buildings (without a building

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<sup>12</sup> There are presently two ways of allocating land for housing construction in Kyrgyzstan. Land plots can be offered for sale on the open market, or municipalities can sell land by auction. Notably, however, despite the provisions of the Land Code, the actual process in the auction and sale of residential land plots can be considered non-transparent, resulting in a high level of irregularity (IFC, 2007).

or occupancy permit). Detection and registration is a complicated process, particularly in countries such as Georgia, Serbia and Albania where nearly half of the construction tends to be illegal or has some informalities. For example, in the Belgrade region, recent annual production by the formal market has been around 1,500 units per year, mostly for the upper segments of the market, while informal production has ranged around 50,000 a year (ECE, 2006a).

#### **Box 10: A New System of Land Administration in Kyrgyzstan**



The land registration and cadastral systems in Kyrgyzstan were unified in 1999 and this was followed by a number of successful projects supported by international donors (SIDA, USAID and the World Bank). These projects have contributed to the following: defining a legal and administrative basis for land and building registration; establishing 50 well-equipped and self-sustained local land registration offices; conducting extensive training for officials and real estate professionals; registering of rights on all land and real estate properties via

systematic land registration; improving access to credit; improving access to cadastre information and mapping, and finalizing the automated registration system and establishing the Kyrgyz Land Information System. These projects have also improved governance of public lands, the use of *the Land Redistribution Fund* and developed real estate valuation methods for taxation purposes.

By 2007 *The Real Estate Registration Project*, supported by a World Bank loan reported the following achievements: the registration of almost 1.2 million real estate units in settlement areas (with buildings); the incorporation in the registry of over 570,000 real estate units outside of settlement areas (without buildings); a substantial improvement in access to credit with the number and value of mortgages increased from 15,437 (US\$ 84.8 million) in 2002 to 43,001 (\$723.7 million) in 2006; a more efficient distribution and use of land and real estate assets demonstrated by the increased registered sales (from 25,901 in 2002 to 39,957 in 2006. Funding of \$6 million for a second project on *Land and Real Estate Registration* was approved by the World Bank in July 2008.

*Source: ECE, 2010a*

Clearly this is not a problem that land administration agencies alone can solve as it involves multiple levels of government, significant resources and major policy commitment (see Box 10). The challenge is to develop a system of records which closely resembles the complete state of affairs in the case of informal settlements. The accuracy and completeness of the information in the cadastre, including the information on informal

settlements, is critical for a well functioning real estate market and the protection of land and property rights. Availability of digital and accurate data sets with common spatial reference concerning ownership, value, and use of land, is essential for efficient decisions of policy makers, planners, real estate developers and individuals. An informed decision on how to solve the problem of informal settlements may be impossible to implement without this information.

### ***Inefficient Planning and Land Management at the Local Level***

Planning has a critical role in defining the appropriate strategies to respond to housing needs as well as in land management for affordable housing. Statutory plans at the city level, complemented by detailed regulatory plans, provide the essential legal framework for housing development. *Since planning is delegated to the local level, but is expected to conform to national spatial development plans or other sectoral strategies, the critical constraints are associated with the lack of institutional capacity and resources to effectively plan and manage local development.* Countries have decentralized functions to municipal authorities, but decentralization seems to have amounted to a huge transfer of responsibilities to the local level without a commensurate transfer of resources. Besides the already noted problem of **fiscal constraints and weak capacity** to invest in essential infrastructure and services, local governments face significant capacity constraints to guide the planning process and to enforce compliance with detailed plans and normative building permits (ECE, 2001; 2010a). Not only is the supply of serviced residential land constrained by local governments' lack of capacity to finance necessary infrastructure, but also by the lack of up-to-date plans and a cumbersome and lengthy approvals process.

The old master plans dating from the Soviet period in some cases have not been updated; often new construction and changes in land use are approved without regard to urban development documentation. In a number of EECCA countries most of the municipalities have resorted to amendments of older plans and *ad hoc* changes responding to development pressure (see Box 11).

### Box 11: Planning Constraints in Montenegro and Georgia



In Montenegro planning is done at three different levels corresponding to a hierarchical structure of planning and approval process—spatial plans, general urban plans and detailed urban plans. While spatial plans exist for 83% of the territory, the general urban plans cover about 5% of the territory in the country's municipalities, while detailed urban plans exist in about a third of the municipalities with general urban plans (Müller and Lješковиć, 2007). In the absence of detailed urban plans, planning and development permits are either delayed or issued on the basis of partial amendments of the old regulatory plan in a rather arbitrary way. Informal development is prevalent and includes over 80,000 buildings, mostly concentrated in Podgorica and the coastal areas (ECE, 2006a).

The lack of spatial plans and adequate institutional structures to enforce effective planning and building control have resulted in massive illegal occupation of land and illegal construction in Georgia. Illegal construction is understood as being the construction of parts of a building, or of an entire building, that does not conform to existing laws, rules and norms. Most common features of illegal construction in Tbilisi are the absence of design, planning documents and construction permits. *Presidential Decree on Activities for the Detection of the Illegalities and their Elimination* issued in June 2002 declares illegal occupation of land a criminal act. The decree has had little impact due to the lack of legislation on the legalization of informal buildings or on legal provisions that allow local governments to demolish illegal construction (ECE, 2007).

In Georgia, for example, the last development plans were elaborated in the 1970 and 1980s and their validity has expired in 2000 (ECE, 2007). In other cases, controversial informal settlement development has challenged the ability of local governments to approve the new generation of plans, as in the case of Greater Baku. Tirana has seen six plans being developed since the early 1990s, but only managed to get a General Plan approved in 2009. In other countries where informal settlements have emerged very quickly over the last decade, the plans are either outdated or simply non-existent.

*In addition to the constraints created by **the lack of detailed regulatory plans**, local governments face the challenge of regulating development in the absence of clear legal and technical frameworks with a high degree of operational applicability. Frequent changes in the normative and legal basis, new construction laws, standards and norms and the lack of normative standards for enforcement is a much more significant constraint for the small and often underfunded departments that deal with building and occupancy permits. Furthermore, complex and less transparent systems for construction permits and licenses contribute to delays and abuse.<sup>13</sup>*

## **4.2 CHALLENGES AND OPPORTUNITIES**

In many ways, the development of land management institutions that support housing markets and enhance private investment is at the heart of the transition in housing governance. Effective land administration and land management institutions are critical in protection of property rights, in securing housing finance, and in enforcement of urban planning and other contract rights central to the success of housing reforms. Across the region once the basic reforms of liberalisation and privatisation have been implemented, and the state has consolidated its new role, the focus of institutional reforms has shifted towards the strengthening of supporting institutions of land administration, planning and land management.

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<sup>13</sup> In Montenegro a recent study demonstrated that a permit to build 1,000 sq m was conditional upon 15 approvals, 3 certificates, and 2 official statements from 15 different institutions. Even more complex are the legal stipulations regarding administrative fees to obtain the necessary documents, which might range from EUR2, 000 to 30,000 in addition to a contribution for communal fees of 5% of the construction costs.

*In the last two decades, the system of land management across the region has undergone a series of changes bringing in new market elements such as land privatization, restitution, market-supporting legislation, land registration and cadastre systems. Despite the successes in establishing a viable land registration, its coverage is not necessarily complete and there is scope for improvement in terms of institutional efficiency. Further progress for effective and sustainable land management systems, particularly in countries with high share of informal development, is inhibited by the fragmented character of the planning, housing and land reforms. Land administration remains constrained by the lack of systematic legislation, land use planning and development control.*

**Box 12: Recommendation 3: Address effectively the problem of informal housing through integrated planning, housing and land administration reforms**

Governments in all EECCA and SEE countries should focus on strengthening the efficiency of land administration system and on the improvement of integration of planning, housing and land reforms to address the problem of informal housing. Efforts should target the completion of nationally unified land registration databases, the efficient operation of land registry offices according to international standards and the simplification of procedures for registering land and real estate. A set of recommendations provided in *Self Made Cities. In Search of Sustainable Solutions for Informal Settlements in the UNECE Region* and several country profiles include the following:

**Central level**

(a) Developing a comprehensive strategy for regularisation of informal settlements that incorporates a set of fiscal, regulatory and financial measures to facilitate implementation at the local level.

(b) Establishing a coordination entity for regularisation of informal settlements through integrated planning, land and housing solutions. Given the emphasis on implementation at the local level, effective collaboration with a system of regional and/or municipal agencies responsible for registration, regularization and upgrading of informal settlements may be necessary.

(c) Supporting the land administration system through a comprehensive land policy, setting clear guidelines and monitoring implementation processes to ensure that the nation's land resources are managed strategically. Land policies should include large-scale real estate evaluation, the development of effective land administration and the formation of a unified system of real estate registration and land cadastre.

(d) Improving real estate registration procedures to meet the standards established by the legal framework. Implement a mass inventory of real estate units, including unauthorised construction. A lack of complete records of buildings, physical infrastructure and the housing stock poses a major challenge to the establishment of an effective land administration system and spatial plans for regularisation of informal settlements.

**Local government level**

(a) Developing a new system of action plans (general and detailed) for integration of informal settlements essential for the implementation of the national strategy for regularisation. Such plans need to be developed with active engagement of residents and to incorporate practical measures for provisions of essential infrastructure and social services.

(b) Applying effective legislation and mechanisms for informal housing legalisation, regularisation and upgrading to address complicated economic, social and environmental problems. Legalisation, where appropriate according to planning and building norms should proceed with financial measures to leverage residents' investment in upgrading of properties and infrastructure.

(c) Considering fiscal incentives to speed the voluntary registration as well as penalties (retroactive taxation) to make the status quo less attractive. Such policies need to be introduced in tandem with means tested support for socially vulnerable households in cases of demolition and reallocation.

(d) Establishing clear mechanisms to prevent further illegal construction and informal housing. This can be achieved through a well-developed building inspection and penalty system combined with simplified procedures for receiving permits and reduced bureaucracy.

## 5 MOBILIZING HOUSING FINANCE AND FISCAL SUPPORT

### 5.1 PROGRESS ACHIEVED AND PROBLEMS ENCOUNTERED

#### *Recent Growth in Housing Loans and Mortgages*

The early years of transition were marked by hyperinflation which structurally paralysed housing finance. Gradual institutional development, more stable macroeconomic environment and banking sector reform have established a more viable system of housing finance in the region, although lending in EECCA and SEE countries is still in the early stages of development. Governments identify the lack of housing finance as a main constraint for efficient operation of the housing market and access to affordable housing. There are different types of housing finance systems—contractual system, commercial bank model, mortgage bank model, and the secondary mortgage bank model. Recent trends suggest a move towards private commercial lending with limited mortgage banking access to capital markets and experiments with the subsidized *bausparkasse* (contract saving model) model (ECE, 2005; 2010b, IFC, 2007; Hegedus and Struyk, 2006).

Studies indicate that consumer lending has grown rapidly in the last five years, including mortgages and housing-related consumer loans. The highlights of the achievements include the following. Collateralized mortgage lending for the purchase or renovation of housing has increased in addition to dramatic growth in housing loans. Mortgage lending is dominated by large commercial banks, often with foreign ownership, bringing international underwriting and servicing skills. Lenders are competing for consumer lending, which ultimately is of great assistance in providing more affordable housing finance. *In terms of constraints, the growth of mortgage lending is limited by the legal and administrative problems, especially those plaguing foreclosure and registration. Banks have conservative underwriting criteria due to legal uncertainties and incomplete property registration systems. Underreported income in the region, and the substantial amount of informal income, limit both the number of qualifying clients and the size of the loan.*

The volume of mortgage lending across different countries, although much lower compared to EU average, indicates a positive relationship between progress in housing reforms, macroeconomic stability and competitiveness in the banking sector. Estonia and Latvia stand out with mortgage debt exceeding 30% of GDP, with Lithuania and the Czech

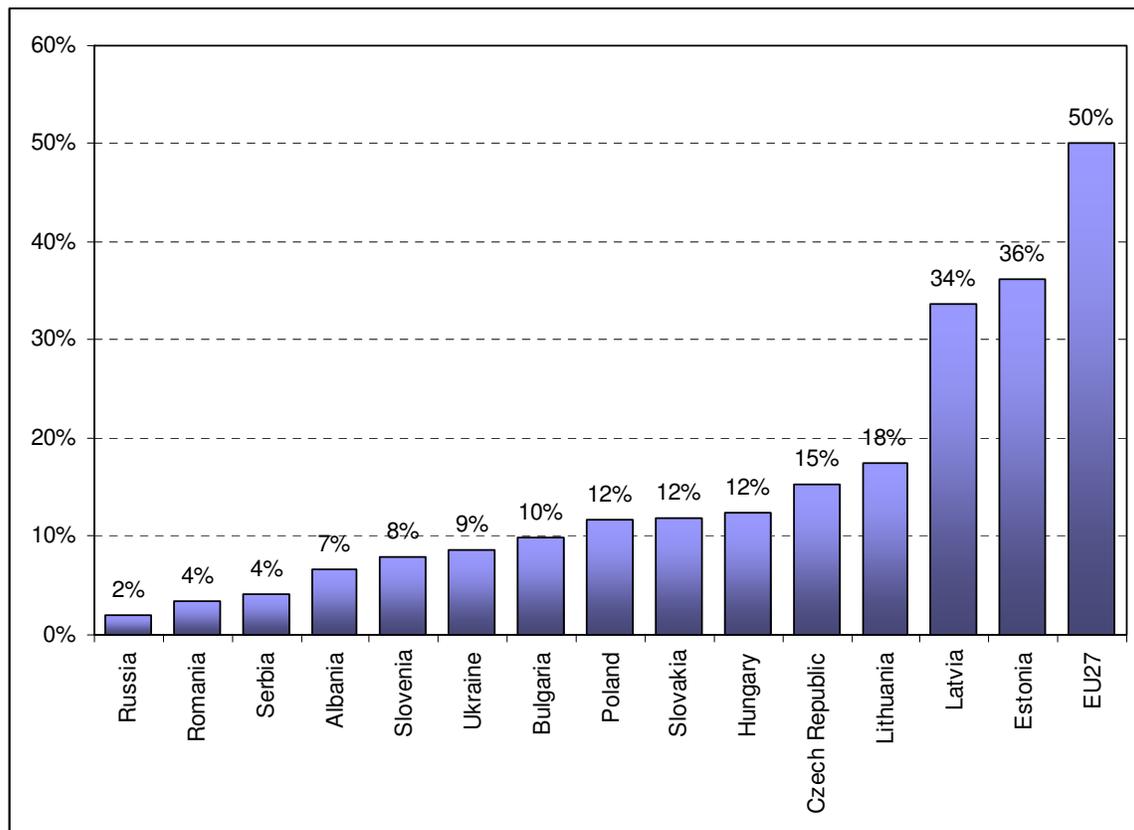
Republic following with 17% and 15% (see Figure 2). Growth rates are indeed impressive for Albania, Serbia and Ukraine (over 85%), albeit from a very low base. In addition to growth in mortgage lending, housing loans generally have been the most dynamic type of borrowing by households. Household loans have experienced dramatic increase in recent years and have reached 30% of GDP in Croatia and 20% in Estonia, Latvia and Hungary by 2004.<sup>14</sup> Notwithstanding these positive developments in the volume of housing finance, borrowing is largely confined to the more affluent groups, who can finance significant down payments and show evidence of regular incomes.

There are significant differences in the extent of mortgage/housing lending in the countries considered. Given the more demanding institutional and informational and operational requirements associated with housing loans and mortgage lending, it is understandable that these have been lagging behind in EECCA and SEE countries. First, the diversity can be attributed to the degree of financial development and the relative growth of housing loans. Second, countries that have addressed the barriers of financial development in general have better functioning housing finance systems. Third, development of mortgage markets is also dependent on institutional developments relating to property rights, well functioning cadastres, and effective foreclosure procedures. Fourth, demand factors that have been affecting the growth of housing loans related to growth in incomes and saving capacity. Finally, fiscal considerations, including various types of subsidies and tax treatment of interest payments, also play a role in explaining cross-country differences in mortgage lending. The impact of a generous system of public subsidies in Hungary, Poland, Russia and the Czech Republic has been particularly notable. In other countries, the introduction of mortgage insurance (Estonia, Serbia) has reduced the required down payment and enhanced the borrowing capacity of households.

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<sup>14</sup> It is important to note that in several countries—the Czech Republic, Latvia, Estonia, Lithuania and Slovakia—over 70% of this household debt is tied to the housing sector (Palachin and Shelburne, 2005).

**Figure 2: Mortgage lending as share of GDP in select countries, 2009**



Source: EMF, 2010

The principal sources of funds for commercial banks, and thus for mortgages, are deposits and, to a much lesser extent, loans, lines of credit, and equity from parent foreign banks. Since mortgage loans are being granted at increasingly longer terms, this situation leads to a significant assets and liabilities maturity mismatch that so far has been partially solved by international credit lines and banking loans from headquarters. The secondary mortgage market does not exist in most countries and the main limitations to its development are the limited depth of financial markets and the lack of institutional investors.<sup>15</sup> In several countries, State agencies have emerged to support the development of a secondary mortgage market, thus overcoming the absence of long-term sources of finance (Box 13).

<sup>15</sup> Bulgaria has introduced legislation and institutional infrastructure to mobilize long term finance. During the period July 2001 to September 2004, seven Bulgarian banks financed mortgages by issuing EUR 63 million in mortgage bonds. The bonds, denominated in either EUR or BGN, had maturities of two, three or five years, and interest rates ranging from 6.1 percent to 8.00 percent (Merrill *et al.*, 2003).

### **Box 13: State agencies for mortgage lending: creating a secondary mortgage market**

The Russian Agency for Housing Mortgage Lending (HLMA), operating on a more significant scale since 2002, provides funding for the refinancing of mortgage loans on the basis of a three-tier system involving commercial banks, regional operators and the HLMA. Bonds issued by the HLMA are not backed by mortgage securities; rather they are corporate bonds with a state guarantee. However, the maturity of these bonds is typically shorter (around six years) than that of the underlying assets. Rising inflation rates imply that the bonds must be replaced at higher rates when they mature, while falling inflation (and interest) rates increase the likelihood of prepayment and associated income loss. The refinancing activities of the HLMA have been crucial in promoting the development of mortgage markets in the Russian regions. Most mortgage lending is denominated in foreign currency, but the HLMA conducts its operations exclusively in roubles. In addition to the direct provision of liquidity, the agency plays a significant role in introducing standards for mortgage products, thus providing the necessary foundation for the development of secondary mortgage markets.

The Kazakhstan Mortgage Company, which started operating in 2001, works in a similar way, buying off mortgages from partner banks and placing bonds with investors to refinance them. The credit risk remains with the participating banks, which must repurchase the loans in case of default. As in Russia, mortgages granted under this programme must observe certain standards related to its key parameters (e.g. loan-to-value ratios, payment capacity coefficients) and can only be denominated in the national currency.

*Source: Palachin and Shelburne, 2005*

### ***Improved Lending Practices for Housing***

The development of a mortgage system has been driven by the banking sector's search for new business opportunities, but also by State programmes subsidizing mortgage finance. This is certainly the case in several EECCA countries (see Box 14). Increasing competition in the provision of financing for housing, particularly in those countries with more advanced systems, has driven the introduction of new mortgage products and better financing conditions. *Typically over the last decade, repayment terms have been lengthened, loan-to-value ratios have increased, and interest rates have fallen, all of which improve affordability.* These changes in mortgage terms have played a significant role in supporting the growth of mortgage lending in the most dynamic markets (Butler *et al*, 2004; Merrill *et al.*, 2003).

#### **Box 14 Subsidized State Mortgages in Azerbaijan**

Development of the mortgage market in Azerbaijan began in 2005 with the adoption of the *Law on Mortgages*. The Law established a legal framework for mortgage lending, including the possibility of using unfinished buildings as collateral. *The Presidential Decree on the Establishment of the Mortgage Lending System in the Azerbaijan Republic* created a State mortgage refinancing facility (AMF). Under the programme, the Central Bank of Azerbaijan selects banks who act as agents of AMF in issuing mortgages. The interest rate for the borrower was up to 8 percent, of which AMF receives 4 percent. There were no limits on banks' issuance of mortgages, which in combination with the high demand has led to AMF unexpectedly running out of money in May 2007 and being unable to purchase all mortgages issued by participating banks. In 2007, the conditions of the programme were changed by a Presidential decree: the term was increased to 25 years, the loan-to-value (LTV) up to 85 percent, the PTI up to 70 percent. The maximum size of a mortgage was set at 50,000 AZN. For several categories of households (e.g. young families and public servants, academics, refugees and IDPs, as well as certain military personnel), mortgages were provided at 4 percent interest.

Before liquidity problems occurred, AMF had refinanced mortgages totalling about 62 million AZN, of which 92 percent were issued in Baku city. A few banks offered their own mortgage programmes, but could not compete with the heavily subsidized State mortgages. Bank mortgage terms were unaffordable, with interest rates around 16–18 percent and average terms of five years. At this stage of development in the mortgage market, mortgages are affordable only for a small share of high-income households. Less than 2 percent of the workers can afford monthly payments for a typical commercial mortgage; these are mainly employed in the financial sector and mining.

Source: ECE, 2010b

A substantial diversity of financing conditions and mortgage products exists in terms of the types of products offered, the funding instruments used by the banking sector and, ultimately, the financing costs borne by households. Banks offer maturities that range from 10 to 25 years. Lending interest rates vary widely, ranging from a low of 5.5 percent to a high of 12% depending on the prime rate in each country and a number of factors such as: (i) the currency of denomination (ii) the client's credit risk profile, (iii) the personal relationship between the bank and the customer, (iv) the number of guarantors and (v) the down payment made. Loan-to-value (LTV) ratios generally range from 50 to 70% (ECE, 2005; 2006a; Butler *et al.*, 2004; IFC, 2007; Merrill *et al.*, 2004).<sup>16</sup> In most cases payment instalments cannot exceed 33% of household (regular and formal) income. Regular

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<sup>16</sup> Foreign-currency-denominated loans dominate the market in Armenia, Kazakhstan due to lower interest spread differentials. A typical mortgage loan currently offered in EECCA countries is short-term (three to five years), requires a considerable down payment (30% to 40%) and carries a high annual interest rate (up to 25%, fixed) for both US\$ and local currency loans (IFC, 2007).

income and employment stability is compulsory. In cases where informal income represents a high amount of total income, lenders usually require collateral for the mortgage as well as 1 to 3 guarantors (ECE, 2010b). Guarantors must meet the same eligibility criteria as the borrower to counteract instability in income and employment. The banks have devised numerous schemes for “risk-based” pricing, varying the interest rate with the size of the loan and the size of the compensating balance.

**Box 15: Inefficient mortgage lending and impact on affordability in Croatia**

The Croatian mortgage market at present, although still far from EU standards, is extremely more developed than any other in the SEE region. The total amount of outstanding mortgages represents 12% of GDP and is 20 times the amount in Bosnia and Herzegovina and over 60 times the amount in Former Yugoslav Republic of Macedonia or Serbia. However, the growth of real estate lending is limited by the legal and administrative problems, especially those plaguing foreclosure and registration. Banks have conservative underwriting criteria, often requiring two to three guarantors and collateral, due to legal uncertainties and incomplete property registration systems. Banks are inherently suspicious of private developers and there is no lending for new housing construction.

Overall, the development of effective institutions – credit bureaus, notaries, property appraisers, mortgage brokers in the emerging mortgage market of Croatia faces numerous challenges. In addition, high interest rates and underreported income, including the substantial amount of informal income, limit both the number of qualifying clients and the size of the loan. The interest rate spread between loans and deposits in local currency of 4.5% is still considerably high, two to three times higher compared to the average in Hungary and Slovakia. As a result of high interest rates and interest rate spreads, but also perceived risks in mortgage lending, banks have focused their marketing on the upper income groups and favour corporate customers. It is estimated that in Croatia only 14% of the households can qualify for a mortgage as opposed to 3% in Former Yugoslav Republic of Macedonia or less than 1% in Serbia.

*Source: Registra et al., 2005*

*The practice of mortgage lending during the transition period indicates that banks remain very risk averse and tend to adopt an over-collateralized approach. This includes multiple guarantors, low LTV ratio, higher interest rate (spread) and lending to high income groups (see Box 15). In addition, many banks do not engage in construction lending due to uncertainty about titling and ownership of un-built land, which is a significant constraint for new housing construction, particularly in the case of multi-apartment housing (see ECE, 2000; 2002; 2003b for country specific information). Furthermore, the lack of mortgage*

support institutions is a constraint. This implies an effective legal enforcement of foreclosure; an appraisal process based on international standards; credit information bureaus; and mortgage-related insurance products. Most of the countries, particularly in EECCA, lack professionally licensed real estate agents and property appraisers and credit bureaus.

### ***Fiscal Policies to Encourage Housing Investment***

Despite the generic subsidy cutbacks during the transition, the housing sector in the region still maintains a diverse set of measures to ensure access to affordable housing as well to provide assistance to groups with special housing needs. The mix is complicated to evaluate since there is no systematic assessment of different government programs (central or local) in terms of their efficiency (costs), targeting and effectiveness (outreach). Expert estimates suggest that in most countries housing subsidies, excluding war reconstruction and refugee related programmes, are less than 1% of GDP (Tsenkova, 2009; Puzanov, 2009). Most of the support aims at homeowners providing a combination of public provision and demand-based assistance (grants, interest subsidies and tax incentives). Romania, Hungary, Poland, Slovakia and The Czech Republic have the most comprehensive housing programs, while in Bulgaria and the former Yugoslav Republic of Macedonia housing has almost disappeared from the policy agenda in the last fifteen years. Other countries such as Albania, Republic of Moldova, Azerbaijan, Belarus and Georgia, to name a few, are grappling with major economic difficulties, which reduce fiscal support to a limited set of policy measures with inefficient targeting.

*The 'trial and error' approach to different subsidy schemes has been plagued by populist policies, lack of political sustainability and inability to establish sound and transparent fiscal policies* (Tsenkova, 2009; Struyk, 2000). Hungary, Estonia and Poland, for example, have experimented with a variety of demand- and supply-side subsidies to increase housing investment in new construction and renovation with constant adjustments in the level of subsidy, interest rates and loan amounts.<sup>17</sup> Although there has been an attempt to

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<sup>17</sup> A popular subsidy in Hungary was the 'Szocpol' (housing construction allowance) introduced in the 1990s, which favoured young families with children. Generous subsidies for soft loans rapidly increased the volume of mortgage lending in 2003 and the Hungarian government in a desperate move to regain some sustainability in the housing system, cut back the subsidies by half. Just in 2003, an additional loan volume of HUD 800 bn (EUR 3.2 bn, resulted in an interest subsidy of

reduce the commitment of governments through State provision of housing, a majority of the countries in EECCA and SEE still maintain these types of programs.<sup>18</sup> Similarly, a large number of countries have grants and subsidies for homeowners with a mix of programs assisting war reconstruction (Bosnia and Herzegovina, Croatia, Georgia, Azerbaijan) and subsidies to purchase or renovate housing through contract saving schemes (Slovakia, the Czech Republic, Romania). Tax incentives for homeowners are applied in Romania, Poland, Hungary, Russia and Croatia.

**Box 16: The role of National Housing Funds as a policy instrument**

In **Slovenia** the Fund has provided 30,000 loans (90% of those to homeowners). The State Housing Development Fund in **Slovakia** established in 1996 served the same purpose, financing 80% of the housing costs at 3% interest rate for 20-30 years. A more generous scheme in the initial years included a grant. Due to rapidly expanding demand for these soft loans, the conditions had to be tightened with limits on the maximum loan amount, income and size of housing. The subsidies required to maintain the Fund's portfolio consume 30% of government expenditure in housing, with the Contract Savings accounting for another 30%. A similar fund exists in the Czech Republic, but its operation has become rather limited since 2005 (Donner, 2006).

By contrast, in **Belarus** the main policy instrument in the housing sector is subsidized housing through soft loans administered by Belarusbank, a state financial organisation. According to Presidential Decree No. 185 of April 2000, soft loans cover 90% of the total cost of construction, have an interest rate of 5% and maturity of 20 years. For families with many children living and working in settlements of up to 20,000 inhabitants, conditions for soft loans are more favourable: 3% interest for 40 years of up to 95% of construction costs. By comparison, market housing loans in Belarusian roubles have a maximum of 15 years maturity with an interest rate of 16–19%. Soft loans are given to households registered on a waiting list in need of housing. In 2008 the list included 717,500 households with the majority living in the capital city and Minsk oblast. Belarusbank allocated about 1.5486 billion roubles in 2007 in soft loans. Certain vulnerable groups on the waiting list can receive an additional down payment grant to cover part of the loan; the maximum amounts to 70% of the normative construction costs/ sq m of floor area and is dependent on the number of years spent on the waiting list and the level of household income (ECE, 2008).

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HUD 80bn (EUR 0.3 bn), or 10%. Further changes limited the loan amount and set 'normative' construction cost ceilings, but introduced tax deductibility for housing investments and a state guaranteed program for young households allowing LTV ratio of 80-90% (Donner, 2006).

<sup>18</sup> In Albania the target group is limited to households affected by restitution or identified as 'homeless', in Moldova public housing agencies are using state subsidies (frozen assets in unfinished housing construction) to complete the projects with additional funding from potential homeowners. In Romania, the national housing agency is building subsidised housing for young households. Serbia and Montenegro until recently maintained a socialist type of housing provision through the Solidarity Fund.

A number of countries have established National Housing Funds in the 1990s to provide soft loans for construction and purchase of housing, while others have used State financial institutions to administer such loans. Due to competition and better performance of housing finance, the role of these institutions has diminished in most of the new EU member states, but they have become an important policy instrument for some EECCA governments (Box 16). The operation is rather similar and consists of lending at below market rates for 20-30 years.

Despite the relatively low level of direct budget allocations for housing, considerable public resources indirectly flow into the sector. These implicit housing subsidies take a variety of forms: subsidies to cover emergency repairs in multi-apartment housing, provision of subsidised land and infrastructure for owner-occupied and rental housing under new programs (Romania, Serbia, Moldova, Albania), non-existent market based property taxation (Serbia, Montenegro, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, and most EECCA countries), no value added tax on housing construction (Serbia, Russia), tax incentives (Poland, Hungary, Croatia, Russia). *These **regressive subsidies** in most of the cases support homeowners in higher income brackets, while very little is allocated for new provision of rental housing and for housing allowances.*

## **5.2 CHALLENGES AND OPPORTUNITIES**

Housing and banking sector reforms in the second phase of transition have improved the availability of long-term financing for housing and the diversity of mortgage products. In some countries in the region these developments have resulted in rapid growth of mortgage lending and in a more efficient legal basis for housing finance (mortgage legislation, collateral, foreclosure). Efficiencies of mortgage institutions and competition have improved the diversity of mortgage products leading to higher loan-to-value ratio, longer amortisation period, lower interest rates and lower spread (the margin between interest rates on mortgages and deposits). *Still in many countries across the region, State housing institutions act as a substitute for market-based finance and Governments continue to identify the lack of housing finance as a main constraint for efficient operation of housing markets.* Mortgage lending is subsidized in most countries through soft loans, deductibility of interest payments, grants and a myriad of housing programs tied to new housing construction. These subsidies, relatively more generous at the start, have been

adjusted over time in an attempt to catch up with market dynamics while maintaining a more sustainable system of housing finance.

In summary, most countries in the region have fiscal policies that support homeowners through a combination of public provision (supply-side subsidies) and demand-based assistance (grants, interest subsidies and tax incentives). *The lack of financial transparency in housing policy and fiscal sustainability, in addition to low targeting reflect the rudimentary nature of fiscal housing policies in the region. The majority of subsidies are regressive in nature, aiming at leveraging private investment in new owner-occupied housing.* It is questionable if scarce public funds should be used to support upper middle income households, while little government funding is directed to public rental housing or assistance of low income households experiencing affordability problems.

**Box 17: Recommendation 4: Establish an efficient system of housing finance and innovative fiscal and financial instruments to support access to affordable housing**

Governments in the region should focus on establishing an efficient housing finance system and on the design of innovative fiscal and financial instruments to support access to affordable housing. These instruments, although different in SEE and EECCA countries, need to be resilient to political and economic instability, sustainable over the long term, and well targeted. Priority should be given to adequate fiscal support to low income households experiencing affordability problems and homelessness.

Notwithstanding the differences in macroeconomic conditions, banking and mortgage lending systems across the region, *UNECE Housing Finance Systems for Countries in Transition - Principles and Examples (2005)* as well as country profiles of the housing sector provide a number of generic and more specific recommendations highlighted below.

In order to improve the legal framework for housing finance and enhance the competitiveness of the mortgage industry, the following actions should be taken:

- (a) Introducing laws regulating the activities of specialized housing finance institutions, such as savings banks or mortgage banks, and financing through bonds and mortgage-backed securities;
- (b) Transforming existing housing development funds into mortgage or saving banks in cooperation with commercial banks with the possibility of being privatised in the long run;
- (c) Managing risks through mortgage insurance, credit security provisions and adequate foreclosure procedures;
- (d) Improving the implementation of legislation on pledge/bankruptcy, which gives priority to creditors secured by a mortgage as well as legislation on evictions on the basis of mortgage default;
- (e) Implementing complete land and real property register (uniform state register) by extending its coverage, streamlining the procedures, reducing the required fees and ensuring reliability of title certification.

To stimulate mortgage lending and to make access to housing finance more affordable, a fiscally responsible housing subsidy policy should be developed. This involves:

- (a) Introducing housing subsidies targeted towards relevant groups (e.g. young families, key workers with a stable income but no possibilities for taking out loans on the open market) that is transparent, means tested and monitored to ensure that the subsidies are limited and not regressive;
- (b) Introducing limited direct subsidies (credit guarantees for lenders, mortgage insurance) and indirect subsidies (e.g. interest subsidies for mortgage bonds) to make mortgage loans cheaper for borrowers and to facilitate the development of a capital market instrument (covered bond);
- (c) Considering incentives that bring about cooperation between commercial and specialized banks to make mortgage lending less dependent on funding through deposits as well as establish a more robust real estate finance system.

In the fiscal realm, the public sector (central, regional and municipal) needs to generate funds for its housing policy addressing the needs of socially vulnerable households and growing affordability problems. The following steps should be considered:

(a) Establishing housing funds at the local and central level by earmarking resources generated by the selling or leasing of real estate, by the property, income and business tax, and by annual budgetary allocations to finance the implementation of central and local housing policy.

(b) Directing such fiscal resources strategically to leverage private sector and international donor investment to support provision of supply- and demand-side programmes responding to the needs of socially disadvantaged and vulnerable households (social housing, affordable rental housing and housing allowances).

(c) Undertaking a complete review and assessment of all fiscal instruments in the housing sector, particularly those subsidies that aim at new housing construction and homeownership and eliminate poorly targeted and inefficient ones. Fiscal responsibility and social targeting need to be consistently aligned.

## 6 FACILITATING IMPROVEMENTS IN HOUSING QUALITY

### 6.1 PROGRESS ACHIEVED AND PROBLEMS ENCOUNTERED

#### *Changing Housing Conditions: Quantity and Distribution*

Housing conditions in most countries in the region have improved in the last decade. Using the general ratio of dwellings per thousand inhabitants as a crude indicator of the adequacy of housing provision, indicates some improvement in the last two decades, although at a much lower level compared to the 1980s. In SEE and new EU member states the number of dwellings per 1,000 people is lowest in Albania (254/1000) followed very closely by Poland (314/1000) and Slovakia (318/1000). Housing shortages across most countries in the region are often associated with particular housing qualities and location than the absolute shortage of housing in general. The question of housing deficits has become less relevant to market realities; in fact a lot of countries have a significant housing surplus.<sup>19</sup>

Local housing market mismatches pose an additional, often neglected quantitative problem. Despite the overall surplus of housing, the census data indicate that the capital cities in the region experience housing shortages and overcrowding and that overcrowding seems to be more problematic for low income households. In the Czech Republic, Hungary and Poland, well over 60 % of those at risk of poverty are identified as having a problem of shortage of space in their house or apartment, and in Latvia, Lithuania and Slovakia over 55 % (EC, 2010). Dwellings on average tend to be small and often accommodate more than one household or the ratio of persons per room is higher than one (Hegedus et al, 1996; Buckley and Tsenkova, 2001). Evidence from the census data in Albania, Bulgaria, Latvia, Ukraine and Romania indicate similar problems (ECE, 2002; 2005, Tsenkova and Turner, 2004). Part of this mismatch, and the deficit of affordable housing in high growth urban centers, is related to migration to places with more dynamic labour markets in pursuit of employment opportunities, but also to the inefficient use of the existing housing stock. Data on vacancy rates show that more than

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<sup>19</sup> The housing surplus ranges from 786,000 units in Romania to 58,000 in Albania. In terms of its share of the total stock, most countries in SEE have a surplus in the range of 12-14 percent with Albania (7%) and Montenegro (24%) being the two extreme situations (Tsenkova, 2005).

10-14% of the housing stock is vacant, substantially higher than the EU average. This might be due to substandardness of housing and/or lack of demand in rural areas.<sup>20</sup>

*EECCA countries* had different housing conditions at the start of the transition, although the legacy of socialist housing provision and extensive state investment has ensured higher availability of housing compared to countries with similar level of economic development and per/capita income. Studies point out to absolute shortages/deficits of housing at the national level and in particular in the capital cities. These countries have experienced delayed urbanisation with rapid influx of rural population since the start of the transition, which added to much stronger population growth rates, has exacerbated the pressures on local housing markets resulting in acute housing shortages. In Tajikistan population growth from 1998 to 2005 was 16.5%, while the growth in housing stock was only 9%. Housing area per capita at the end of 2005 was 8.7 square meters, which is 27% less than the norm of 12 sq.m. Similarly in Kyrgyzstan the population has grown from 4.7 million in 1997 to 5.1 million in 2005. Bishkek with 200,000 migrants from rural areas reportedly experiences acute housing shortages. In Dushanbe, the capital of Tajikistan, the city's population has reached close to 1 million due to rapid migration creating a potential deficit of 100,000 dwellings (IFC, 2007).

### ***Improvements in Housing Quality***

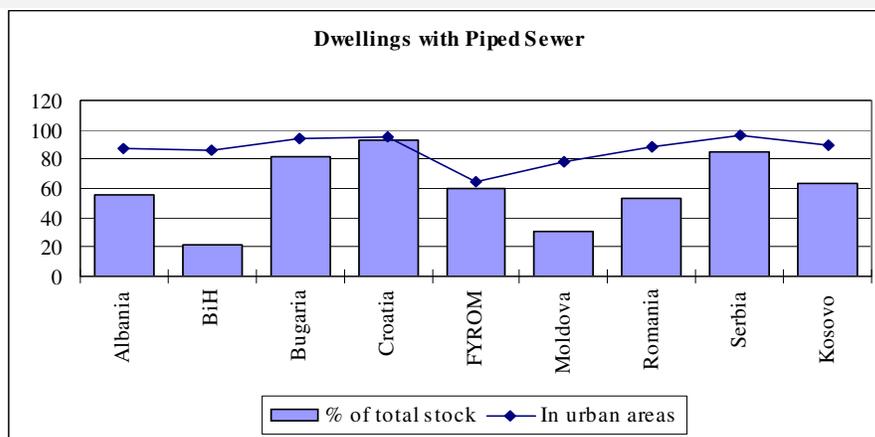
Access to water and adequate sanitation in the region is relatively high with significant regional variations. The available data indicate improvements in the share of housing serviced with piped water and sewer since the 1990s. However, the situation with piped water supply in the housing stock of *EECCA* countries is particularly problematic in countries such as Moldova and Uzbekistan with services available in one third of the stock. In *SEE*, Albania and Romania stand out with half of the housing lacking piped water. Available data presented in Box 18 indicate even more limited servicing in Bosnia and

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<sup>20</sup> In some countries—Albania, Bulgaria and Romania—high vacancy rates are reportedly due to immigration. Absentee homeowners often do not rent out these units, even in urban areas where demand is high. In countries affected by war, massive displacement of the population has resulted in higher vacancies in areas where people are reluctant to return (Leckie, 2002). Last but not least, second homes, which are not used for permanent habitation, are very important element of the housing markets in Croatia, Montenegro and Bulgaria, explaining the high vacancy rate and the surplus of housing in these countries (Tsenkova, 2009).

Herzegovina and Moldova, as well as a significant urban-rural inequality. Certainly high connection rates do not necessarily mean good quality of piped water since drinking water frequently fails to meet basic chemical standards. Substantial problems are known to exist in the water supply in Albania, the Republic of Moldova, Georgia, Kyrgyzstan and Ukraine related to poor quality and interrupted service. Sanitation is also problematic in Belarus, Georgia and the Russian federation where 15-22% of the samples do not meet chemical standards (WB 2005a).

**Box 18: Urban-rural inequality in housing services**



The pattern of urban-rural inequalities illustrates the difference in housing quality standards in rural and urban areas. The comparative data suggest a backlog in the provision of sewer for close to 80-70% of the

dwellings in Bosnia & Herzegovina and Republic of Moldova. In Albania and Romania 60% of the dwellings lack these essential services. While the majority of the urban housing (80-98 percent) has piped water, two thirds of the dwellings in rural Moldova, Albania and Romania lack modern water and sewerage facilities. Furthermore, the scarcity of resources for much-needed upgrades in the technical infrastructure has led to deterioration of existing networks and frequent disruption of services.

Source: Tsenkova 2009

Supplying safe drinking water and adequate sanitation in the housing stock is therefore an important issue in many countries and requires explicit emphasis on quality. The problems are complicated by the inability of national governments, municipalities and municipal companies to ensure maintenance and investment in the existing infrastructure systems. On the demand side, contracting incomes and growing poverty have prevented price adjustments to achieve cost recovery and to provide needed revenue (World Bank 2000; 2005a).

**Figure 3: Deteriorating quality in privatised housing in Tbilisi**



Closely related to housing quality are the age characteristics of the housing stock. The available data indicate that most of the housing across the region was built after the Second World War, coinciding with urbanization and the growing affluence in these nations. The oldest part of the stock, built before 1919, is less than 4-5%. Investment in housing provision during communism across the Soviet Union and Eastern Europe has resulted in waves of new construction, particularly in urban areas since the 1970s, to respond to urban growth. The output from 1971 to 1989 was particularly significant in all countries with the exception of Poland, Slovenia, Romania and the Czech Republic, where the share of new construction between 1946 and 1970 played a more prominent role (ECE, 2006, MolIR, 2006). Not surprisingly, housing production in the post-transition years added less than 10% to the housing stock in most countries. In the newly built housing, quality and standards are higher with significant diversity manifested in the provision of different types (low to mid-density housing), styles and architectural design. While new housing is generally larger and adequately serviced by infrastructure (electricity, water, sewer), which contributes to the overall improvement in housing

conditions, a new pattern of informal housing provision, through illegal construction, has emerged in a number of post-socialist cities. These informal developments are often substandard and difficult to evaluate as neither the houses nor the level of services are documented in official statistics (see ECE, 2002; 2006a; 2007; 2010a for additional detail).

### ***Ensuring Safety and Quality in Privatized Multi-apartment Housing***

*An important aspect of housing quality in region is related to improvements and investment in multi-family housing. In the privatization aftermath, the management and rehabilitation of multi-apartment housing is potentially one of the largest problems facing municipalities in the region, since failure to carry out repairs will result in massive structural problems in more than 40% of the urban housing stock. Addressing the problems of deteriorating housing quality in privatised multi-apartment housing is related to two significant challenges—technical/management and financial. Some municipalities have initiated pilot projects that demonstrate positive results (see Box 19).*

#### **Box 19 Tbilisi Corps Experience in Multi-apartment Housing**

In July 2004, the city of Tbilisi has established Tbilisi Corps to implement the programme supporting the development of homeowners' associations. Tbilisi Corps is a municipal unit that employs 21 persons as well as several contract-based individuals in different parts of the city who serve as a contact between residents and the city. It assists owners in establishing homeowners' associations and provides training and capacity building on condominium management to association leaders. Tbilisi Corps also offers financial assistance to established associations for renovation projects. Three major projects have been initiated, following the public-private partnership principles of financing.

The activities of Tbilisi Corps depend fully on the municipal budget. So far, 10 million lari have been provided from the city budget. An additional 1.5 million lari for 2006 were guaranteed, and 750-800 homeowners' associations had submitted applications for 1,600 renovation projects by June 2006. Similar projects are foreseen in the future to assist 2,600 homeowners' associations in Tbilisi to undertake improvements in the privatised multi-apartment stock. This pilot initiative establishes the financial, organisational and technical mechanisms to improving the management and quality of multi-apartment housing. It is equally important, however, that follow-up activities and maintenance schemes be established to keep reconstructed roofs, lifts and pipelines in satisfactory condition for the long run.

Source: ECE, 2007

**On the technical and management side**, the collective form of privatised housing from the past has a critical effect on housing management in terms of institutional, legal and organisational challenges. Every observer in the region concludes that the deterioration process in parts of the urban stock has reached a critical stage. Panel technologies, which featured prominently in Russia, Lithuania, Bulgaria, Republic of Moldova, Romania, Georgia, Kyrgyzstan Tajikistan and Azerbaijan, resulted in large scale developments with demanding requirements for their housing management. Multi-apartment panel blocks account for nearly half of the urban housing stock in Bulgaria, Romania, the Czech Republic and Moldova. They make up 70% of all housing in Bucharest, 45% in Sofia, 30% in Budapest and 20% in Ljubljana (Tsenkova, 2008). In Armenia the share of multi-apartment housing is 52%, while in Georgia it is 67% in urban areas (ECE, 2004; 2007).

Although most urban multi-apartment housing is less than 40 years old, its initial quality was not very high. Subsequently, inadequate investment in maintenance as well as deferred capital repairs have aggravated the technical problems with leaking roofs, obsolete installations, elevators and poor wall insulation (ECE, 2002; 2008; 2010a). The energy efficiency of the stock is very low and with the deregulation of energy costs and the elimination of subsidies, households were faced with disproportionately high costs for heating, crowding out the ability to invest in other housing related costs.<sup>21</sup> In several countries, particularly those with cold winters, energy poverty has become a major problem. In Armenia and Moldova, the country profile team reports that over 50% of the residents use wood as the main source of heating due to the deterioration of district heating systems (ECE, 2002; 2004). In Russia, a complex system of tariff subsidies reduces the costs to residents, but leads to chronic underinvestment in utilities. Residents cover only 20-40% of their housing costs as the tariff system includes a complicated social support system, privileges and subsidies for 60-70% of the population. The remaining housing costs, 60- 80%, are supposed to be provided by municipalities, but this is rarely the case (ECE, 2005). Furthermore, the accelerated privatisation of the housing stock often transferred ownership of the apartments while municipalities were left with the ownership of buildings, land and common areas. Mixed ownership is an issue in countries such as Latvia, Russia and the Czech Republic where owners and tenants live in the same building (Tsenkova, 2005).

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<sup>21</sup> Households in Hungary spend approximately 20% of their incomes on utility costs of which a major part is heating expenditures. For lower income categories this share increases to 27-37 % of their incomes (EC, 2010).

Studies indicate that despite the effort to establish an adequate legal framework for the operation of homeowner's associations, new owners are reluctant to take over these responsibilities. Municipal maintenance companies still manage privatized housing under contractual obligations at locally controlled prices. The tariffs for maintenance are too low so households do not pay the true costs for services. At the same time the government lacks sufficient funding to make up the difference. In addition, the level of housing related services (water, energy services, district heating, garbage collection and waste management) has declined because of subsidy cuts, rapidly escalating costs and utility payment arrears. As a result of these processes not only the public services have deteriorated, but the normal maintenance of the housing stock has also accumulated a huge backlog (ECE, 2007; World Bank, 2006). These problems manifest themselves to various degrees across the region with many of the new EU member states performing better in terms of the institutional and financial framework for housing management. Access to EU structural funds for energy efficiency retrofits has provided an additional boost for such developments.

**Lack of adequate financing** is considered a major constraint for asset management. While recent years have introduced a budgetary discipline and more transparent and accountable budgetary processes in some countries, chronic underinvestment in maintenance has left owners with major technical challenges. In most of the cases multi-apartment buildings have reached this critical stage in the lifecycle assessment where a major infusion of capital will be needed to bring them back to standards. The buildings have poor quality and the current stream of revenues does not ensure sufficient funds for renovation and improvement of the building envelope (roof, foundations, elevation, etc) and energy efficiency retrofits. Furthermore, in addition to the traditional technical and organizational challenges, it is difficult to borrow funds for major improvements. Banks often request individual owners to sign a mortgage or a loan contract, which makes the process extremely cumbersome and costly.

## Box 20: Housing rehabilitation programs in Hungary and The Czech Republic



In **Hungary**, the *Széchenyi Plan* of 2001 aimed at mobilization of the nation's resources to improve the energy efficiency of housing estates built from pre-fabricated elements and owner-occupied single family housing. Two programmes with a total budget of 55 million EUR provided a 30% subsidy towards the cost of energy efficiency retrofits and quality improvements. The subsidy leveraged substantial private investment and targeted the improvement of energy efficiency parameters of the buildings (insulation, heating, individual heating regulation facilities, replacement of doors and windows).

**The Czech Republic** offers another positive example, despite the small outreach of its panel renovation programs. The government has launched two programs since 2001 aiming at the rehabilitation of multi-apartment as well as regeneration of panel housing estates. Low-cost credits and subsidies fund up to 70% of the costs, while homeowners, cooperatives and municipalities provide matching funds. Most of the borrowers (85-90%) are housing cooperatives and homeowners' associations. So far the programs have assisted the rehabilitation and energy efficient retrofitting of less than 8% of the panel housing.

*Source: Tsenkova, 2010b*

The financing of rehabilitation requires specially designed credit lines and some incentives (tax exemptions, rebates, etc) to facilitate the process (Box 20). Very few countries have launched national programs to assist this process (e.g. Latvia, Lithuania, Hungary, the Czech Republic and Slovakia). The key issue is mobilization of funds, savings (including intergenerational savings), loans and mortgages to pay for rehabilitation and renewal. Various mechanisms can be used to encourage financial institutions to develop competitive products (state guarantees, shallow subsidies, insurance). This needs to be complemented by targeted subsidies and reversed mortgages for low income owners to allow renovation measures to proceed at a large scale for the whole building.

### ***The Growing Problem of Substandard and Informal Housing***

Across the region, studies point out to a growing share of housing in unsafe and substandard conditions in rural and urban areas due to systematic disinvestment and deferral of maintenance in the last decades (Tsenkova et al 2009, Duncan, ECE Country Profiles on the Housing Sector). Some estimates by UN-HABITAT indicate that about 10% of the urban population in the new EU member countries lives in substandard conditions without access to basic services and/or in overcrowded dwellings. In Central Asia more than half of the urban population lives in such conditions (56% in Tajikistan, 52% in Kyrgyzstan and 51% in Uzbekistan). Elsewhere in the region these rates are 30% for the Republic of Moldova and Kazakhstan and 19% in Romania, Bosnia and Herzegovina, Croatia and Macedonia (UN-HABITAT, 2005a).

**Figure 4: Substandard informal housing in Podgorica, Montenegro**



Substandard housing is often found in the residualised public housing sector, as is the case of the *kommunalki* in Russia, but also in inner city slum areas designated for ‘bulldozer type of renewal’ in many CEE cities. These are often Roma communities who live in *mahalas* consisting of make shift huts and shacks without any garbage collection, sewerage and indoor plumbing.<sup>22</sup> In addition to high shares of substandard housing, housing quality in war affected countries continues to be a major challenge in the region. In Bosnia and Herzegovina some 445,000 homes in the country have been partially or totally destroyed, more than 37% of pre-war housing stock. In Kosovo, 30% of the housing stock was damaged and in some cases whole villages were totally destroyed. In Croatia the damaged and demolished housing stock is over 200.000 dwelling units, or close to 13% of the total for the country. Governments in these countries have not been able to mount housing investment and reconstruction efforts to respond to the need for massive rebuilding (Tsenkova et al., 2009).

**Box 21: The new faces of urban poverty and housing deprivation in Azerbaijan**

There are approximately 800,000 illegal/informal constructions in Azerbaijan. Of these, about 350,000 are located in Absheron, Baku and adjacent areas. Estimates indicate that about 30% of the population lives in informal developments and that half of Baku’s population (4 million) lives in informal housing without any building or planning permits. Ninety per cent of illegal buildings in Baku are thought to be temporary residences for IDPs. The growth in informality has been driven by several major changes. During the period of political instability refugees and IDPs from Nagorno-Karabakh and Armenia arrived in Baku, settled on State-owned land and built houses themselves. Since 1992 migrants from poverty-stricken provinces further exacerbated the growth in informal housing. The migrants illegally occupied the land of the former State agricultural enterprises building housing without any planning permit, often with illegal connection to water and electricity.

The municipality of Khirdalan also has a disproportionately high share of squatter settlements with mixed-quality housing and varied access to basic utilities. A number of positive improvements occurred between 2005 and 2009, when more parks, schools, roads, and new houses were provided by the State. In recent years, some of the squatters have gained access to new infrastructure through projects carried out by the State-run water company under a World Bank investment and legalization project.

*Source: ECE, 2010b.*

<sup>22</sup> In Serbia around 70% of Roma households reportedly live in dwellings with no water connection, over 80% with no sewerage and 65% in illegally built settlements. In Montenegro, 32% of the Roma live in collective centers and 47% live in barracks while 455 lack plumbing and tap water at home (World Bank, 2005).

In other countries affected by internal conflicts, a high share of internally displaced people has triggered a housing crisis in host cities. Almost 7 million have become refugees or are internally displaced (IDPs) in the last decade (ECE, 2004, 2010a; IDMC, 2007; Wegelin 2003). Across the region, internal displacement continues to be a major problem in the Balkans and the Caucasus with more than 2.8 million IDPs. *These are indeed the new faces of urban poverty associated with housing deprivation and social exclusion.* IDPs often inhabit tent camps, temporary housing, old railway cars and buses clustered in unsafe and impoverished areas. They build housing by themselves using non-durable materials with limited connections to water and no sewer (see Box 21). These vulnerable groups continue to face poor housing conditions and significant obstacles to social and economic integration (IDMC, 2007). Such informal housing has emerged on the outskirts of Podgorica, Belgrade, Baku, Sarajevo and Tbilisi.

In several countries the problems are compounded by rapid migration to urban centres with migrants joining the cohorts of socially disadvantaged and vulnerable groups and housing themselves in peri-urban areas. In Kyrgyzstan, over 200,000 people have migrated to Bishkek and Osh housing themselves in informal substandard housing (IFC, 2007). In Albania informal settlements contain up to a quarter of the population in major cities and 40 percent of the built up area. The scale of these developments poses a significant economic, social and environmental challenge. In addition to the infrastructure deficit, and high economic costs due to illegality of buildings and land occupancy, some settlements are directly exposed to environmental hazards associated with land slides, flooding and environmental hazards (see Box 22).

*Notwithstanding the economic challenges for the individual residents, informal settlements pose a high political and economic cost for governments, especially in cases of evictions, legalization and resettlement.* Efforts to document the extent of informal development as well as to allocate the extra institutional capacity to integrate the settlements into the planned area of the city are extremely costly. Furthermore, local governments and public institutions need to deal with land and real estate registration, dispute resolution and in some cases compensation of private landowners. Often the inability to absorb these costs perpetuates the tolerance to the 'informal city'. The solutions so far have been limited and range from legalization, upgrading and resettlement (Tsenkova et al., 2009).

### **Box 22: The Environmental and public health challenges in the peri-urban areas of Bishkek**

Large internal migration flows in the Kyrgyz Republic in the past ten years have seen the emergence of new slums in the periphery of Bishkek—the so-called “*novostroiki*.” Today there are 23 precarious settlements of this type in the city—the largest has 4,800 land parcels, while the smallest have about 100. Most of the settlements lack basic infrastructure services and are often located in areas where there are adverse environmental health-related impacts *World Bank, 2003*.

One of the most populated slums, the Ak-Bosogo settlement, has very serious problems with water supply. Another populated area, Bakai-Ata, is located close to the ash dump of the Bishkek power and heating station, which is the source of heavy pollution. Other settlements located in the lower part of the city are flooded after rains or melting snow, which regularly destroys the houses. While some settlements resemble simple residential areas with brick houses, others constitute an agglomeration of one-room huts that have to accommodate entire families. During the harsh winters the huts are heated with coal ovens and insulated with plastic bags that close the windows and the partly open roof. While the local government has used funds from donor countries to provide the *novostroiki* with electricity, many settlements still have no water supply. Families cook and wash clothes in front of the huts using water that the women have to carry from sources that are sometimes several kilometres away. The situation seems to be particularly difficult in the Ak Bata settlement, situated near one of Bishkek’s main markets.

Due to the bad condition of the houses and the dirty coal smoke inhaled during the wintertime, lung diseases like tuberculosis are common among the settlers. Medical care is only available in some of the *novostroiki* which have medical centres. Many others do not have any medical services. As a side effect of this, the capacity of district hospitals in the cities is overstretched and the overall quality of health-care provision is deteriorating.

(source: ECE, 2010a).

## **6.2 CHALLENGES AND OPPORTUNITIES AHEAD**

The legacy of housing conditions under socialism and the level of economic development continue to influence housing quality increasingly mapping diverging experiences in EECCA and CEE countries. *The transition in housing has exacerbated the initial differences across the region leading to deterioration of housing infrastructure, growth of substandard housing and slum formation in EECCA countries.* War-related conflicts in the Balkans have resulted in a housing crisis, massive need for reconstruction and demanding provision for refugees and IDPs exceeding the ability of governments to cope with such challenges. An important aspect of housing quality in region is related to improvements and investment in multi-family housing. In the privatization aftermath, progress in developing an

adequate institutional and financial framework has been limited and a handful of countries have experimented with energy efficiency improvements with restricted impact.

*A major housing problem, largely attributed to the transition, is the manifestation of poverty, exclusion and informality in housing.* Countries in the region experiencing informal settlement growth are grappling with the same set of systemic problems related to lack of access to affordable housing, inefficient planning and land management systems as well as growing urban poverty, though in very different national contexts.

**Box 23: Recommendation 5      Develop systematic programs to improve housing quality, infrastructure provision and management of multi-apartment housing**

Governments in all countries should focus on developing systematic programs to improve housing quality and distributional efficiency. Considering the wide differences in terms of housing quality, these programs should set country specific priorities and target several policy domains—improvement of housing infrastructure, multi-family housing through energy efficiency retrofits and the eradication of informal settlements. Efforts should be placed on designing a mix of policy instruments—regulatory, financial and fiscal—to mobilise private and community sector response to achieve tangible and measurable results. Governments in EECCA and SEE should effectively mobilize national and international support to provide sustainable housing solutions to refugees and other vulnerable groups residing in substandard and informal housing.

Three UNECE publications provide a framework for policy intervention and action: (a) *Guidelines on condominium ownership of housing for countries in transition* (2003); (b) *Self-made Cities: In search of sustainable solutions for informal settlements in the UNECE region* (2009); and (c) *Green Homes: Towards energy efficient housing in the UNECE region* (2010). Key recommendations related to improvement of housing quality, infrastructure and energy efficiency are summarised below, while the issue of informal settlements is addressed in box 12.

**Central and local government need to urgently address the deteriorating utility infrastructure through:**

- (a) Mobilising funds, from all possible sources (budgetary, loans with state guarantees, grants), for repair and reconstruction;
- (b) Pursuing the principle of cost-recovery user fees, which would take into account the long-term maintenance requirements of the utility infrastructure;
- (c) Improving the quality of infrastructure services by establishing quality criteria, tariffs aiming at cost recovery and accompanying quality and quantity control mechanisms;
- (d) Complementing such policies by a system of means tested social security assistance to those households that are not able to pay tariffs at cost-recovery levels.

**The worsening condition of the housing stock, in particular the huge maintenance and repair backlog, is one of the most pressing issues in the housing sector and needs to be urgently addressed.** In this context it is recommended that:

(a) The central governments develop a strategic programme addressing the maintenance and repair needs of the stock, regardless of tenure form. This should particularly entail legislation and regulations to make sure that the common structures of multi-apartment buildings are adequately taken care of;

(b) The local governments assess the repair and renovation needs of the local housing stock and prepare local programmes with clear priorities for addressing these needs. These programmes should take into account the possibilities for mobilizing resources from the public and the private sector, including from homeowners.

**To manage and maintain the existing stock effectively**, current insecurities concerning ownership responsibilities need to be addressed in privatised multi-apartment housing which entails:

(a) Completing the transfer of ownership of privatised housing, including a corresponding share of common areas and land to homeowners and homeownership associations;

(b) Clearly defining in multi-apartment blocks the ownership and responsibilities for the building as a whole, the individual flats and the common spaces;

(c) Addressing the current management vacuum in multi-apartment buildings by local governments through assuming management responsibilities where most flats are publicly owned; and establishing effective management systems in privatised housing. Whatever the legal structure ultimately decided upon (be it a condominium managed through a homeowners' association or a cooperative), it is essential that for each building an organizational entity is responsible for the entire building and its common parts;

(d) Implementing mechanisms to ensure that homeowners' associations can effectively borrow funds to carry out repairs, improvements and energy efficiency retrofits using the land under the condominiums as a collateral;

(e) Introducing fiscal incentives (property tax waivers, grants) to encourage condominium associations to carry out long-term repairs by applying the principle of matched funding, where public funding is conditional upon investment from condominium owners;

(f) Introducing a system of targeted, means tested social security payments to support members of condominiums who otherwise would be unable to meet their obligations.

(g) Considering the introduction of reverse mortgages to fund major energy efficiency retrofits and housing quality improvements.

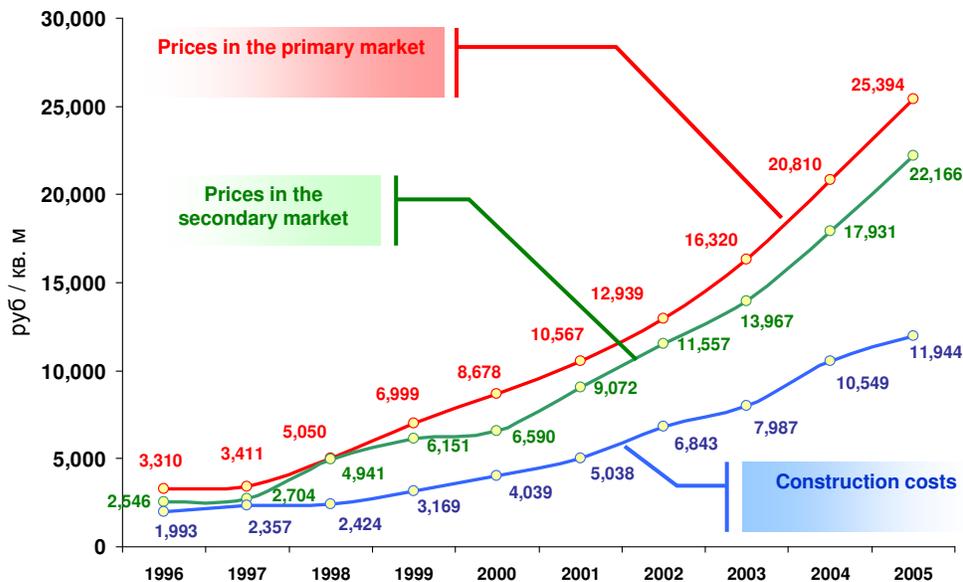
# 7 SUSTAINING HOUSING INVESTMENT AND PRODUCTION

## 7.1 PROGRESS ACHIEVED AND PROBLEMS ENCOUNTERED

### *Developing a Competitive Provision System for New Housing*

Competition and penetration of the market in the housing provision system have facilitated the development of a more diversified structure of housing provision with self-help, speculative and informal housing becoming dominant as opposed to State-funded and State-built housing provision. Privatisation measures have shifted the balance in new housing production to small firms and individual households who now account for over 85% of the total output. These rapid shifts on the supply side have resulted in better quality and more diversity of the final product. As might be expected, market agents, largely profit motivated, respond to effective demand rather than need. As a result, low-income and socially marginalised households face increasing housing problems manifested in their inability to afford adequate housing. The increase in construction costs has been a consistent trend in the markets for new housing affecting prices. Figure 5 presents these dynamics in Russia, where the increase in construction costs per sq m has been dramatic since 1996, but really accounts for less than half of the sale prices in the primary and secondary market. The formal market is delivering better quality with more variety and choice for consumers, compared to the socialist system, but at a price that excludes most first time buyers from access to it.

**Figure 5: Construction and house price dynamics in Russia**



Source: Federal Statistical Institute (Rosstat), various years.

On the basis of processes and institutions related to the promotion, production, allocation, and consumption of housing, the following major forms of new housing provision have become prominent: public/private cooperation, speculative housebuilding, self-help and informal housing.

#### **Box 24: New Housing Provision in Moscow**

Housing development is a priority in the city's investment programmes. In the next eight years Moscow municipality plans to build some 36.5 million sq m of new housing and demolish 5.6 million sq m of derelict housing. The city finances about a third, the rest is financed from private sources. Some City financed projects end up as rental housing compensating displaced residents from run down inner city neighbourhoods, others are sold to households on a municipal waiting list. Moscow is undoubtedly the leader in the Russian real estate market. In the early 1990s, realtors estimated that Moscow's housing market represented up to 75% of the whole turnover of the Russian housing market. New unfinished housing sells for US\$ 900-1,000 per sq m (without internal walls in the dwelling, equipment and finishing), while the cost of construction is only about US\$ 250 per sq m. In the elite housing sector in the city centre prices range from US\$ 3,000 to 10,000 per sq m (profits in the elite housing sector can be as much as 1,000%).

The price also depends on the stage of construction at the moment of the purchase. Shared participation (*dolevoe uchastie*) in housing investment has grown rapidly reaching 19,000 dwellings in 2002. Agreements are concluded by private individuals who acquire new dwellings at the project stage or before their completion. The price of a dwelling in a finished building can be twice as high as at the initial construction stage. One of the main reasons why such type of acquisition is more favourable than taking out housing credits from banks is the fact that, with a bank credit, borrowers have to declare their income. With the present state of the labour and taxation legislation, most people and companies prefer not to do that. However, this system of new housing construction is based not on legal regulations, but simply on people's trust in investment companies. This type of acquisition is not defined in the *Civil Code* and courts are not willing to consider cases where individual investors lose their money.

Source: ECE, 2005

**Public/Private cooperation** In this model, widely used in EECCA countries, local or national housing agencies initiate the majority of the housing schemes. Other developers are municipalities, non-profit agencies and public organisations on municipal land. The construction process is carried out on a contract basis by private construction firms under regulated costs. Funding is provided proportionally by all parties in the project using different sources: loans, mortgages, enterprise funds, subsidies, etc. Often those shared

participation schemes have evolved as a strategy to overcome shortage of construction finance, deal with upgrading of run down inner city neighbourhoods or develop non-profit housing (see Box 24). Allocation to each partner is according to its share of financed development costs. Municipalities and other public institutions as landowners often receive up to 20–25% of the units. More recently, the model has been implemented in several countries – Romania, Macedonia and Albania – to provide public rental housing, often with state guaranteed loans.

**Figure 6: A landmark residential building in Prague, architects Frank Gehry & Vlado Milunic; Client: ING Real Estate**



### ***Speculative housebuilding***

accounts for more than half of the output in the urban markets of the new EU member states, bringing investors with capital, land, building materials, equipment or labour. In the case of condominiums, landowners acquire a share of the built units, though larger firms are often in a position to buy the land. Condominiums have become a significant part of the new housing market in urban areas (Figure 6). Equity financing is the dominant source of funding both for multi-family and single-family housing, particularly in countries with underdeveloped

markets for construction finance (see ECE 2002; 2004; 2007). Costs are lowered through collective ownership over the land, common elements and shared maintenance. The scale of some developments, however, creates difficulties in management of the production

process and in coordination of financial contributions. Furthermore, the legislation provides limited protection for investors in cases of bankruptcy (see Box 24). In some cases housebuilders provide unfinished apartments (Georgia and Russia), in others, they build additional apartments within any permit (Serbia, Montenegro, Albania), which makes the building difficult to legalise (ECE, 2001; 2006a; 2007). There is a growing preference on behalf of speculative housebuilders to initiate single family housing in attractive suburban areas, where the investment risk is more manageable.

**Self-help housing** is initiated by one or two households on privately owned land and has a long tradition in small towns and villages across the region. Future homeowners often control the promotion, financing and production process. Construction tends to be labour intensive, and is carried out by a contractor with the help of the extended family for four to five years. Access to land is critical, housing construction costs are lower and the quality varies. In a number of EECCA countries self help housing is the easiest and most affordable way for the population to improve their housing situation. In Kyrgyzstan in 2007 it accounted for 87% of the total housing output (ECE, 2010a).

**Informal housing** has grown rapidly since the early 1990s. In fact, authorities in Yugoslavia had a higher tolerance towards informal housebuilding both in rural and urban areas, so large informal areas in Montenegro, Serbia, Croatia and former Yugoslav Republic of Macedonia date back to the 1970s. However, the scale of these developments today is much more challenging and varied – from slums to luxury residences, from centrally located areas to suburbs, and from several small units to large settlements. Such housing dominates the new supply in Serbia, Montenegro, Albania, Georgia, Azerbaijan and Kyrgyzstan (see country profiles for further information). Apart from addressing housing needs, illegal investments in housing have been used by many households as a ‘shield’ against instability and hyper-inflation. The construction process is heavily dependent on the availability of funds and remittances from family members. Land is often unserviced, without a clear title, but the construction is solid with concrete frame and bricks (Figure 7). As both building and planning control is limited, the quality of construction varies and materials can be of poor quality. Informal construction is carried out by private housebuilders in many high growth areas in the region (Tirana, Tbilisi, Sarajevo, Belgrade, Baku), but housing is legalized after its completion.

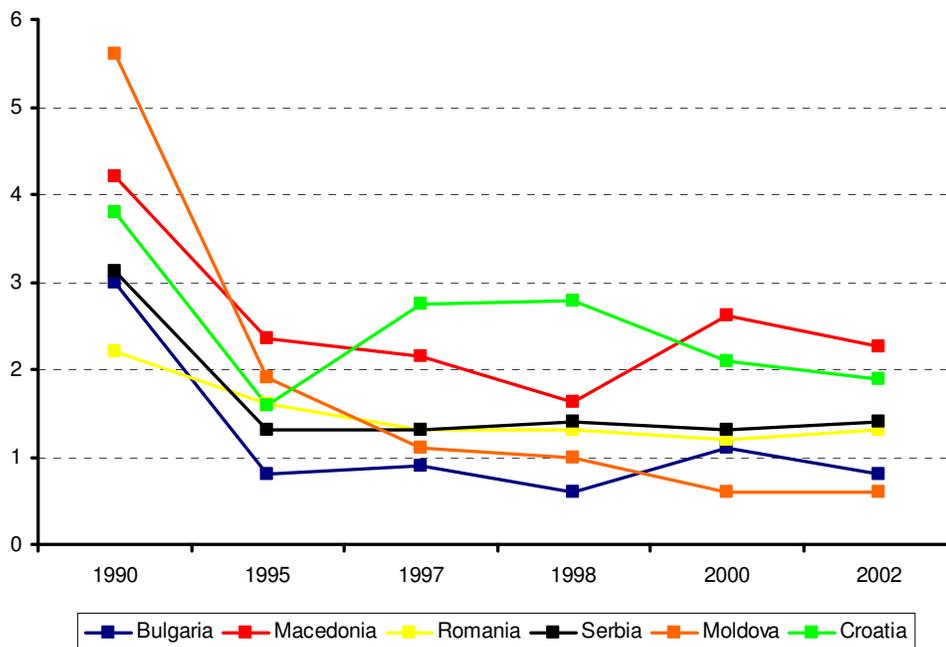
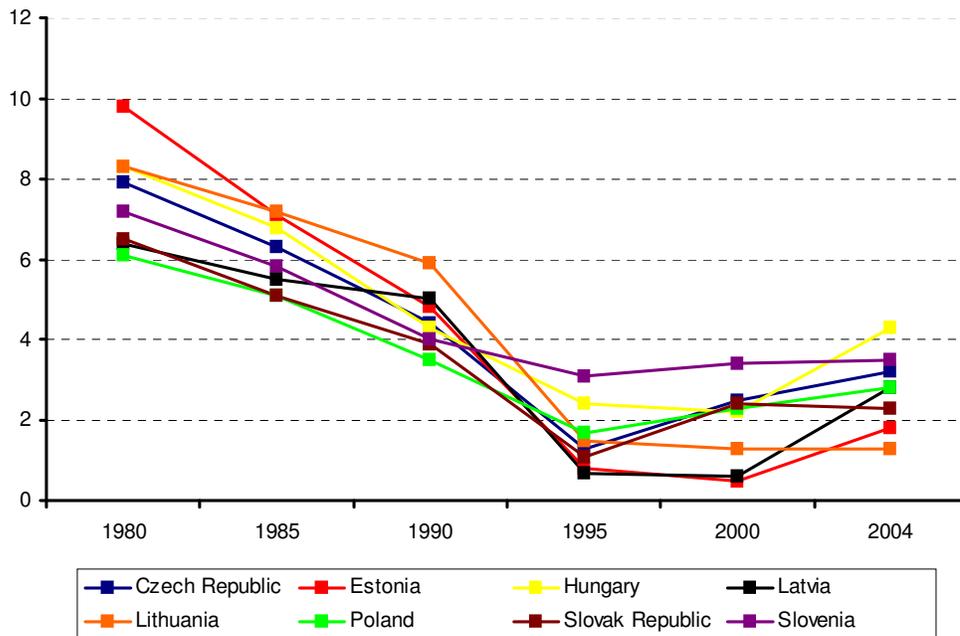
**Figure 7: Informal housing in Bathore neighbourhood, Tirana**



### ***The Recession in New Housing Production***

Available data on new housing construction in select countries are presented in Figure 8. Construction rates (dwellings per 1,000 residents) indicate different subregional patterns. Housing construction has shown signs of recovery, particularly in the new EU member states, reflecting macroeconomic stability, rising consumer confidence and availability of mortgage credit. In SEE the level of new production is around half of the level in the 1990's. Private developers continue to face financial difficulties, high inflation and a lack of adequate credit supply. With few exceptions, mortgage lenders have been reluctant to introduce alternative mortgage instruments more suitable to inflationary environments, although recent developments in Bulgaria and Romania suggest a rapid growth in mortgage lending and greater diversity of mortgage products.

**Figure 8 Rates of new housing construction in select countries**



\*Dwellings completed per 1000 inhabitants

**Source: Tsenkova, 2010b**

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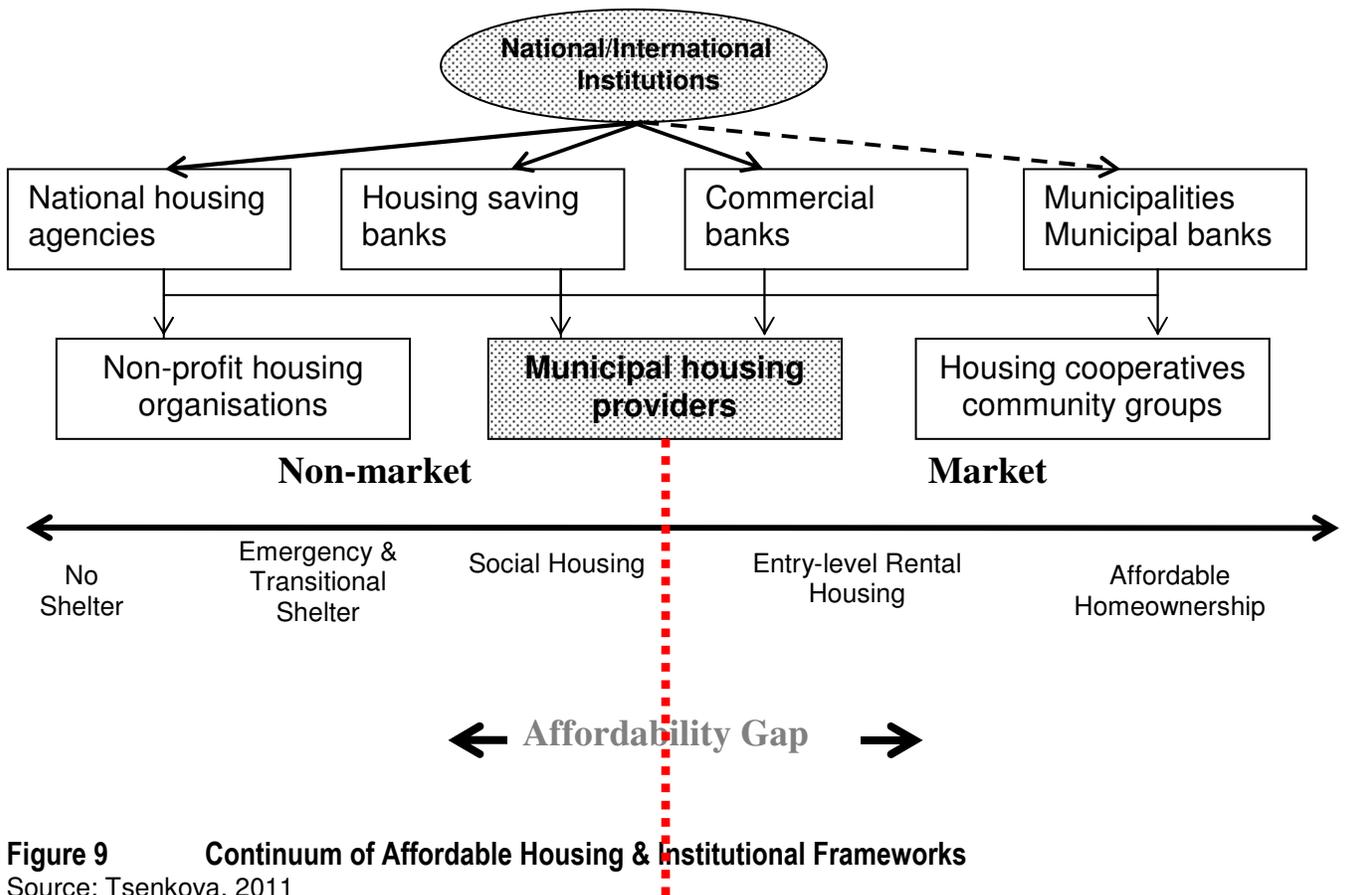
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The impact of the turbulent economic and social transition on housing output across the EECCA countries is equally significant. Lower GDP growth, persistently high inflation and low level of public investment have reduced housing output to half of its level in the early 1990s. In Azerbaijan output in 2002 was 50% of the 1993 level, in Kazakhstan - 23%, in Ukraine-35% and in Georgia-40%. Although systematic data on rates of housing construction is lacking, its volume has tripled since 2003 albeit from a very low level. For example, in Azerbaijan new housing construction has increased from 560,000 square meters in 2001 to about 1.4 million square meters in 2005 with half of that concentrated in Baku. In Kazakhstan new housing construction in 2002 was 1.5 million square meters and reached 5 million in 2005, partly fuelled by some government programs accounting for 25% of the output (IFC, 2007).

The global financial crisis in 2008 did cool the residential markets across the region. Mortgage markets in the new EU member states have tightened, some countries have plunged into a deep recession, unemployment has risen and a sharp decline in speculative housebuilding has occurred. In such circumstances the house price falls witnessed in 2008 have intensified in 2009, leading to a fall in completions. For example in Poland, starts fell by 38% and in Hungary by 40% in 2009 (RICS, 2010). In EECCA a more limited exposure to mortgage lending paradoxically has made housebuilding more immune to the financial crises, but lower remittances and household equity has slowed the level of completions. So far there has not been any response by Governments in the region to address the impact of the economic and financial crisis on new housing provision, other than the general rescue packages for the banking sector. Such policy instruments, and the tightening of mortgage lending in particular, has had a detrimental impact on housing markets.

### **Limited Provision of Social Housing**

Despite differences in the housing systems in the region, the governments of most countries have adopted and continue to apply, even in times of strict public expenditure constraints, a number of instruments to provide a continuum of affordable housing options. Figure 8 schematically presents the range of opportunities ranging from non-market (emergency shelters, social housing) to market based options (entry level private rental housing and affordable homeownership). Central, local government and international donors provide financial support to increase the provision of affordable housing, but the output is rather limited compared to need. During the second phase of housing reforms (starting in 2000), a number of experimental projects and programmes has been launched. Funds are channelled through national housing agencies, specialised housing finance intermediaries, large commercial banks and municipalities.



**Figure 9** Continuum of Affordable Housing & Institutional Frameworks  
Source; Tsenkova, 2011

These intermediaries in turn lend funds for the construction, renovation or acquisition of social housing and/or affordable homeownership to social housing providers—non-profit organisations, municipal social housing agencies and housing cooperatives/community based organisations. Notwithstanding these diverse institutional arrangements, the experience suggests that municipalities have acquired a critical role as providers of land and infrastructure for social housing, as well as act as social housing developers with the responsibility to house the most vulnerable households.

The description of projects in several housing profiles of Serbia and Montenegro, Georgia, Romania, Russia, Belarus and Azerbaijan further illustrates the diversity with respect to three important characteristics: i) *target groups* - ranging from vulnerable households, migrants, seniors to young households and middle class homeowners; ii) *options along the housing continuum* - from shelters, assisted housing to social rental housing and affordable homeownership; and iii) *level of public subsidy* - from extensively subsidised projects to projects operating with means tested and shallow subsidies.

#### **Box 25: Provision of Social Housing for Vulnerable Families**

**In Serbia** 25-30% of the population lives a precarious and vulnerable existence. This does not include refugees, IDPs, Roma and those living in collective centres. The Swiss Agency for Development and Co-operation (SDC) has assisted the construction of over 2,600 housing units in Serbia, promoting low cost solutions, mostly through self-help. Through this programme new social rental housing has been built in 19 municipalities for low income residents (about 20% of the dwellings) and IDPs from collective centres. Housing units range from 22 sq m per one person up to 55 sq m for a larger family. The rent is based on the income of a household. The running costs are shared by the municipality, Ministry of the Social Welfare and UNHCR. SDC closed its office in Belgrade at the end of 2004.

**In Montenegro** Roma IDPs live mainly in Podgorica in two camps: Konik Camp 1 contains about 1,400 persons, while Konik Camp 2 - about 350 people. The camps consist of wooden barracks, some of which are in danger of collapsing at any time; eight people live in 16 sq m housing units. The German NGO Help constructed a building with 22 apartments and has planned another. The municipality of Podgorica has taken a loan and built several social rental buildings with the assistance of Dutch non-profit housing associations to reallocate IDPs. Rents are symbolical and the families receive assistance to cover their utility payments.

Source: ECE, 2006a

While affordability constraints have grown in the last twenty years, less social housing has been provided for low income households. Furthermore, international donor assistance has targeted the most vulnerable groups (homeless, low income, IDPs), but such small scale innovative projects need a supportive financial and fiscal framework to be scaled up (see Box 25).

**Box 26: Social housing projects supported by Council of Europe Development Bank**



Since its inception, the CEB has approved a cumulative amount of more than € 16 billion of loans for the social housing sector, making the Bank a leading financier in this important area across a number of countries in Europe. During the last decade, CEB's activity in this field has accelerated with over 32% of its housing loan portfolio targeting 12 CEE and SEE countries.

approximately 12,500 social housing units intended for low-income families, shown in the photo above. This will enable over 40,000 people to gain access to affordable rental housing through a new model of non-profit provision—*Towarzystwa Budownictwa Społecznego*. **In Romania** a subsidised € 250 million credit is financing a large scale social housing programme targeting young people and low-income families through the provision of 31,700 social housing units. In the Western Balkans with a total loan portfolio of € 200 million, CEB has provided financial support for the resettlement and reintegration of thousands of refugees and displaced persons **in Croatia and Bosnia and Herzegovina**.

**In Poland** CEB supports the construction and modernisation of

**In Albania** a CEB loan of € 15 million is co-financing the construction of 1,100 social housing apartments in seven cities with the greatest need. Despite its small scale, the project is innovative in establishing a system for effective collaboration between central and local governments to deliver social housing as well as developing the institutional capacity at the local government level to manage and maintain social housing.

*Source: CEB, 2010*

With slim chances for a significant expansion of state subsidies, the prospects for a meaningful reduction in the number of households with growing affordability problems in large urban centres across EECCA countries in particular are dismal. Developing housing for extremely low-income households is difficult without multiple subsidies and complex

financing packages. While a lot of the projects aim at private or non-profit sector involvement, without capital subsidies to fill the gap between what low-income renters can pay and the rents needed to cover development costs, programs cannot adequately serve the poor. Furthermore, the combination of high construction and operating costs, along with stagnant or even declining rents tied to household income limits, can undermine the fundamental viability of affordable housing projects.

In this context, it is not surprising that very little new social housing has been provided in the region. Poland is a notable exception with a vibrant limited-profit housing sector since 1995. *Towarzystwa Budownictwa Społecznego* (TBS) account for 5-7% of the housing output and rely heavily on preferential loans and subsidized access to land.<sup>23</sup> In several countries (Poland, the Czech Republic, Romania and Slovakia) social housing accounts for less than 10% of housing completions, while in other countries (Albania, Macedonia, Hungary) new small scale social housing programs for marginalised groups have been initiated since 2002. In addition to government funding, the construction of social housing is supported by the Council of Europe Bank (CEB) through the provision of low cost credit guaranteed by central governments (see Box 26).

## **7.2 CHALLENGES AND OPPORTUNITIES AHEAD**

The transition in housing has promoted a more diversified structure of housing provision with self-help, speculative and informal housing becoming dominant, but levels of output have remained low. *Given the recession in new construction during the last two decades, a large cut back in residential capital has occurred. Housing production capacity in the region has remained limited due to a shortage of affordable housing construction finance and shortages of serviced land with clear title and planning permit.* The market-based system of housing provision is delivering better quality with more variety and choice for consumers, but at a price that excludes most households from access to it. As a result, the previous shortage of housing has been replaced by a shortage of affordable housing.

*Despite a growing need for affordable rental housing, policy action focusing on legislative and financial opportunities to build a continuum of housing for a variety of needs has been*

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<sup>23</sup> Poland has over 600 TBS, mostly concentrated in Warsaw, Poznan and Wroclaw. Financing is secured through soft loans from the National housing Fund, 10% contribution from tenants and subsidised land and infrastructure provided by *gminas* (local municipalities). Rents are set at 4% of construction costs (Donner, 2006).

*extremely limited*. Very few countries have considered alternatives to public rental to bridge the gap, such as limited profit housing or site and services options mobilizing self-help and incremental household investment in low income countries.

**Box 27: Recommendation 6: Implement policy measures that increase the supply of new affordable housing, particularly for socially disadvantaged groups**

Governments in the EECCA and SEE countries should implement policy instruments that enable more efficient access to construction finance and serviced land for new housing construction. Policy action focusing on legislative and financial opportunities to build a continuum of affordable housing such as public and non-profit rental with targeted government support should receive a priority. In low income countries, sites and services options should be systematically explored, mobilizing self-help, microfinance and remittances for affordable housing solutions.

**Construction lending** for housing needs to be promoted to ensure a more transparent market for new housing and improve affordability. To achieve this, at the central level the current risks stemming from the incomplete legislation need to be addressed by:

- (a) Promoting lending using the land as collateral, bank guarantees, income from pre-sales and housebuilder's own sources as credit security;
- (b) Introducing a transparent legal and financial framework for management of disbursements aligned with phases of the construction process;
- (c) Improving the procedures for implementing provisions in Civil Codes, Laws on Bankruptcy and other appropriate regulatory instruments to ensure that investors in new housing construction are protected.

**Urban planning should be streamlined** and the roles of the different planning documents in the planning system clarified to ensure timely provision of land for housing and its servicing. The following priority actions at the local level should be considered:

- (a) Developing complete urban plans that constitute the legal basis for issuing planning permissions and building permits, particularly in areas of high demand for new housing;
- (b) Integrating transport and infrastructure planning in urban plans by paying particular attention to improving infrastructure in existing and new areas designated for housing development;
- (c) Streamlining the planning permission process through 'one-stop shop' with clear and predictable requirements for project documentation prepared and delivered by the developer.
- (d) Providing flexibility of urban plans by avoiding prescriptive zoning and design guidelines to allow for diversification of new housing construction in response to changing demand and social needs;
- (e) Strengthening planning and building inspection to address the problems of illegal construction; reinforce supervision and quality control requirements to ensure consistency with project design;

**In the development of policies to assist the socially weak in accessing housing**, central governments should make full use of the *UNECE Guidelines on social housing: principles and examples (2006)*. Several important priorities regarding new social housing provisions should be considered:

**Central level**

Governments need to specify which social groups have priority for social housing assistance in order to address them directly through:

- (a) Developing a supportive framework (regulatory and financial) to encourage the operation of non-profit and community-based institutions in social housing;
- (b) Ensuring fiscal and financial support for the provision of shelters for the homeless, socially disadvantaged, and IDPs and providing a consistent framework for their management by non-profit social service agencies;
- (c) Adopting as a guiding principle the policy of means-tested assistance to end implicit and poorly targeted housing subsidies.

**Local level**

- (a) Encouraging local governments to invest in new social housing through pilot projects targeting special groups such as low income young families, single parents and the elderly;
- (b) Augmenting the present system of social housing provision and allocation through the waiting lists of municipalities by prioritizing social needs and means-testing;
- (c) Allocating serviced land for social housing (sites and services), including self-help rental provision;
- (d) Providing assistance on design and construction standards for self-help housing construction.

## **8 ENABLING ACCESS TO AFFORDABLE HOUSING AND TENURE CHOICE**

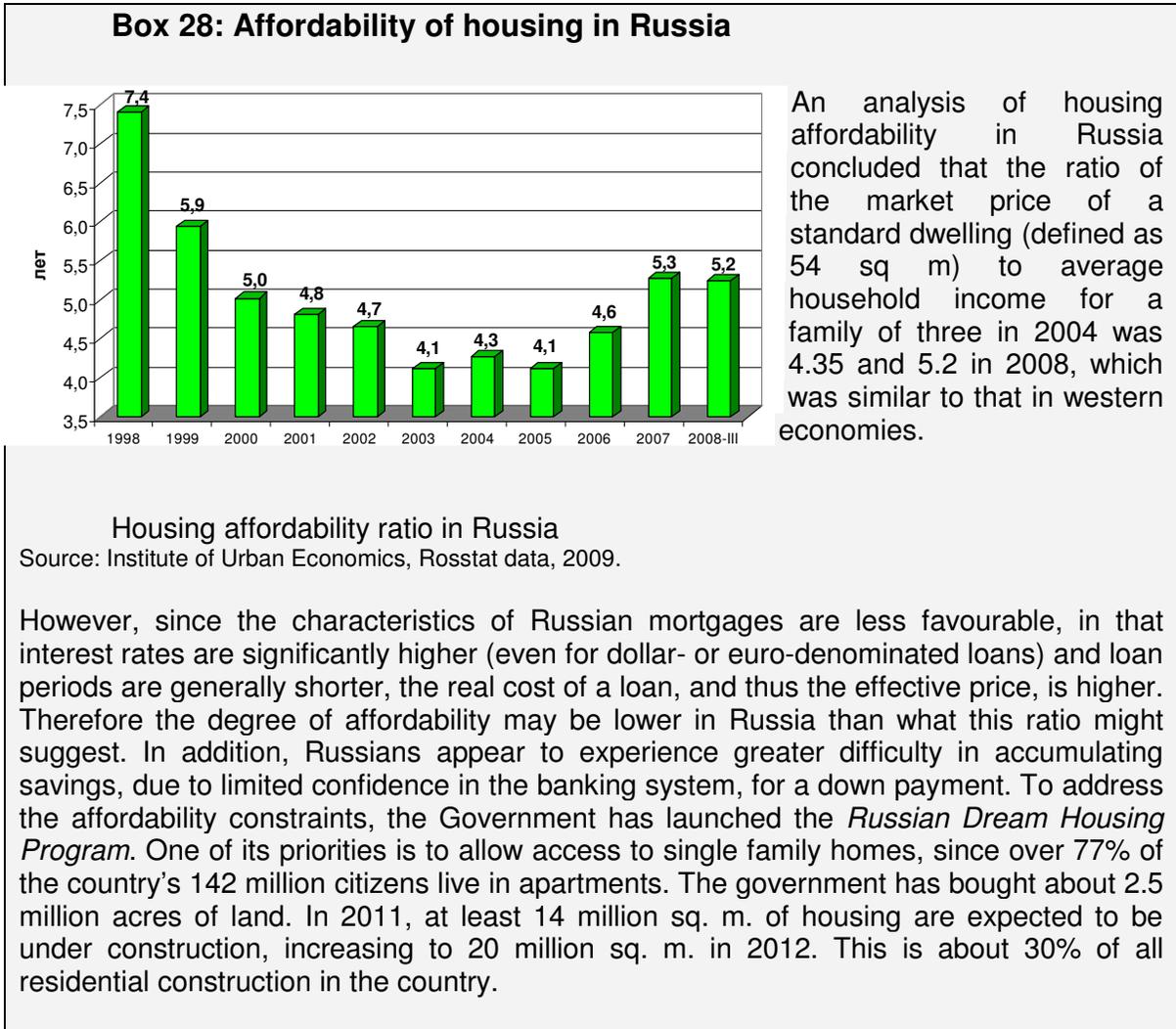
### **8.1 PROGRESS ACHIEVED AND PROBLEMS ENCOUNTERED**

#### ***The New Subsidy Regime and Affordability Constraints***

Across the region, the changing demographic and social composition of the population, the growing social polarization and income differentiation have influenced housing demand dynamics. On the one hand, this has led to a more diverse pattern of lifestyles and housing choices. People with more disposable income seek better living standards and move upmarket to more attractive environments. On the other hand, poverty manifests itself through the growing number of people on welfare, rising homelessness and a general shortage of affordable housing, particularly in urban areas.

In the new EU member states, housing policies have emphasized the importance of financial instruments – mortgage insurance, tax incentives and demand assistance to target groups -- to facilitate access and choice. However, due to price inflation and higher rates of homeownership, the gap between income and entry costs has continued to increase for low-income households, making affordable housing of decent quality more difficult to obtain. Studies point out that rapid house price increases since 2005, despite the improvements in mortgage lending, have excluded more than 80 percent of new households from the housing market (Tsenkova, 2008; Registra et al., 2005). However, large increase in house prices before the global financial crisis have been followed by equally dramatic decline since 2008, potentially improving affordability. In Slovenia, for example, average prices rose by 14 % in 2004–2006, while in Poland they rose by almost 20 % in 2007 and in Slovakia, by 24%. By mid-2009, however, prices fell in most of these countries – in Lithuania by 20 %, in Bulgaria by 22 %, in Estonia, by 31 % and in Latvia by a staggering 60% (EMF, 2010). At the peak of the cycle in 2007 apartment prices in Riga reached EUR 7,000 per sqm in the up-market apartments in the old town, a level comparable with Stockholm, Copenhagen and Oslo. For very low-quality Soviet-type blocks in the suburbs the market peaked at EUR 1,800 per sqm. The prices then in Riga tumbled by as much as 70-80% reaching its low-point at the end of 2009. This is arguably, the largest property crash that

the world has ever seen. Price declines in the Lithuanian and Estonian capitals were more than 50% (EMF, 2010).



In the EECCA countries, less transparent housing markets, bureaucratic barriers, red tape and inefficient mortgage institutions have contributed to higher prices (see Box 28). In many parts of the region, the lack of effective competition in the supply of new housing has led to monopolistic pricing with prices per sq m exceeding the average annual salaries, suggesting a deepening housing crisis (ECE, 2008; 2010a; IFC, 2007). In Russia, average house prices have increased faster than income, with Moscow and St Petersburg taking the lead (Palachin and Shelburne, 2005). From 2000 to 2007, prices in Russia's secondary market rose by 436%, while primary market prices rose 362%. The Central Federal District, which includes Moscow, registered the highest secondary market

house price increases at 589%. Primary market prices rose 345% over the same period. Such property bubbles were followed by dramatic decline since the start of the global financial crisis. House prices continue to fall, despite a strong economic recovery in 2010.

Under the new subsidy regime, *subsidies in all countries in the region have focused on making homeownership more affordable*. This option is the last one on the continuum of affordable housing presented in Figure 9 and in housing policy terms the most expensive and less targeted to low income and socially vulnerable households. Mortgage interest tax relief exists in Russia, Hungary, and Poland. Kyrgyzstan, Azerbaijan, Belarus and Georgia offer subsidies on savings schemes in addition to grants for many newly-built housing projects. Looking beyond this group, housing subsidies and tax breaks are common in Russia, Croatia, the Czech Republic, Slovakia, Hungary and Poland. Part of these subsidies leak out to benefit mortgage and other providers in the housing systems, and raise the value of existing dwellings and development land. The prime intended beneficiaries, nonetheless, are the better-off owner-occupiers who can qualify for mortgage interest tax relief (Angel, 2000; Hegedus and Stryuk, 2006). The new subsidy schemes in SEE and EECCA countries have been criticised for being particularly inefficient in targeting households in need and in supporting the most affluent housing consumers (ECE, 2005; 2008; 2010a; Tsenkova, 2005; Lowe and Tsenkova, 2003).

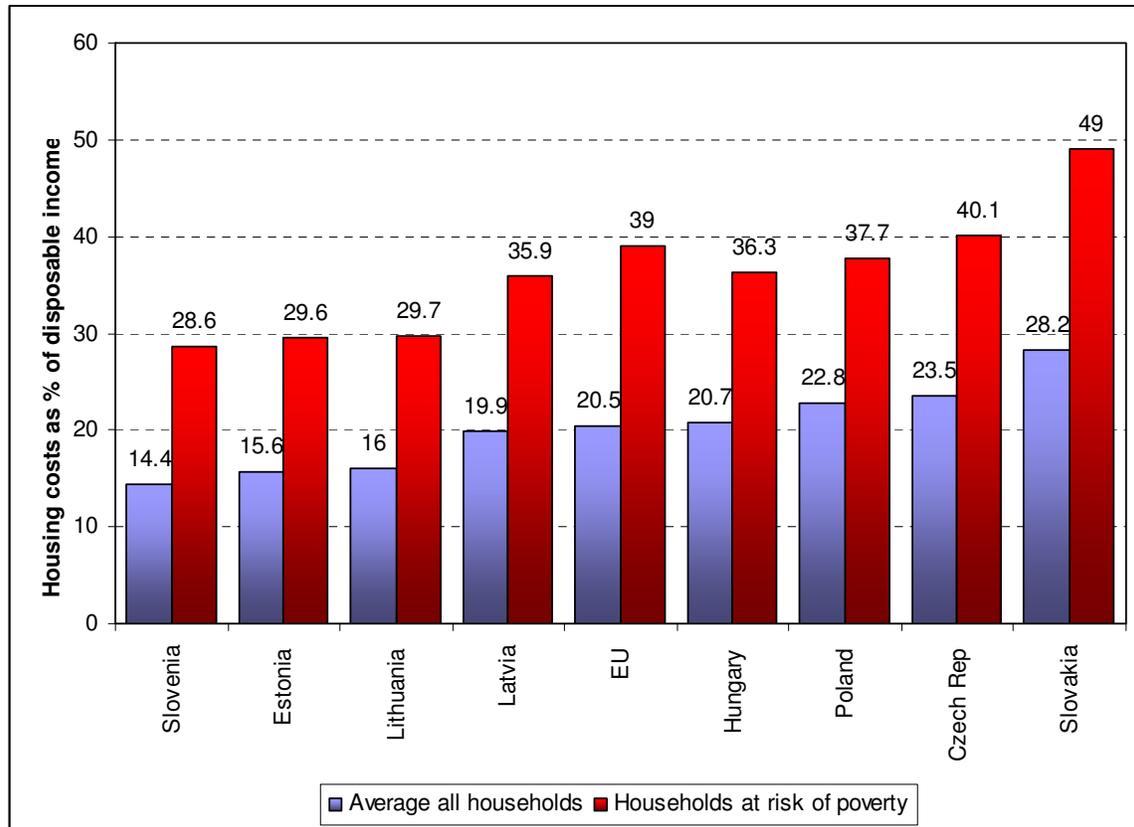
Meanwhile, demand-based subsidies to low income renters have failed to keep pace with the rising housing costs. In most transition countries such assistance is non-existent and where it has been launched (e.g. The Czech Republic, Poland, Romania, Estonia and Latvia); it reaches a small number of households and is grossly inadequate (Lux, 2003; EC, 2010).

### ***Rising Housing Costs: Housing and Income Poverty***

Data on housing expenditure—housing, water, electricity and gas—show that it accounts for more than one fifth of total household expenditure in 2007. The proportion of household expenditure devoted to housing is presented in Figure 10. The highest share is reported for Slovakia (28%), followed by the Czech Republic (23.5 %), which is 3 to 4 times higher than housing costs in Belarus, Azerbaijan or the Republic of Moldova (ECE, 2002; 2008; 2010b). Levels of homeownership do not seem to be correlated with

household expenditure on housing. Housing costs average 20% of disposable incomes in Latvia, 21% in Hungary and 15.6% in Estonia, yet in all three countries just under 90% of the people own their homes. Not surprisingly, housing costs are much higher for those at risk of poverty, reaching 40% in The Czech Republic and 49% in Slovakia, a share much higher than the EU average (EC, 2010).

**Figure 10 Housing costs as % of disposable income in select countries, 2007**



Source: EC, 2010

Notes: EU refers to EU25; data based on EU-SILC Survey carried out in 2007.

*Affordability of housing remains the fastest-growing and most pervasive housing challenge in the region.* Housing costs have increased with significant implications for access to adequate and affordable housing, particularly for low income groups. The privatization has reduced the housing costs for most of the population, thus alleviating the risk of poverty by providing mortgage free housing. In practice, however, the result is not quite as simple. Despite the fact that levels of homeownership across the region are disproportionately high, in countries where housing reforms are more advanced in shifting the burden of housing costs to the individual consumers, housing costs in relation to disposable income

are comparable and even higher than the EU25 average (EC, 2010). In the EECCA and SEE countries, lower housing costs may mean that many households are foregoing necessary repairs and maintenance of their homes and/or putting up with living in low quality housing. For most of these countries, however, the main component of the housing costs arises in general from utility and heating charges that account for the bulk of the housing costs and only to a minor extent from rent and mortgage interest payments.

While the data are limited, it appears that countries in the new EU member states have higher housing costs leading to more significant affordability problems. The situation appears to be more problematic for single person and single parent households in urban areas where higher prices for housing and concentration of poverty create cumulative disadvantages (EC, 2010). In EECCA and some SEE countries the housing sector has been sheltered from price adjustments due to high levels of poverty and housing shortages for IDPs and other vulnerable groups. Utilities are still heavily subsidised as well as maintenance through regulated management fees in multi-apartment housing. Despite such implicit subsidies in the sector, homeowners find it increasingly difficult to pay the cost of housing services—utilities, heating and maintenance—which systematically erodes the quality of the housing stock.

### ***Limited Tenure Choice***

Cross country comparisons on housing tenure are normally criticized for their broad brush approach which does not take into account differences concealed under the tenure label. Across the region, different tenure forms can be identified: public and private rental, owner-occupied (single family, condominium/equity cooperatives), and other categories related to housing owned by state institutions, tenant cooperatives, housing under restitution, etc. The division apparently accommodates a number of differences and conceals significant variations within one category. Homeownership has grown steadily in most countries, particularly as a result of privatization policies. *Although some of this housing might actually function as private rental, responding to pressures from migration and labour market adjustment, the tenure structure is quite polarized leaving a small and residual sector of publicly owned housing with a social purpose.*

**Social or non-profit rental housing** is owned by local governments or social housing providers. Its share is significant in several countries (Poland, the Czech Republic, Ukraine and Russia) but is declining gradually through continuing transfers to sitting tenants (Tsenkova and Turner, 2004; World Bank, 2006b). In most transition countries, social housing is not really defined in the legislation; however, public rental housing gradually assumes this function. Public housing is owned by local governments and is concentrated in urban areas. It is often funded with municipal or state/public enterprise funds and managed by municipal maintenance companies, which collect rents and handle tenant agreements. Rents are controlled and determined at the local level with some direction from central government (World Bank, 2006). *UNECE Guidelines on social housing: principles and examples (2006) provide important recommendations on ways through which this sector can be expanded and reformed.*

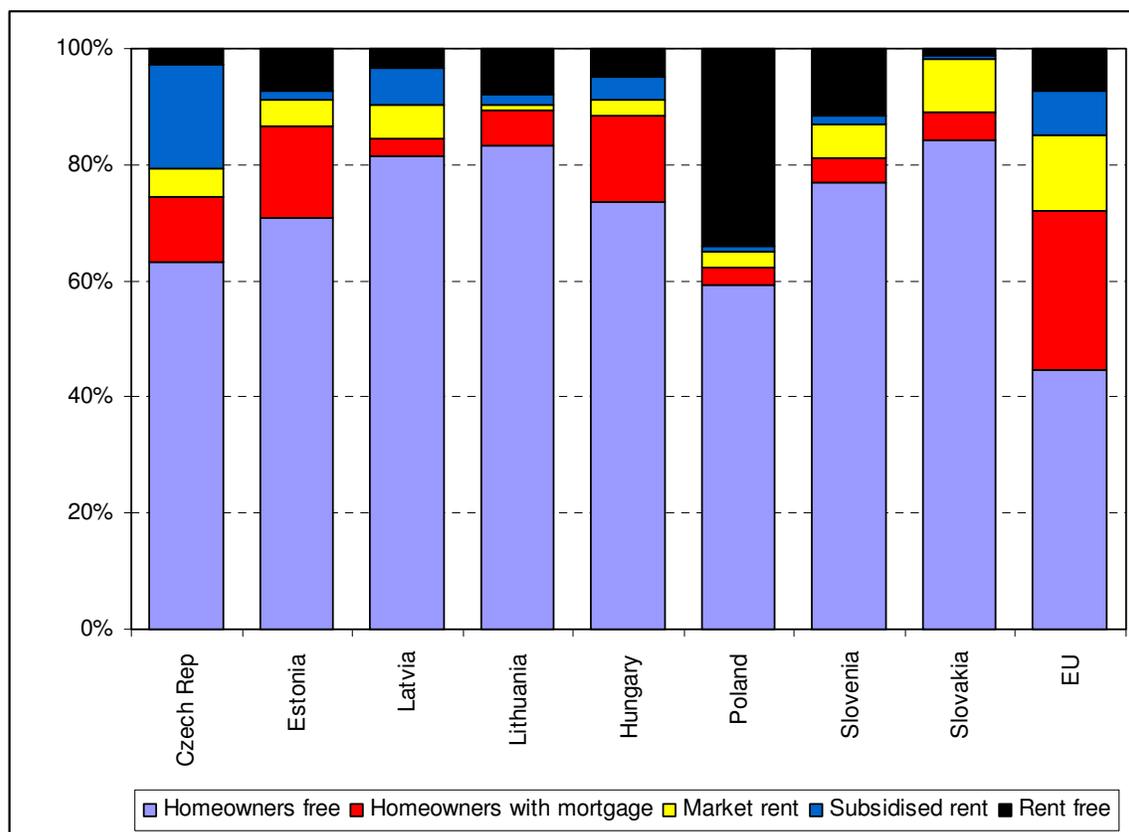
Available data on residents in different types of tenure in several countries highlights some important differences with respect to affordability and choice (see Figure 11). First, a large segment of homeowners lives in mortgage free housing. In Latvia, Lithuania and Slovakia this share tends to be higher than 80 percent. In all of these countries housing represents a large proportion of household wealth as house prices have risen faster than earnings. Second, mortgage debt has also risen sharply in relation to household income, especially in Estonia and Hungary, where homeowners with mortgages are close to 15% of the population. Despite this being almost half of the EU average (27%), the recession is likely to increase the numbers of people unable to afford mortgage or rent payments, as well as the number of evictions and repossessions in these countries. Homeowners with mortgages tend to be also higher in the Czech Republic and Lithuania corresponding to better development of mortgage markets. Third, a smaller share of the population lives in subsidised or market rent accommodation compared to the EU average, with the Czech Republic being a notable exception.<sup>24</sup> People living in rent free housing also comprise a much more significant portion in half of the countries with Poland having almost 30% of the people in such accommodation. In some cases rent free housing is tied to the workplace, in other cases public rental housing tends to function as a safety net for poor

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24 For example, in the Czech Republic, where social rented housing is close to 20% of the stock, rents are less than 25% of the market rents. The sector is home to 10% of the most affluent households.

households with zero rent. The proportion of tenants living in subsidised housing in the Czech Republic (18%) is much higher than the EU average, followed by Latvia (11%). Renters in subsidised housing have their rents subsidised by the State, local authorities or housing associations without necessarily accounting for income differences.

**Figure 11** Division of population by housing tenure in select countries, 2007



Source: EC, 2010

Notes: EU refers to EU25; data based on EU-SILC Survey carried out in 2007.

In EECCA countries, where *social housing* has shrunk as a result of massive privatization, local governments are left with the worst stock in a poor state of repair and with the poorest tenants. So it is not surprising that in countries such as Armenia Georgia, Azerbaijan, Kyrgyzstan social housing is used as a safety net and rents are below cost recovery levels with a limited number of tenants receiving housing allowances (see corresponding housing profiles for additional information on these issues).

*Tenure choice is important for long-term housing market stability and access to adequate and affordable housing. Most countries in the region have a polarised tenure structure*

*with excessively high share of owner occupation. Entry into owner occupation is expensive, even if it might lead to significant financial benefits over the long term.* Households, particularly in EECCA and SEE countries, have limited resources to sustain their homeownership status acquired through privatisation or during state socialism under a universal subsidy regime. With few alternative options, new households may be pushed into owner occupation when financially stretched. Tenure choices are much broader in Poland, the Czech Republic, Ukraine and Russia thanks to a tenure structure offering a continuum of housing opportunities ranging from social to private renting to homeownership. By contrast, in most other countries the rental option is severely curtailed (e.g. Albania, Georgia, Serbia). Households have to rely almost solely on access to affordable housing finance, intergenerational transfer of wealth to afford a delayed entry to homeownership. The opportunity for a decent rental home in the private rental sector is non-existent, with the exception of countries where its share has increased due to restitution (The Czech Republic and Latvia). However, over time rent deregulation has made it less affordable.

### ***Learning from the European Experience***

In all countries the future, purpose, and form of social housing are being questioned with a focus on the re-examinations of the long-standing 'subsidise properties or subsidise people' debate. Comparative studies indicate a renewed emphasis on the supply of social housing in a number of EU countries and city-wide initiatives to encourage private and non-profit provision to minimise 'poverty trap' effects (Scanlon and Whitehead, 2007). Although there is no single definition of social housing across Europe, Gherkiere (2007) has pointed out two essential characteristics: it is provided by landlords that are not profit-motivated and is administratively allocated according to need. There are two broadly defined systems of social housing in Europe—dual systems, based on small and residual social rental sector, and unitary systems with a competitive and more universally accessible sector (Kemeny, 1995). Within these distinctive groups the rationale for and mechanisms by which social housing is provided diverges greatly between European countries and influences its institutional structure and the choice of policy instruments (Buckley and Tsenkova, 2001; Gruis et al, 2009). Social housing as a share of total housing stock across Europe varies with unitary systems maintaining 20-25%, and dual systems - less than 5%.

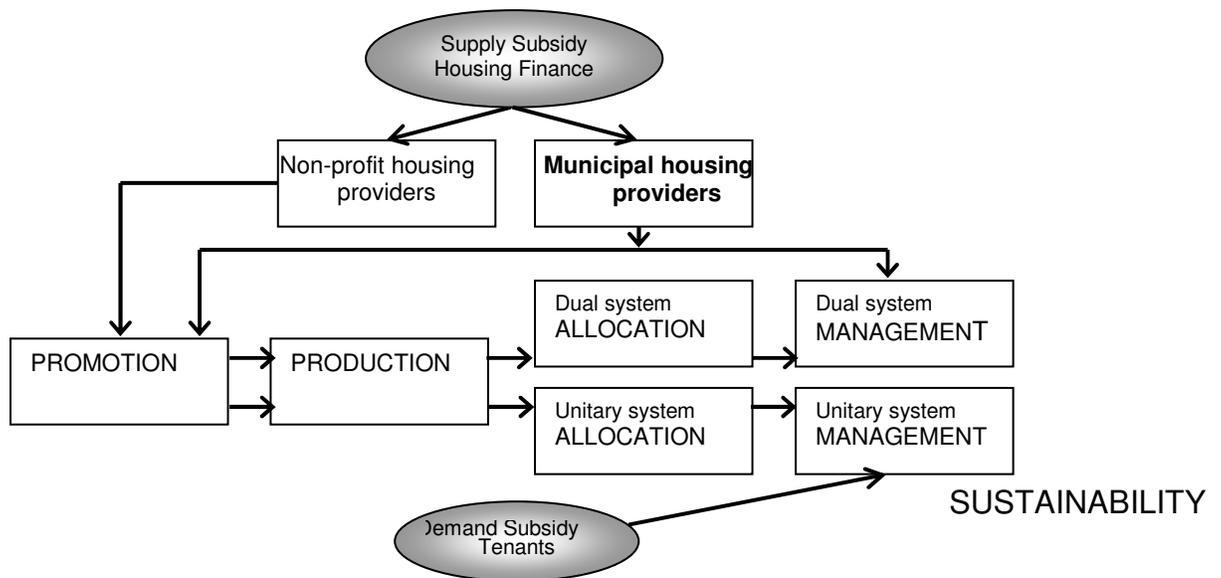
In countries with unitary systems the sector operates like a 'social market' (The Netherlands, Austria, Denmark, Sweden, Finland), the institutional arrangements favour private ownership by non-profit landlords, rents are close to market level and allocation extends access to a more diverse income group. Distortions in pricing are less prevalent, since rental systems not only ensure cost recovery for services, but allow rent setting to be adjusted to a range of property attributes (Kemeny *et al.*, 2005). In dual systems, the social housing sector is less than 5%; it is operated by public landlords and allocated to low income and vulnerable households (e.g. Italy, Spain). Rents are geared to income, the sector operates as a safety net and is continuously subsidised by senior governments through supply- and demand-side subsidies. These relationships sketched in broad strokes define the role of social housing in unitary and dual systems and affect the effectiveness and efficiency of government programmes.

The supply of new social housing in both types is dependent on the availability of *fiscal, financial and regulatory instruments* to encourage provision and to respond to general supply and demand trends affecting levels/costs of housing production. Different countries have experimented with a range of *fiscal instruments* on the supply side (grants, subsidies, tax incentives), or indirect, such as depreciation allowances or rent control. England and Austria rely on capital grants, Denmark on interest rate subsidies, while the Netherlands has abolished direct subsidies (Boelhouwer, 1997; Whitehead, 2007). Austria, England, and France provide limited 'brick and mortar' subsidies to housing suppliers with conditions on production levels and rents to reduce production costs in social housing. State grants combined with subsidised loans feature in most countries with dual systems, such as the transition economies (Hegedus and Struyk, 2005). Across Europe a second major stream of subsidies, as the main instrument of housing policy, through housing vouchers, rent supplements or housing benefits is implemented (Haffner and Oxley, 1999).

*Financial instruments* to encourage new supply of social housing relate to the availability of long-term finance and the diversity of mortgage products. In most countries with unitary models private finance is the main source of funding for social housing, supporting a steady level of production. Borrowing costs from private institutions are subsidised in Denmark and England, borrowing guaranteed in the Netherlands, and/or made available

at sub-market rates from public financial institutions in the Czech Republic and Poland. Finally, tenants provide up to 2% of the funds for new social housing in Denmark and up to 20% in Poland with additional grants available from local municipalities (Tsenkova, 2007). A wide range of *regulatory instruments* facilitate the physical production, allocation and consumption of social housing by making land, infrastructure and building inputs available at controlled costs or by regulating the supply through planning deals and density bonusing.

**Figure 12** *Evaluating efficiency and effectiveness in social housing provision*



Source; adapted from Tsenkova, 2011

This in turn is manifested in diversity of institutional arrangements (municipal vs. non-profit providers), rent-setting policies, allocation rules and more importantly, dependence on continuous subsidies. The implications for post-socialist countries are important. In countries where the share of public, non-profit and social housing is larger (Russia, Poland, the Czech Republic, Ukraine), they may evolve as unitary systems, where access is more universal, rents are higher ensuring cost recovery and the subsidies are lower. In dual systems, where most of the EECCA and SEE countries fit due to a small share of public housing (less than 5%), access should be targeted according to need, rents will be symbolical and the dependence on high level of subsidies fundamentally challenges the ability of the system to reproduce itself. In cases when both supply and demand side

subsidies are downloaded to lower levels of government (municipalities), the ability of public housing providers to maintain housing quality is very limited and practically non-existent. A situation where social housing in dual systems, operating with extensive subsidies and government support, is allocated to higher income households should be avoided due to poor targeting of public funds. Similarly, in unitary type systems a non-discretionary subsidy policy through low cost rents charged to low and middle income households should be eliminated due to lack of efficiency and poor targeting. These considerations are particularly important for the design of effective and efficient central and local government programmes in the long term.

## **8.2 CHALLENGES AND OPPORTUNITIES AHEAD**

Affordability of housing remains the fastest-growing and most pervasive housing challenge in the region. Housing costs have increased with significant implications for access to adequate and affordable housing, particularly for vulnerable groups. While the data are limited, it appears that countries with higher homeownership rates, limited access to mortgage finance and constrained tenure choice tend to have a higher share of households experiencing affordability problems. Mortgage debt has also risen sharply in relation to household income, especially in former communist countries. *The recession is likely to increase the numbers of people unable to afford mortgage or rent payments, as well as the number of evictions and repossessions. Furthermore, the situation appears to be more problematic in urban areas where higher prices for housing and concentration of poverty create cumulative disadvantages. Under the new subsidy regime, subsidies focus on making homeownership more affordable. Meanwhile, demand-based subsidies to low income renters have failed to keep pace with the rising housing costs.* In most transition countries such assistance is non-existent and where it has been launched (e.g. The Czech Republic, Poland, Romania, Estonia and Latvia), it is inadequate. A major change in housing policies needs to address affordability constraints of the urban poor and socially vulnerable groups through an appropriate and targeted subsidy system.

**Box 29: Recommendation 7: Address the shortage of affordable housing by efficient and effective systems of fiscal and financial support**

Governments in all EECCA and SEE countries need to consider a major shift in housing policies to address affordability constraints of the urban poor and socially vulnerable groups through an appropriate and targeted subsidy system. Such policies should emphasize strategic approaches to the provision of affordable rental housing to enhance tenure choice and the provision of means-tested demand assistance.

In the development of such policies, central government should make full use of the *UNECE Guidelines on social housing: principles and examples (2006)* as well as *UNECE Housing Finance Systems for Countries in Transition - Principles and Examples (2005)*. Furthermore, specific recommendations regarding the supply of new social housing are provided in Box 27 and 12. Most country profiles of the housing sector emphasise the following:

- (a) Create a State subsidy system to improve people's access to affordable housing;
- (b) Improve targeting of affordable housing programmes and increase available options;
- (c) Introduce a means-tested housing allowance and operate it at the central level with adjustments to local housing market conditions;
- (d) Introduce cost recovery principles in the rental sector, particularly in countries where the sector is fairly large.

**Create a State subsidy system to improve people's access to affordable housing.** Housing policy should aim at the creation of affordable housing finance mechanisms to improve the housing situation for IDPs, the homeless and other vulnerable groups that currently live in low-quality housing without basic services. Given the economic difficulties and fiscal constraints, the subsidy system must be targeted to groups in urgent need of State support. These groups should be able to solve their housing problems through transparent, means-tested subsidies. The programmes should contain tools for assessing the effectiveness and efficiency of public funds.

**Access to affordable housing should be better targeted and options should be increased.** It is vital to reduce the number of needy households waiting for soft loans – sometimes over 20 years in many countries. State policy should cater to the very needy citizens, such as low-income households living in the worst conditions. Those falling outside the very poor could be granted other support programmes that would allow them to improve their living conditions with different and diversified financial instruments (e.g. mortgage guarantees, microfinance, longer amortization periods of up to 35 years, etc.).

**A means-tested housing allowance should be introduced** and operated at the central level with adjustments to local housing market conditions. Taking into account the relatively low average share of total household expenditures for housing in EECCA and SEE countries and the already large subsidies stemming from “giveaway” privatization measures in the past, the universal subsidy covering the difference between tariffs and housing costs should be gradually withdrawn and a new, means-tested housing allowance introduced. Such housing allowance should be targeting households in need, i.e. those spending high share of income on housing and should be limited by norms on costs and size of housing.

A means-tested housing allowance to assist low income households in the rental sector with rental costs and utility payments should be urgently implemented. The allowance should be tenure neutral, available in the public, private and social rented housing. Such income-based support will provide a more efficient response to housing shortages using the existing housing stock as well as making private rental housing more attractive and transparent.

**Cost recovery principles in the rental sector should be introduced**, particularly in countries where the sector is fairly large and might be operating as a unitary system allowing a social mix of low income and middle class tenants. Such rent adjustment policies, complemented with demand-based assistance, will ensure a steady and predictable flow of funds for maintenance and repairs.

## 9 RECOMMENDATIONS FOR A STRATEGIC POLICY FRAMEWORK AND ACTION

A resilient and sustainable housing system in the region can contribute to economic growth, prosperity and poverty alleviation. Improvement of housing conditions and quality has undeniable positive welfare effects for households and local communities. Since housing accounts for a growing share of investment, wealth and finance, when managed effectively it can be an important source of financial stability and economic resilience. Given the durability of housing and its capital intensive nature, resilience means stability of investment and growth in the system as well as sheltering the sector from extreme economic and political shocks. Perhaps equally important is the ability of the housing systems to ensure improvement in housing quality, affordability and tenure choice. Such outcomes depend on sustained political commitment to efficient and equitable housing policies as well as long-term strategic programs to assist access to affordable housing.

### ***The importance of housing profiles for housing policy development***

The country profiles on the housing sector carried out in 15 countries in the region under the auspices of the UNECE Committee on Housing and Land Management assist the Governments in improving the performance of their housing sector by providing country specific recommendations. Furthermore, in response to requests from national governments and policy makers, the UNECE has addressed cross-cutting issues and policy priorities of common interest through several guidelines. These important comparative perspectives are an important source of policy learning and diffusion of good practices that can be applied in different countries. *Guidelines on condominium ownership of housing for countries in transition* (2003), *Housing finance systems for countries in transition: principles and examples* (2005) and (c) *Guidelines on social housing: principles and examples* (2006) are such examples.

The recommendations of the housing profiles, if implemented in a consistent and coherent manner, are in a position to influence the performance of housing systems and to fundamentally improve housing policy. The studies also have value as a comprehensive analytical assessment and can be used as monitoring and evaluation tool assisting

housing policy makers. While it is difficult to discern the role of housing profiles on the reform process in different countries, government representatives (e.g. Romania, Serbia, Georgia, Albania, and Belarus) report at UNECE committee meetings on the official launch of the studies to build consensus on housing policy priorities. They also highlight their role as capacity building tools (Russia, Albania, Slovakia, Kyrgyzstan, Azerbaijan) in education and training programmes. In some cases, there is evidence of impact. For example, the delegation of Georgia reports on the implementation of the recommendations dealing with illegal construction and modernization of existing housing stock. The delegation of Kyrgyzstan provides information on the implementation of property registration procedures in cooperation with banks and a unified policy for land management. The delegation of Slovakia highlights the importance of country profile recommendations as the basis for substantive updates of the State housing policy in 2000, 2005 and 2009. As a result, much progress had been achieved in developing a new set of housing policy instruments, adopting new housing legislation and introducing the national system of housing allowances.

### ***The contribution of this comparative assessment***

This study makes an important contribution in this regard by providing a comprehensive overview of progress and challenges affecting housing policy and practice in the region. It does address major policy challenges in the development of appropriate regulatory, fiscal and financial instruments to enable the operation of housing markets and access to affordable housing. The assessment draws on most up-to-date research, comparative studies and existing housing profiles to provide evidence-based policy recommendations organized in a consistent framework for strategic action.

Recognizing the complexity of housing systems, the study does focus on seven important housing policy domains critical for the efficient performance of housing systems and the design of well targeted (effective) and sustainable (fiscally and socially responsible) policies. The domains reviewed are: i) strengthening political support for housing reforms; ii) establishing reliable and effective housing institutions; iii) developing effective land administration and land management; iv) mobilizing housing finance; v) facilitating improvement in housing quality; vi) sustaining housing investment and production; and vii) enabling access to affordable housing and tenure choice.

On the basis of comparative, evidence based research the study suggests that better policy environment and the use of well designed policy instruments—regulatory, fiscal, financial and land management—can facilitate better performance of the housing system. More importantly, the research indicates that certain policy instruments, introduced in more advanced reformers, can assist in delivering housing quality, affordability and tenure choice in a more effective manner. Important policy recommendations address the most important challenges in the region—the growing shortage of affordable housing, deterioration of the existing multi-apartment stock and the proliferation of informal settlements. While different countries may chose a different mix of policy instruments, the study advances a framework for strategic housing policy intervention in seven priority areas presented in the matrix below. Specific policy tools for implementation associated with each of the seven clusters are presented in Boxes 4, 9, 12, 17, 23, 27 and 29.

**Table 1: Strategic Policy Framework and Priority Actions**

<b>STRATEGIC RECOMMENDATIONS</b>	<b>PRIORITY ACTIONS FOR IMPLEMENTATION</b>
<p><b>1: Strengthen political support and develop effective legislation to resolve persistent housing problems.</b></p>	<p>Housing needs to be a political priority due to the scale of the present problems and the social and economic significance of the housing sector. Reforms need to be addressed in an integrated way through systematic changes in the legal, institutional and financial framework. Governments in all countries should strengthen their political support to resolving persistent housing problems. They should focus on more strategic interventions, streamline housing priorities, rationalize the legal framework and reinforce implementation in order to promote a more sustainable housing policy that facilitates investment and improvements in housing quality and ensures access to affordable housing. The focus of legal reforms in EECCA needs to shift towards the strengthening of the consistency and coherence of supporting legislation and towards establishment of adequate capacity for implementation and enforcement, particularly in areas of condominium management, mortgage lending and property rights.</p>
<p><b>2: Strengthen central and local government institutions in housing policy and improve governance in the sector</b></p>	<p>Governments in the region should urgently address the problems caused by weak housing institutions and ineffective housing governance. They should strengthen the mandate and capacities of the central and local government institutions in housing policy, and should improve institutional coordination, mobilization of funds for housing program implementation and enforcement. In EECCA countries governments should work to improve the quality and the efficiency of private sector housing institutions, including market intermediaries and non-government institutions, to improve the functioning of housing systems at the national and local levels.</p>
<p><b>3: Address effectively the problem of informal housing through integrated planning, housing and land administration reforms</b></p>	<p>Governments in all EECCA and SEE countries should focus on strengthening the efficiency of land administration system and on the improvement of integration of planning, housing and land reforms to address the problem of informal housing. Efforts should target the completion of nationally unified land registration databases, the efficient operation of land registry offices according to international standards and the simplification of procedures for registering land and real estate. Sustainable solutions for informal settlements need to become a priority at the local, national and international level.</p>
<p><b>4: Establish an efficient system of</b></p>	<p>Governments in the region should focus on establishing an efficient housing finance system and on the design of</p>

<p><b>housing finance and innovative fiscal and financial instruments to support access to affordable housing</b></p>	<p>innovative fiscal and financial instruments to support access to affordable housing. These instruments, although different in SEE and EECCA countries, need to be resilient to political and economic instability, sustainable over the long term, and well targeted. Priority should be given to adequate fiscal support to low income households experiencing affordability problems and homelessness.</p>
<p><b>5 Develop systematic programs to improve housing quality, infrastructure provision and management of multi-apartment housing</b></p>	<p>Governments in all countries should focus on developing systematic programs to improve housing quality and distributional efficiency. Considering the wide differences in terms of housing quality, these programs should set country specific priorities and target several policy domains—improvement of housing infrastructure and improvement of multi-family housing through energy efficiency retrofits. Efforts should be placed on designing a mix of policy instruments—regulatory, financial and fiscal—to mobilise private and community sector response to achieve tangible and measurable results. Governments in EECCA and SEE should effectively mobilize national and international support to provide sustainable housing solutions to refugees and other vulnerable groups residing in substandard and informal housing.</p>
<p><b>6: Implement policy measures that increase the supply of new affordable housing, particularly for socially disadvantaged groups</b></p>	<p>Governments in the EECCA and SEE countries should implement policy instruments that enable more efficient access to construction finance and serviced land for new housing construction. Policy action focusing on legislative and financial opportunities to build a continuum of affordable housing such as public and non-profit rental with targeted government support should receive a priority. In low income countries, sites and services options should be systematically explored, mobilizing self-help, microfinance and remittances for affordable housing solutions.</p>
<p><b>7. Address the shortage of affordable housing by efficient and effective systems of fiscal and financial support</b></p>	<p>Governments in all EECCA and SEE countries need to consider a major shift in housing policies to address affordability constraints of the urban poor and socially vulnerable groups through an appropriate and targeted subsidy system. Such policies should emphasize strategic approaches to the provision of affordable rental housing to enhance tenure choice and labour mobility and the provision of means-tested demand assistance. Other important priorities refer to improved targeting of affordable housing programmes and cost recovery principles in the rental sector.</p>

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