III. HOUSING ECONOMICS AND AFFORDABILITY

A. Investment in housing

In most west European countries, housing construction constitutes a major share of the national economy. Housing construction is generally seen as an important factor in overall economic development. During the transition, investments in Polish housing declined from about 25 per cent of the total investment volume in 1990 to 10.5 per cent in 1996. Other countries in transition show a similar development, though the decrease in Poland is more recent. Till 1993 the share of housing production in total investments was rather high (table 11). In 1992, Poland had similar figures to western Europe, where investments in housing constitute about 20-30 per cent of the total investment volume.

TABLE 11

Investment in housing in selected countries in transition as a percentage of total investment

Country	*1980*	*1991*	*1992*	*1993*	*1996*
Bulgaria	13.0	8.7	6.6	-	-
Hungary		22.3	-	14.8	-
Poland	20.8	27.8	22.2	16.2	10.5
Romania	9.3	10.1[a]	-	5.9	-

Sources: Economic Commission for Europe, *Annual Bulletin of Housing and Building Statistics for Europe and North America*, 1996 (United Nations publication, Sales No. E/F/R.97.II.E.3). Data supplied by the Housing Research Institute.

[a] 1990.

During the transition period in Poland, there has been a considerable reduction in total investment in housing as a percentage of GDP from 5.2 per cent in 1990 to 1.7 per cent in 1996 (table 12). Even though in 1992 the Polish economy started to pick up, housing investments continued to decline and the private sector was not able to compensate for the loss of budgetary expenditures on housing. In comparison with some other countries in transition, in the 1990-1994 period, investments in housing as a percentage of GDP fell most dramatically in Poland and Latvia, 62 per cent and 64 per cent respectively, while elsewhere the figure ranged between 47 per cent in Bulgaria and 22 per cent in Romania (but the latter was at a very low level of housing investments in 1990: 0.9 per cent of GDP). At the same time, like Poland, other countries also experienced a decline in the share of housing investment as a percentage of GDP after positive economic changes in 1993, which is an indication of the internal restructuring in investment priorities moving away from housing to trade, services and other sectors and shifting from new housing construction to modernization of the existing building stock.

TABLE 12

Total investment in housing as a share of GDP

	1990	*1992*	*1993*	*1994*	*1995*	*1996*
Housing investment	5.2%	3.9%	2.6%	2.0%	1.9%	1.7%

Sources: Housing Research Institute, *Construction in 1994 (monitoring)* (Warsaw, 1996). Data supplied by the Housing Research Institute.

TABLE 13

Investment in new housing development in selected countries in transition

	Housing investments			*New housing construction*		
Country	*As percentage of GDP 1990*	*As percentage of GDP 1994*	*Change (percentage) 1994/1990*	*Dwellings per 1 000 population in 1990*	*Dwellings per 1 000 population in 1990/1994*	*Change (percentage) 1994/1990*
Albania	1.4	..	..	3.9	3.7	95
Bulgaria	1.5	0.8	53	3.0	1.1	33
Croatia	3.2	2.0	63	3.9	2.0	51
Czech Republic	3.2	2.4	75	4.3	1.8	42
Estonia	..	0.2	..	4.8	1.3	27
Hungary	4.2	2.8	67	4.2	2.1	49
Latvia	4.5	1.6	36	5.0	0.3	6
Lithuania	..	2.7	..	6.0	1.8	30
Poland	5.2	2.0	38	3.5	1.9	54
Romania	0.9	0.7	78	2.1	1.6	76
Slovakia	..	0.2	..	4.9	1.3	27
Slovenia	4.2	3.0	71	3.9	2.8	72
Average countries in transition	3.2	1.6	50	3.6	1.8	50

Source: J. Hegedüs, S. K. Mayo and I. Tosics, *Transition of the Housing Sector in the East-Central European Countries* (Budapest, 1996).

TABLE 14

Housing construction by type of developer
(Percentage)

	1989	1990	1991	1992	1993	1994	1995	1996
Public	18.3	13.7	9.7	8.9	11.7	9.7	8.5	5.4
Municipal	3.1	2.2	1.9	2.7	4.9	4.7	4.9	3.2
Enterprise	15.2	11.5	7.8	6.2	6.8	5.0	3.6	2.2
Cooperative	45.1	50.0	61.0	63.4	53.0	41.7	39.9	36.8
Private	36.6	36.3	29.3	27.7	35.3	48.6	51.6	57.8

Source: Data supplied by the Housing Research Institute.

Housing production measured in terms of new dwellings per 1,000 population fell in Poland from 3.5 in 1990 to 1.9 in 1994, which is a drop of 46 per cent. Among the countries listed in table 13, the sharpest drop occurred in Latvia (94 per cent), Slovakia and Estonia (73 per cent each), while Albania experienced only a 5 per cent reduction. Despite the reduction in the number of new housing units, it is evident that in Poland, like in other countries in transition, the opening-up of the housing market to the private sector has resulted in a significant increase in quality and size of new dwellings.

Another indicator which shows the relative weak position of the housing sector in the Polish economy is the share of new housing credits. In 1994 housing credits amounted to about 9 per cent of all newly granted credits, while the value of all outstanding housing loans amounted to 19 per cent of all outstanding loans. This corresponds to the decreasing trend in construction output.

Housing construction by the private sector has been gaining importance during the transition. The share of private investment in housing rose from 36.6 per cent in 1989 to 57.8 per cent in 1996. But in absolute numbers the growing share of the private sector still means a severe reduction because of the total drop in production. The cooperative sector showed a decrease in production from 45.1 per cent to 36.8 per cent in the same period. Production by the public sector also fell from 18.3 per cent to 5.4 per cent.

B. Housing economics

Inflation rates have been declining steadily during the transition years. However, incomes have kept close pace with consumer prices, whereas construction costs have relatively declined. It should be kept in mind that looking at averages does not give a clear view of the real problems. The current market price of a new, standard flat of 60 m^2 of living space is still 8 to 10 times the average annual wage of a skilled worker.

Both physical and legal persons owning real property are subject to real-estate tax. Those managing State property or leaseholders of real estate are liable, too. The Local Taxes and Fees Act set maximal tax rates, which are differentiated only according to the function of the property concerned: residential or commercial. In 1996, maximum tax rates amounted to 0.23 zloty per m^2 for residential buildings or parts thereof; and 8.62 zlotys per m^2 for commercial buildings or parts thereof (excluding agriculture and forestry). Municipalities, however, do not charge maximum real-estate tax rates for political reasons. Consequently, tax revenues are still quite low.

Tax deductions for housing purposes are also incorporated in the Polish taxation system. For private individuals, tax deductions are available for the construction of new dwellings, for purchasing municipal or cooperative flats, for repaying cooperative housing loans and for repairs and maintenance. The maximum tax deductions are set by special legislation. Companies and other legal persons are also entitled to deduct their investments in housing from their taxable income, but they are not subject to the maximum deductions applying to private individuals.

TABLE 15

Maximum tax deductions for private individuals, 1996

Purchase of a dwelling or a building plot	64 400 zlotys
Repairs and maintenance	16 800 zlotys
Repayment of cooperative loans	11 340 zlotys

Source: Data supplied by the Housing Research Institute.

C. Housing finance systems

Two issues had priority in the reform of the housing financing system: (*a*) the reform of the existing, highly subsidized system for housing construction; and (*b*) the introduction of new financial instruments.

Reforming existing cooperative loans

The reforms cover the existing financial support especially in regard to the cooperative sector. As a first step a variable interest rate in line with inflation both for co-op owners and tenants was introduced. Due to the high nominal interest rate many households found it very difficult to repay the loans. In an attempt to prevent borrowers from refusing to repay their loans and to alleviate the financial burden on households, several measures were taken successively, for example amortizing part of the debt, capitalizing interest and limiting repayments to a maximum share of household income.

The reforms were aimed at protecting both outstanding loans and borrowers from the negative effects of inflation. Repayment principles have been changed many times. In 1990, capitalization and partial takeover of interest by the State was introduced. This measure allowed borrowers to add 60 per cent of interest due to the loan principal, whereas 32 per cent of it was amortized by the State. The remaining 8 per cent had to be financed by the borrowers themselves. This system was abolished in 1992, when it became clear that these principles led to an increased burden on the State budget and to liquidity problems for banks.

The second step in the housing financing reforms, in 1992, was the introduction of a so-called standard payment, set at 25 per cent of the borrower's income. At the same time, so-called block loans taken out by cooperatives were split into construction credits for builders and mortgage loans to the buyers of the cooperative dwellings. Both the construction credits and the mortgage loans are described in more detail below.

Reforming the housing booklets system

The housing savings system was reformed as well. A housing savings system, in the form of so-called housing booklets, had been operational for a number of years. In 1993, the so-called *guarantee premium* was implemented to allow valorization of accumulated savings at the moment of purchase of a dwelling. In 1994 alone, 460,000 people received guarantee premiums, and State budget expenses for this purpose amounted to almost 13 billion old zlotys. Besides this guarantee premium, the old housing savings system provides for *compensation*, a State subsidy for holders of housing booklets. Those applying for compensation have to meet several conditions: they have to be a candidate of a housing cooperative, prove their housing needs and be of legal age. Compensation is earmarked for improving the housing situation by buying a dwelling in private ownership. Compensation can be given in cash or in kind. Applicants can request the sale or leasehold tenure of municipal land, preferential granting of non-residential spaces for converting them into residential premises. Receiving compensation does not affect the housing booklet holder's claim for a guarantee premium.

Mortgages and construction credits

At the same time as the standard payment was introduced, the so-called *dual index mortgage* system was set up. It protects both deposits and the borrower by establishing instalments at 25 per cent of the borrower's income, indexed to the average increase in wages, thus separating repayment from the variable rate of interest. This system is based on the assumption that in the long run wage and price increases compensate each other. In this case, indexing to wages rather than to prices does not bring about a significant change. There is a risk, however, that incomes may decline, which would prolong the redemption period. The system is most susceptible to this risk in the initial period, when liabilities are still large. The system required State support for the first few years, as well as guarantees for borrowers and banks against rapid changes in economic parameters (as the repayment of loans is not correlated with changes in capital markets, but, rather, with changes in income levels).

The dual index is used for both construction credits (multi-family construction) and mortgages (individuals). The total production financed by dual index mortgages has been very low due to the competition of highly subsidized credits by the Polish State Savings Bank (for instance, by repurchasing of capitalized interest, 12-month grace periods). However, for loans taken out after 1 April 1995 the Government will no longer repurchase interest.

In 1995 the Polish State Savings Bank started granting new types of loans. The maximum loan amount is the borrower's documented gross monthly income multiplied by 25, or 70 per cent of the market price of the collateral. The interest is variable. Unpaid interest is capitalized. The maximum term is 25 years. This Bank has a near monopoly position for housing loans among credit institutions. In 1990, 84 per cent of all housing loans were granted by the Bank; in 1994, 96 per cent.

Interest on long-term mortgages amounted to 36.3 per cent in 1994 and to 38.5 per cent in 1995, whereas interest on medium-term (one to two years) development loans ranged from 35 per cent to 40 per cent. In 1996 the interest on mortgages was lowered to 30 per cent. Though this declining trend should be seen as a positive development, interest rates are still too high and drastically restrict the number of investors. Housing loans from the Polish State Savings Bank still predominantly come from short and medium-term deposits. Such a system does not provide a stable basis for an increasing supply of loans and for offering a variety of loans. Another complication resulting from the housing policy's emphasis on reducing the inflationary aspects is that it raises expectations among borrowers that the State will continue to bear the financial risks associated with housing loans in periods of high inflation.

Construction credits

All investors in housing, including companies, cooperatives, individuals and local authorities, can apply for construction credits. These loans are available for a wide range of housing construction projects. Construction credits are primarily targeted at investors in housing, as the loan's term equals the period of construction and sale of the units. Market interest rates are charged on construction credits. An investor must finance 25 per cent of the investment from other sources. For individual families building their own home, construction credits are converted to mortgages after completion. Construction credits must be secured by the property constructed, including land and other buildings. Additional guarantees may be required by the bank granting the credit. In the loan assessment procedures, the financial feasibility of the project and its technical standards are taken into consideration.

National Housing Fund

The 1995 Act on Supporting National Housing Construction introduced a National Housing Fund to support the State housing and construction policy, particularly emphasizing construction of rental dwellings for lower-income population groups. The means for this Fund were provided by the World Bank (US$ 50 million), the European Bank for Reconstruction and Development (US$ 65 million) and the United States Agency for International Development (US$ 35 million). Resources from this Fund are allocated to participating banks, which in turn grant mortgages and construction credits to borrowers. The National Housing Fund is an independent organization under the National Management Bank, primarily funded with State subsidies. It is envisaged that the Fund will become self-supporting by issuing securities. The Housing Fund's resources are designated for preferential loans for housing construction by newly-established social housing associations (TBS) and by housing cooperatives. Loans cover up to 50 per cent of the construction costs.

Contract savings system

In September 1995, a credit and savings system for households with modest incomes was introduced, the so-called contract savings system, which is comparable to the German *Bausparen* system. Participants make deposits for at least three years. After this period, they will be eligible to apply for a loan of up to 150 per cent of their savings, including interest. The savings period may be shortened by maximum 12 months, provided that the participant's housing booklet savings, including possible premiums, are transferred to the contract savings account. Interest on deposits is minimum 25 per cent and on loans maximum 50 per cent of the current National Bank refinancing rate. Loans are granted for purchasing homes, renovation or modernization, purchasing building plots or repaying old housing loans. Participants are permitted to terminate the agreement at any time. If this happens before the end of the agreed savings period, the amount specified in the agreement is refunded, otherwise the fund reimburses the deposited amount plus one year's interest.

Participating banks may set up independent housing funds granting contract loans. The draft law entitles these funds to financial support from the National Housing Fund. Banks will be able to use surpluses in savings above their fund commitments to purchase bonds, bills and other securities from the State Treasury and to make deposits in term accounts. Deposits will be guaranteed by the State Treasury. Housing funds are not obliged to grant loans without a guarantee. In this case, the depositor can either wait for his financial situation to improve or withdraw his deposit and lose the interest. When used for the declared purpose, deposits may be deducted from income tax. Deposits have the same interest rates as three-year deposits. Similar procedures apply for transferring an account. Resources used to repay a loan are tax deductible as well.

D. Affordability of housing

Rent policy

Until 1994, the rents for all residential units (municipal, enterprise-owned and private) were regulated centrally and calculated from a standard basic price per 1 m^2 of floor space, amounting to 0.12 zloty from April 1992. Depending on the type and quality of the building or dwelling, the rent could be lowered or raised by a maximum of 120 per cent. Rent for a standard dwelling, therefore, amounted to 0.26 zloty per square metre. These rents covered barely one third of normal maintenance costs.

In November 1994, the Act on Rental Housing and Housing Subsidies was introduced. It regulates the rents for municipal, company-owned and some older private rental dwellings. Rents are set by the owners at maximum 3 per cent of the so-called replacement value. Surveys, however, indicate that in many cases rents do not exceed 1 per cent of this value. Municipalities often do not charge the maximum allowed rent level. Rents therefore cover only part of the cost of maintaining the country's rental stock. Renovation costs, interest and amortization are not covered.

Regulated rents for municipal property will be in force until the end of 2004, although this period can be shortened, if rent liberalization is not expected to worsen the tenants' financial situation too much. In this case, permission from the regional authorities should be obtained. Tenants of private rental buildings and those occupying dwellings on the basis of administrative allotment will pay regulated rents until the year 2004. Regulated rent levels should take into account the location of the building (central or suburban, joined or detached), the layout of dwellings within the building, building fixtures, appliances and fixtures in the dwellings, and the overall condition of the building, but do not include utility charges (water, central heating and the like). Regulated rents apply to nearly half of all dwellings in Polish cities. Besides regulated rents, liberalized rents were also introduced. Liberalized rents are agreed upon by the landlord and the prospective tenant on the basis of contract freedom. Dwellings over 80 m^2 are subject to liberalized rents, large dwellings can be let by municipalities on the basis of tenders. Regulated rents established by municipalities may not exceed 3 per cent of the replacement value of the unit, set each year by the regional authorities.

Affordability

According to official statistics, average rent expenditures for flats constituted only 1.5 per cent of average household expenses in 1995. Total housing-related expenses (including utilities) amounted to about 6 per cent. Some surveys, however, indicate that the last few years have witnessed a rapid increase. Housing expenses now amount to 15 per cent to 23 per cent of expenditure, depending on the income group. Low-income groups spend about 19 per cent of their earnings on housing. The variety in housing-related expenses is quite large.

Surveys indicate that about 10 per cent of households spend less than 10 per cent of their income on housing, whereas another 10 per cent spend more than half on this item. It should be noted that the increase in housing expenses is mainly caused by higher utility bills.

E. Subsidies and housing allowances

Poland has quite a comprehensive system of subsidies for the housing sector, comprising both reformed, older elements and new ones. Public expenditures on housing during the transition period varied from nearly 7 per cent of the total public budget in 1992 to 3.3 per cent in 1995. Table 16 gives an overview of the different items on the public housing budget.

TABLE 16

State expenditures on housing
(In millions of zlotys)

	1995	*1996*
Subsidies to housing cooperatives	650	450
Repurchase of interest on housing loans	830	1 200
Housing allowances	480	480
Guarantee premiums on housing savings booklets	600	1 300
National Housing Fund (rental construction)	30	50
Mortgage Fund	120	100
Preparation of plots for housing construction	90	-
Total expenditures on housing	2 800	3 580

Source: Data supplied by the Housing Research Institute.

Table 16 also shows that a considerable amount is still spent on "old obligations". Another significant indirect housing subsidy can be found in the levels of regulated rents. Charging rents far below what is necessary to maintain and run residential premises could be seen as an indirect and untargeted subsidy to the rental housing sector.

As some incomes are not declared, there are large uncertainties about exact income figures. However, it is clear that especially for low-income groups the affordability of housing is becoming a problem.

Housing allowances

The Act on Rental Housing of 1994 enables municipalities to grant housing allowances to low-income households. Housing allowances are available to tenants of municipal and enterprise-owned dwellings, to members of housing cooperatives and owner-occupiers. Recipients must meet several conditions, such as limits on income, dwelling size and minimum housing expenditures. Municipalities are legally obliged to pay the allowance to those who are entitled to it, but, in many cases, do not have sufficient resources to do so. Central Government funds allocated for housing allowances (in 1994: 1.25 billion zlotys) do not provide sufficient resources for this purpose either.

TABLE 17

Recipients of housing allowances according to municipality size and tenure form

Population of municipality (x 1 000)	*Percentage of households receiving a housing allowance*			
	Total	*Municipal*	*Cooperative*	*Other*
< 5.0	13.6	26.7	44.4	12.8
5.1-10.0	14.4	24.6	35.1	8.0
10.1-50.0	11.2	19.3	19.5	4.7
50.1-300.0	6.8	7.7	9.8	3.1
> 300.1	4.4	5.3	5.8	2.1
Total	6.2	7.5	8.7	3.1

Source: Data supplied by the Housing Research Institute.

By March 1995, about 400,000 households had received housing allowances. According to surveys, 7 per cent of the population applied for an allowance. The housing allowance option is used more in smaller municipalities than in cities. The rate of households applying for a housing allowance is higher in the cooperative sector than in others (see table 17).

F. Social housing and target groups

As part of the housing reforms, a National Housing Fund was established (see section C above). Its resources are earmarked for granting preferential loans to cooperatives with tenant status and to so-called social housing associations. Social housing associations (TBS) are not-for-profit organizations that build and manage dwellings for lower-income groups. New social housing can be let for a maximum rent of 4 per cent of the replacement value, as opposed to the existing housing stock, for which maximum regulated rents are set at 3 per cent of the replacement value. Municipalities are also expected to play an important role in social housing, for instance, by contributing building plots at reasonable prices. Social dwellings are let to lower-income households that cannot afford other housing. The Central Bureau for Statistics estimates that, in 1994, about 30 per cent of all households could be classified as low-income, in view of the fact that 25 per cent of employees had a salary below the social minimum level and that nearly half of the unemployed were not entitled to unemployment benefits.