

FINANCIAL FRAMEWORK**A. Overview of housing finance issues in the Republic of Serbia****1. Investment in housing**

As has been shown in chapter IV, based on the laws “on Housing Relations” (1990) and “on Housing” (1992), tenants/users of the public owned flats had the possibility to privatise the flats at prices far below the market value in the early 1990s.⁵⁸ Investment in new housing in the Republic of Serbia has decreased in the last decade. The withdrawal of public funding from housing construction has not been matched by private investment. For example, close to 9,000 units were financed by the public sector in 1991, and this declined to 1,817 units in 2002. Similarly, the economic recession has affected residential investment by the private sector (see table 5.1). Production of new housing declined from 250,000 units in the period from 1985 to 1990 to 115,439 units in the period from 1991 to 1995. It should be noted that this indicator is not very reliable given the amount of illegal housing construction in most large urban areas.

Table 5.1. Dwelling units completed

	1991	2002
public sector ⁵⁹	9.066	1.817
Private sector	18.639	8.896

Source: Republic of Serbia Statistical Office: Serbia in Figures 2003, p. 17.

In most cases a developer sells the units before he starts to build. Prices are paid on a cash basis. As reported for 2004 there have been frequent cases where investors had not sold all the flats even 6 months after completion of the building. The returns in this business are still

high, despite the fact that the ratio between invested money and return decreased from 1:3 to 1:2 in 2004.

The risk of default or abuse by the developer remains with the investor/buyer of the flat. Mortgage lending is still in its infancy.

2. Public expenditure on housing

In the past the Government of Yugoslavia, later Serbia, had a system of state/public housing. *The Housing Law 1992* stipulated the establishment of the Solidarity Housing Fund, to which employers contributed. Enterprises, institutions and state bodies were obliged by law to set aside funds of 1.3 per cent of gross salaries for providing housing to employees who did not possess their own housing units. A part of the fund was aimed at meeting the housing needs of war invalids and other disabled and their families. The Solidarity Housing Fund was decentralized and deregulated. Units were produced by municipalities based on their own criteria and funding.⁶⁰

Article 4 in the *Salary and Wage Fund Tax Law in 2001* replaced article 44 from the *Housing Law*, which regulated resources for financing the system of solidarity housing funds (one of the main social housing elements in the *Housing Law*) in the Republic of Serbia. This tax was set between 0.3-1 per cent of salary by the self-government units (possible by law: up to 3.5 per cent). The assembly of municipality defined the tax rate and the allocation of revenues for the housing construction. The legislation neither defined conditions for disposal of the resources (criteria, target groups, conditions for granting and returning the resources, etc.), nor enacted other by-laws or a monitoring system. This tax was abolished in July 2004. The Solidarity Housing Fund resulted in an approximate distribution of 1 flat per 10,000 inhabitants. Due to the favourable selling conditions, this fund functioned mainly as the delivery mechanism of highly subsidized owner-occupied housing for middle-income households.⁶¹

⁵⁸ In Belgrade e. g. 65 m² for 100 DEM (50 EUR), see: Milicevic, Goran: Characteristics of the real estate market in Serbia, lecture for “Workshop on Real Estate Research and Education”, Budapest, February 18th – 20th 2005, pt. 2) a).

⁵⁹ Public sector including public, state, mixed and co-operative sector.

⁶⁰ Petovar, 2004.

⁶¹ UN-HABITAT, 2003.

The program of building 100,000 flats during ten years (10,000 a year) for young couples, army and police was announced by the Government of the Republic of Serbia in 1999. The local authorities were expected to give the land free of charge as their way of contributing to the program. Construction started in 121 locations and the Republic Construction Directorate run the program. In the middle of 2000, the first 1,000 flats were allocated, without defined quotas for the specific target groups and the program was terminated after the change of government later in this year.

In addition, there have been a number of other central and municipal programs for the provision of housing in the last decade. The funding allocated is unknown. An example is the housing program for University lecturers and scientists which started in 1995 with the construction of 1,000 apartments in Belgrade. It was administered by the Foundation of Housing for Young Scientists and Artists of the Belgrade University. The land was granted by the City of Belgrade, and the main financial source was the Government of Serbia with the provision of housing loans at favourable terms. Since 2000 the Foundation is supervised by the Ministry of Science, Technology and Development. The first allocation of the Foundation consisted of 387 flats. There have been more applicants and therefore also complaints have been lodged concerning the slow delivery mechanism.

A new policy instrument has been launched, the State Insurance of Mortgage Credits, which is based on central budget funding. Another – the establishment of a National Housing Fund as well as regional/municipal funds – is under discussion.⁶²

Property taxes are charged on the basis of the area of housing in m². Typical tax is 8,000

CSD per year. In 2003, the state earned CSD⁶³ 13.204 million from property taxes, compared to the CSD 18.942 million in 2002⁶⁴. The property taxation so far was not based on market value of real estate and the mechanisms for taxation remain unclear.⁶⁵ Recent changes in the Property Tax Law, effective January 2005, indicate that in accordance with Article 5 the base of property tax shall be the market value of real estate of the year preceding the year for which property tax is levied and paid.⁶⁶ The real estate market value shall be determined by the tax office. In the absence of information on market prices of housing/apartments in different locations and the incomplete cadastre system of real estate registration, the practical implementation of the new legislation will be particularly challenging.

The cost of land lease for residential land is based on (six) categories of land and typically is Euro 50/m²/year. Construction requires a one-time fee of (typically) Euro 4,000 for an 80m² housing unit. Fees for infrastructure connection and public utilities differ on a regional basis but remaining an important share of housing costs. Legalization of buildings in most cases is easier, faster and cheaper than obtaining a building permit in advance.

3. Trends in the housing market

Market transactions are on the rise in Belgrade and have reached 100,000 as shown in the table below.

Table 5.2. Sale of housing units in Belgrade

Year	Number of transactions
2001	25,000
2002	37,000
2003	59,000
2004 (estimated)	100,000

⁶³ CSD = Serbian Dinar; 1 CSD = 0,0124 EUR or 0,0166 USD; 80,6449 CSD = 1 EUR; 60,3404 CSD = 1 USD (National Bank of Serbia, March 16th 2005)

⁶⁴ Statistical Yearbook of Serbia and Montenegro 2004, tab. 4.11, p. 94.

⁶⁵ USAID/ Urban Institute: An Assessment of the Mortgage Market in Serbia (prepared by Merrill, Sally / Rabenhorst, Carol / Butler, Stephen B.), March 2004, p. 21.

⁶⁶ Article 6 states that the market value of any real estate shall be determined by applying the basic elements: 1) useful area; 2) average market price per square meters of corresponding real estate in the territory of the municipality concerned, and adjusting elements such as location of real estate, its quality and other elements affecting the market value of real estate.

⁶² Proposed in the draft law "On social housing":
The tasks of the National Housing Fund will be (Art. 6 of the draft law):

- To prepare a Fund programme,
- To prepare sources for housing programmes,
- Supervising and controlling the use of money for housing programmes,
- Providing expert and technical assistance to realize housing programmes,
- Research and proposing of regulations to improve housing finance.

Purchase prices in the secondary market vary widely depending on location and the condition of the property. Interviews with real estate agencies in November 2004 indicate that the purchase price of a typical 80 m² flat in Be (Source: *Real Estate Agencies Belgrade, Interview data, 25 November 2004.* location) it ranges between Euro 50,000 and 75,000. At the high end, these are mostly newly built units and/or completely renovated, with garage, telephone, and in an attractive location. Another overview of purchase prices in a more systematic order is presented in table 5.3.

Market prices in provincial towns are influenced by much lower activities and are therefore lower, as the example of Kragujevac shows. Kragujevac has a population of 175,000, of which 145,000 are urban. The urban population lives in about 60,000 housing units and average house prices in the secondary market are in the range of Euro 500-1,000 / m². In Niš or Novi Sad the prices are around Euro 900 – 1000 /m².

4. Affordability of housing

As reported, the average annual household income in Serbia in 2002 was 206,000 CSD. Only

less than three per cent of the households earned more than 500,000 CSD, while 22 per cent of all households had an average annual income below 84,000 CSD. With an unemployment rate of 29 per cent and large scale underemployment (employees kept on payroll waiting the privatization of public enterprises), one might expect low purchasing power in the housing market. Despite these trends, the above sporadic statistics on housing prices demonstrate clearly that the housing market reflects the size of the grey economy, which is estimated to be in the range of 30 – 50 per cent of the official economy.

A World Bank report presents available data on housing costs in the rental and owner-occupied housing for Serbia. Owners and public sector tenants spent close to 10 per cent of their income on housing, while in the private rental sector the share is as high as 27 per cent. It is reported, that the rent for public rental apartments is not made or collected, only for utility and maintenance costs.⁶⁷

Table 5.3. Market prices for housing in Belgrade (in Euro per m²)

Zone	New construction	Resale	Luxury
“Extra” zone	1900 – 2000	1800 – 2000	3000
First zone	1600 – 1700	1300 – 1500	-
Second zone	1200 – 1300	1000 – 1100	-
Third zone	900 – 1000	700 – 800	-
Fourth zone	650 – 700	600	-

Source: Real estate agencies in Belgrade, November 2004.

Notes: The “zones” are just concentric rings around the centre of the City of Belgrade

⁶⁷ Duebel, Brzeski, Hamilton, 2005, chapter 3.3.3.

5. The housing finance system

Banking sector

In Serbia there are 46 banks⁶⁸, less than 10 of them are foreign owned with a strong position of Austrian banking groups (HVB-BA, RZB, Volksbank, Hypo Alpe Adria); 10 – 15 banks still have the State as a significant stakeholder. The National Bank of Serbia has banking supervision authority.⁶⁹ The total balance sheet of all banks at end of June 2004 was CSD 401 bn.

Mortgage lending is just emerging with initial offerings by Raiffeisen bank, and HypoAlpeAdria Bank. Official statistics on the volume of mortgage loans given by Serbian banks are not available. In the first half of 2004 so called “housing loans”⁷⁰ rose by 42 per cent while retail loans rose by 82 per cent. Interviewed banks named mortgage lending as a growing business.

Mortgage credits are mainly funded by deposits or credit lines of International Financial Institutions or – for foreign owned banks – by credit lines of the holding bank. It is reported that the same banks are starting to propose savings schemes with the purpose of obtaining a flat. Table 5.5 presents current mortgage lending conditions.

Main problems in mortgage lending are:

The mortgage as a credit security is only cursory regulated in the existing laws (see chapter IV p. 43). A new law on mortgage is under discussion;

- Many properties are not registered;
- Registration of a mortgage, as well as foreclosure, takes a long time;
- Taxes and fees on mortgage lending and home purchase.⁷¹

Table 5.4. Long term^a loans from December 2003 to June 2004

	Total volume of long term loans ^b	Housing loans	Retail loans
December 2003	17,1 bn CSD	4,4 bn CSD	5,1 bn CSD
June 2004	25,7 bn CSD	6,3 bn CSD	9,3 bn CSD

Source: National Bank of Serbia.

Table 5.5. Mortgage loan conditions of Serbian banks

Amount (min)	10,000 EUR
Loan to value ratio (LTV)	70 % - 100 %
Monthly part of salaries to pay the loan	Up to 50 %
Interest rate	8.5 – 10.5 floating
Maturity	Up to 20 years
Guarantors	0 – 2
Property insurance	Yes
Life insurance	No
Currency clause	Yes
Acknowledgement of indebtedness	Yes
Registration of the real estate	Not in all banks, but then only with guarantors
Prepayment	Possible, fee up to 2 % of the loan amount
Collateral	First ranking mortgage

Source: Interview data, Belgrade, November 2004.

⁶⁸ As of November 2004.

⁶⁹ www.nbs.yu

⁷⁰ Loans for housing purpose, mainly – but not necessarily - using a mortgage as credit security.

⁷¹ Taxes and fees include: (1) profit tax on interest income, (2) origination fee, (3) property transfer tax, (4) registration costs, (5) credit insurance on cash loans. (More detailed: USAid / Urban Institute: Assessment of the Mortgage Market in Serbia, p. 16.)

^a Long term under Serbian circumstances means longer than 12 months.

^b Including also agricultural and commercial loans.

National Corporation for Insurance of Housing Credits

A credit bureau *National Corporation for Insurance of Housing Credits (Nacionalna korporacija za osiguranje stambenih kredita - NKOSK)* was established in 2004 to improve the situation on the mortgage market. NKOSK is modelled after Canada Mortgage and Housing Corporation,⁷² which insures mortgage credits and issues securities. NKOSK is a public enterprise with an implicit state guarantee. The original capital is Euro 10 mln (Art. 4 NKOSK law) from the State budget. Maximum exposure is 16 times the capital. The supervision is provided by the Ministry of Finance (Art. 21 NKOSK law), with the obligation to report annually to the government and correspondingly to Parliament. The risk weighting of the NKOSK will be – as far as known today – zero per cent. NKOSK does not need a licence as do an insurance or a bank. Its board members will be appointed by the Ministry of Finance and it can be reorganized as a joint stock company in the future.

The NKOSK will insure mortgage credits given by banks up to an amount of 80 % of the value of the real estate. In the case of default on a mortgage when the bank has to foreclose, a loss will be covered by the insurance. The premium for the insurance will be 1 – 4.5 per cent, depending on loan amount, borrower, real estate and credit terms. If a bank will have a general contract with NKOSK, it is obliged to propose all mortgage credits for insurance with NKOSK. It is up to the NKOSK to decide, if it will insure or not. The banks will be obliged to lower the interest rate for the credit by at least on per cent. At a later point the NKOSK intends to securitize mortgages following standardization of mortgage credits. NKOSK plans to work as a profit organization, but the Ministry of Finance will use it as housing policy instrument.

Capital market

The Belgrade Stock Exchange (BSE) – closed after the Second World War – was reopened in 1990. The only debt instruments traded on the BSE are so called fx-bonds of the Republic of Serbia, based on shares (issued through the process of privatisation of the companies), frozen foreign currency deposits and some bills of the National Bank. Banks and Enterprises have not issued debt instruments yet and only shares of some banks are available. Possible investors for bonds are banks and insurance companies.⁷³ The National Bank supervises the insurance companies.

The pension system is still looking forward to a reform. Today some state-owned and some private funds are active. State-owned funds in the legal form of a public enterprise are:

- State Fund for employees (2.2 million insured persons);
- Fund for farmers (200,000 insured persons);
- Military Fund (80,000);
- Fund for small entrepreneurs (40,000).

As reported, these funds are based on an assessment system and lack a sufficient capital base.

Pension funds in private legal forms are DDOR (Novi Sad) and Dunav (Belgrade), both state owned.

B. Overview of housing finance issues in the Republic of Montenegro

The economy of Montenegro is small compared to Serbia. Montenegro introduced the Euro as its currency following a period with a dual currency system of Dinar and Euro.

⁷² www.cmhc.ca, www.schl.ca.

⁷³ As reported some foreign investors are also interested in shares and fx bonds.

1. Trends in the housing market

As demonstrated in chapter II, the housing situation in Montenegro is characterized by some interesting statistics: in particular, the number of dwellings is higher than the number of households. This is mainly explained with a large number of seasonal coastal houses in Bar, Budvar and Kotor. It is also interesting to note that the number of dwellings grew much faster than the number of households and population.

Unfortunately no statistics on the financing of the dwellings are available. It is reported, that in many cases public enterprises or the State give credits directly to persons for housing construction. As reported, in many cases these credits are pre-paid under very favourable conditions for the borrower (and losses for the State or state enterprise). A legal basis is e.g. Article. 61 of the *Law on Housing Property*: firms, legal persons or other entities shall provide funds for addressing housing needs of employees; including the right to sell flats to employees under favourable conditions.

The number of legal transactions in Montenegro in general and in the capital Podgorica is rather low. The data on prices in the housing market are scarce. As an example, typical rents in Podgorica are between Euro 100 to 300 (average Euro 150) for a small apartment, although the average monthly income is only Euro 200. The purchase of a housing unit would require the payment up-front of the total purchase price of Euro 50,000 to 150,000 to the real estate developer (with a huge amount of risk involved) in the case of new construction, or to the owner in the case of real estate transaction in the secondary housing market.

Typical offers for a house with adjacent land in Podgorica are for Euro 65-150,000. Apartments appear to be priced similarly (see Table 5.7). Given the lack of crediting for the purchase of residential properties and the official income data, prices in the housing market reflect the size of the grey economy and the lack of any other opportunities for investment.

Table 5.7. Housing market data Podgorica, 2004

	Price (Euro)
Houses (size & land)	
80m ² / 1050 m ²	65,000 Euro
250m ² / 640 m ²	150,000 Euro
Apartments (size)	
62 m ²	57,000 Euro
76 m ²	70,000 Euro

Source: Real estate agencies, Podgorica, November 2004.

2. Banking system

Montenegro has 10 active banks supervised by the Central Bank of Montenegro. A Deposit Insurance Fund is created, financed by the banks without a State guarantee. The following banks have foreign shareholders:

- Montenegrobanka: Shareholder Nova Ljubljanska Banka (Slovenia);
- Crnogorska komercijalna banka (CKB)⁷⁴: Shareholder German Development Company DEG⁷⁵ and Netherlands Development Finance Company FMO⁷⁶;
- Euromarketbanka⁷⁷: Shareholders Soros Economic Development Fund, EBRD, German Development Company, Raiffeisenbank Sarajevo;
- Podgorička banka⁷⁸: Minority shareholder IFC;
- Opportunity Bank⁷⁹: Shareholder Opportunity International and Rabobank group.

As reported, only Montenegrobanka is offering housing loans, using housing as collateral. Mortgage loans are given for a maturity of 10 – 12 years, loan-to-value ratio of 40 per cent, interest rate 9.5 per cent floating, down-payment of 20 per cent. Loans are only given for renovation, not for buying a flat. A land registration system is under development. Many properties are not registered. As in Serbia the number of illegal constructions is high. A credit bureau does not exist.

Hipotekarna Banka is only using the name, but is not engaged in the mortgage business. A

new *Mortgage Law*⁸⁰, adopted in August 2004, provides a reliable basis for mortgage lending.

Capital market⁸¹ Montenegro has two stock exchanges: Montenegroberza (Montenegro Stock Exchange) and NEX Montenegro; both are taking part in the informal platform of SEE stock exchanges.⁸² The main debt instruments are – as in Serbia – fx-bonds of the government, based on frozen fx-deposits. Euro-denominated short-term government bonds (earlier 1 – 2 month, today 6 months) are traded only between banks. The investors are private investors and privatisation funds. Privatisation funds were introduced in 2003 to invest (only) in privatisation vouchers, however since July 2005 they will be reorganized as investment funds with the right to invest in all kinds of assets in accordance with the *Investment Fund Law*.

Some broker firms are active, and organized in to the Association of Brokers of Montenegro. Four insurance companies exist, but so far they are not engaged in life or car insurance. A pension reform is planned for the future. Today only the state pension fund exists (60 per cent is funded by pension revenues, 40 per cent by the State budget).

Housing Policy Action Plan For working groups, supported by the Stability Pact for South East Europe of the Ministry of Environmental Protection and Physical Planning have been discussing a housing policy action plan for Montenegro for some months. One of the results of the working group for financial issues is a proposal for a tax subsidised Bauspar system. Other proposals as introducing covered bonds have been discussed.

⁷⁴ www.ckb.cg.yu

⁷⁵ Deutsche Entwicklungsgesellschaft (German Development Company), www.deginvest.de

⁷⁶ Netherlands Development Finance Company (Nederlands Financierings-Maatschapij voor Ontwikkelingslanden, www.fmo.nl).

⁷⁷ www.euromarketbanka.cg.yu

⁷⁸ www.pbanka.com

⁷⁹ www.opportunitybank.cg.yu

⁸⁰ Text with introduction (German): Jessel-Holst, Christel: Republik Montenegro: Hypothekengesetz; WiRO 2004, 337 – 343.

⁸¹ Detailed information: Asocijacija Brokera Crne Gore (Association of Brokers of Montenegro): Vodič za akcionare – Shareholders Guide – Das Aktionärshandbuch, Podgorica 2003.

⁸² Stock Exchange Monitor (www.sem-on.net). Other participating stock exchanges are: Banja Luka, Belgrade, Ljubljana, Skopje, Sarajevo, Varazdin.

