

# **Social Housing in the Czech Republic – Unresolved Question and Future Prospects**

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## **Introduction**

It has been demonstrated elsewhere (Lux (ed.) 2003, Lux 2007, Lowe & Tsenkova 2003, Donner 2006) that very different approaches to housing privatization, rent regulation, new supply-side as well as demand-side subsidies and establishment of market-based housing finance systems were applied among transitional CEE countries. It has been also argued (Hegedüs & Toscis 1998) that if there is anything common in housing policy reforms in this region, then it is the fact that housing became a shock absorber of substantial decrease in living standards in early years of transition and therefore the housing policy reforms were realized only partially. The question is what was also shared in housing reforms in transition, later EU accession, countries if we suspend those changes that were the logic outcomes of wider economic and political reforms?

There is one fact that is generally marginalized when comparing transition housing systems. Most of the international comparisons of state interventions pay attention only to explicit subsidies, whether of direct or indirect type. Such subsidies are often well documented in public expenditure sheets, national budgets, and macroeconomic statistics. However, there is a group of subsidies that is generally not measured and definitely not demonstrated in official statistical figures – so called economic (hidden) subsidies. These often hidden subsidies are equal to the difference between market and actual price for goods and services. In other words, people pay for some service (housing) less than they would pay under market conditions.

It can be proved that there was no common shift in tenure structure during the transition among those transitional countries that became EU members in 2004 or 2007. Although the mass privatization of former public housing prevailed in the region there were at least two countries (Poland, the Czech Republic) that did not apply right-to-buy policy for privatization of their public housing. However, the substantial part of population in both groups of countries received generally the same economic subsidy – either in the form of owner-occupied flat purchased for very low or no price, or in the form of rental housing with very low regulated rent. This hidden economic subsidy probably formed the main financial subsidy in the field of housing during the transition and its marginalization may lead to distorted picture of housing reforms in those countries.

The economic subsidies were “distributed” mainly from the centre (by right-to-buy or rent legislation). In spite of the proclaimed decentralization of housing policy to municipalities, central governments thus did not want to be compromised by local governments and preserved the housing privileges for existing occupants of public housing – whether by giving them flats for “give-away” prices or by giving them low rents and generous tenant protection. Later, this dominant role of centre weakened but the dominancy of central decision makers in housing policies of 1990s was another common similarity among transitional countries (though poorly visible behind the decentralization rhetoric and some legislative activities).

If we take it another step forward we would find another outcome. The dominant states decided to allocate the huge economic subsidies but eligibility for these subsidies had to be, logically, restricted. The state could not give the same level of economic subsidy to all existing and newly created households as in such case the state budget would end in the bankruptcy. Only the existing occupants, and especially existing occupants of former public housing, were those who could be labelled as the winners of housing policy transitions. The income and/or social situation of eligible household has not been important in this allocation process; the only criterion has been the occupancy title. As the allocation of huge economic subsidies has not been means-tested there is high probability that these subsidies increased the income and social inequalities in transitional societies; this fact has been proved for the Czech Republic (Sunega 2005).

The economic subsidies divided households into two very different groups. The “insiders” enjoyed low housing costs and tenure protection (with no regard to their social needs or income levels) while the “outsiders” were often left to the uncompromising market forces. Additional subsidies directed to outsiders (if any) were, when compared to the hidden economic subsidies to insiders, marginal. Though this problem did not overflow into significant social conflict thanks to the traditional inter-generation transfer of housing privileges, it is obvious that the costs and benefits of housing reform were unequally distributed.

### **Economic subsidies in the Czech Republic**

We tried to estimate the amount of the economic subsidy stemming from rent regulation in the Czech Republic, and we did it by relatively complex simulation model fully described in Lux & Sunega (2004). In the model we simulated tenure choice among households living in rent-regulated housing (using Family Budget Survey data) when controlled rents are gradually increased. We also simulated the situation on housing market when supply of vacant market rental housing rises as the consequence of migration of better-off households to homeownership. In this way we estimated equilibrium market rents (which were substantially lower than current market rents distorted up due to regulation itself) and the economic subsidy has been computed as the difference between equilibrium market rents and regulated rents. Such subsidy was, in total, equal to about 10 bill CZK in 2002 and due to decreasing share of rent-regulated housing on total housing stock it decreased to about 7 - 8 bill CZK in 2005.

The estimate of the size of the second economic subsidy stemming from public housing privatization is more difficult. More than half of total public housing stock has been sold out between 1990 and 2004; mostly for low “residual” prices to tenants. Due to very variable conditions applied on municipal housing privatization between different points of time as well as in each point of time among different municipalities, it is simply impossible to calculate this economic subsidy exactly. There is no central statistics that could be used for such a purpose. Based on some partial information on privatization prices collected for Prague and some other cities by the Institute for Urban Development, it is probable that if we annualize the total subsidy allocated between 1990 and 2004 by assigning the same size of subsidy to each year, then annual level of it would be close to 10 bill CZK. In total, *the hidden economic subsidies were the most important annual housing subsidies during the transition in the Czech Republic.*

The economic subsidies were badly targeted to those in need and they were and probably still are income regressive – this means that instead of decreasing the income inequality in society they strengthened them. Large part of housing subsidies thus still goes to people who do need them while many low-income “outsiders” were left behind with few effective public help.

However, economic subsidies come gradually to an end nowadays. This fact could have been expected as these were, by their nature, only one-time subsidies that could not be sustained in long-term. Since 2006, the new “temporary” Act on Unilateral Housing Rent Increase has been in force; its aim is to remove, by the end of 2010, the deepest distortions between two artificially differentiated rent levels (i.e. regulated and free-market rents) and to “close the gap” to substantial extent in places with more rented flats. In 2011 and beyond, housing rent levels will depend on the local housing market – i.e. local demand and supply. Despite of this the private landlords and also many representatives of municipalities turned with several thousands of charges to the European Court for Human Rights in Strasbourg and ask for the state compensation of the loss caused by the past rent regulations. Due to the prospect of rent deregulation as well as due to the fact that about 70 % of former public housing has been already privatized till now, the scale of housing privatization substantially slowed down, or, at least, the offer prices to purchase the municipal flat increased. This means a gradual end also to the second economic subsidy – subsidy stemming from public housing privatization.

The main challenges the Czech housing policy faces now can be summarized into following questions: What kind of help we are going to offer to people who cannot afford housing at market prices when economic subsidies will cease to exist and overwhelming majority of municipal housing will be already privatized? How to assure that housing is affordable for low-income earners, socially or physically handicapped, lone parents, young couples; and how to do it especially in regions that offer enough employment opportunities but where house prices are also very high? What approach to apply to prevent from social segregation? And what approach to apply to prevent from price (rent) inflation which is often connected with demand-side subsidies (grants and loans for owner-occupied housing or housing allowance for tenants)?

### **Supply-side subsidies in the field of rental housing since 1992**

Social housing is not defined on the central level, with the exemption of the Act on Value Added Tax. The reduced VAT rate in the Czech Republic has been increased from 5% to 9%; the Act amendment (approved in 2007) includes also the definition of “social housing”, for which the reduced tax rate has been applied since January 2008. For new construction, as well as for fitting, refurbishment or change of the “social housing buildings”, including facilities, the reduced tax rate is applied. The reduced tax rate is also applied for construction or change of residential as well as non-residential building or family house (or even space in a building) with the aim to create “social housing”. “Social housing” thus means:

- *Flat for social housing* - here belong all flats (in all tenures and for all households) with the total floor area up to 120m<sup>2</sup>;
- *Family house for social housing* – here belong all family houses (in all tenures and for all households) with the total floor area up to 350m<sup>2</sup>;
- *Block of flats for social housing*;
- Accommodation facilities for state administration and police employees;
- Social services facility providing accommodation services according to the Act on

Social Services;

- Education facility with accommodation;
- Special children accommodation facility;
- Hospice;
- Buildings for war-veterans.

The floor area of a flat means the sum of floor surface of all rooms in a given flat, including rooms with facilities (bathroom, WC, etc.). The floor area of a family house means the sum of floor surface of all rooms in a given family house, including rooms with facilities (bathroom, WC, etc.). Block of flats for social housing means a building, where only flats for social housing are located. Room means defined space (part of a building) with the floor, ceiling and tough walls. As it may be clear from above mentioned conditions, overwhelming majority of the Czech housing stock (even the newly constructed housing) belongs to the category of “social housing”. The only ceiling concerns the total floor area of dwellings and this is set on high level. The definition of “social housing” has been therefore used only as a trick to sustain low VAT for housing construction/reconstruction after the transition period agreed in accession agreements between EU and the Czech Republic expired.

In the Czech Republic, the financial affordability of newly built dwellings is considerably lower than in EU-15 countries while financial affordability of older dwellings has increased thanks to rather low interest rates, growing supply and increasing real incomes. At the same time, from the half of 1990s the free market rents have decreased in their real values due to growing supply, growing real incomes and partly thanks to the “cheap privatization” of municipal dwelling stock to the tenants (some of such “new owners” do not use their flats for their own needs and so they offer them for lease or for sell). Despite of that, when taking into account aggregate average figures there is clear trend of decrease in financial affordability of housing and housing expenditures became the main consumption item in the household budgets; this trend has been currently strengthened by the end of economic subsidies and substantial house price growth in the last two years.

Owing to the high, though latent and often overlooked, economic subsidies, the division of responsibility for housing policy between three ministries, and especially due to the absence of any subsidy distribution evaluation and monitoring, Czech housing policy is in violation of the imperative of transparency and obstructs the possibility of making an evaluation of the efficiency and effectiveness of individual programs. However, since 2003 we see that at least some housing policy programs became more effective, i.e. more targeted to those in need. There is no real definition of social housing in the Czech Republic. However, there are several types of subsidy programmes aimed at new housing construction of smaller flats for people socially in need. About 13 bill CZK have been spent by the state to build around 23 thousands subsidized new rented flats allocated to socially defined target groups of household between 2003 and 2007. We can, in this respect, thus refer to following housing stock as real social housing:

***Supported housing*** – new municipal rental housing constructed under the programme introduced in 2003 by the Ministry for Regional Development. The grants are provided to municipalities for the purpose of construction (exceptionally reconstruction) of municipal rental flats. These flats may be allocated only among people who face housing accessibility problems due to their special needs (following from their health, age, unpleasant life circumstances) and who are endangered by social exclusion. This housing includes: *protected housing* (for handicapped and old people needing special flat design and social care), *half-way*

*housing* (for people living in risk social environment who are unable to solve their social situation by themselves like adults leaving children homes, people returning from prison, lone parents, victims of domestic violence) and *entry housing* (for people for whom housing is inaccessible, even after all existing means of housing and social policy were used). *Protected housing* may be allocated only among people with low self-reliance due to the handicap and/or age, especially among people with limited ability of movement and orientation, people with mental illnesses, seniors. *Half-way housing* may be allocated only among people living in unpleasant social situation due to the domestic conflicts or risk environment and/or people having the problem with social integration due to their low level of socio-psychological skills, especially among people leaving children homes, psychiatric clinics, social care institutes, asylum housing, prisons and people living in socially segregated communities and non-functional families. *Entry housing* may be allocated only among people that due to the unpleasant life circumstances are not able to find housing, especially people leaving children homes (when they are prepared for independent life), people endangered by social segregation due to their ethnicity, people leaving asylum housing or prisons (after living some time in half-way housing), asylum seekers. This subsidy programme has not been notified, so the intensity of this kind of support is limited on “de minimis” level (according to the European Commission Regulation No. 1998/2006).

***New municipal rental housing*** – new municipal rental housing constructed under the program introduced in 1995 by the Ministry for Regional Development. The government started to support new municipal rental housing construction through total subsidies amounting, a bit later on, to CZK 400,000 per new dwelling (about one third to one quarter of average dwelling construction costs in that time). The scale of housing output was about 62,000 housing starts till the end of 2002. Due to the fact that there were no bidding cost or income ceilings (targeting) for dwelling allocation and mainly the fact that the program has been transformed in a way that allowed speculation and abuse, it was highly criticized and, finally, largely amended in 2003. The original program allowed for creation of cooperatives between municipality and participants (future “tenants”): a municipality, with the help of commercial developer, often only secured the state subsidies and remaining costs of house development were covered from down-payments of future “tenants” and commercial mortgage loans. Though the right-to-buy was allowed only after 20 years from the year of completion, the share in housing coop could be liquidated under valid legislation immediately. Many coop flats constructed from this program were therefore soon sold or rented out by participants profiting from state subsidies; moreover, some flats were constructed only as a secondary homes and some as luxurious dwellings. The abuse of the original system was criticized by the National Control Office in 2005. Though some flats remained as real municipal rental housing, most of flats received the coop form.

Since 2003 the coop form is forbidden, cost and income ceilings were introduced (allocation is targeted according to household income); on the second side the subsidy was increased to the maximum of CZK 630.000 per dwelling. Since 2003 the allocation of flats is income targeted and, what is more important, the flats cannot be transferred to coop form and remain as municipal rental housing. The new flats may be allocated only among singles with monthly income (during the last 6 months) lower than 0.8 multiple of average monthly wage in the Czech Republic and among households with more members with monthly income lower than 1.5 multiple of average monthly wage in the Czech Republic. The maximum rent in new municipal housing and in new supported housing is set as cost rent, more specifically as multiple of total flat construction costs and coefficient of 0.00333. This rent may be increase annually (1<sup>st</sup> of July) by increase in CPI (inflation). The new municipal housing must also

meet size criteria. Minimum of 80 % of new municipal flats in apartment buildings constructed with the subsidy from the Ministry of Regional Development must have floor area lower than 60 m<sup>2</sup>. This subsidy programme has not been notified, so the intensity of this kind of support is limited on “de minimis” level.

***Asylum housing, temporary housing, lodging housing, etc.*** – temporary housing (stay in this type of housing is time limited) owned by municipalities or NGOs serving to those in acute housing need – homeless people, victims of domestic violence, lone mothers after divorce, people returning from prison, asylum seekers. Though this housing is often understood and named as social housing in the Czech environment, it has more character of temporal lodging housing (the contract is temporal and several people share generally one room) – i.e. this kind of accommodation is not the same as “permanent dwelling” according the Construction Code (with all necessary facilities in a dwelling).

Concerning the aggregate statistics, considerable confusion especially surrounded the figures used for international comparison of systems of supply-side subsidies (social housing). Under the socialist regimes, there was no special definition of social housing because at the time the state was generally responsible for providing housing for all its citizens and not just for those who, in a period of “general equality”, were financially worse-off. The right to housing for all citizens was guaranteed often by the state, and although it could take many years before that right was satisfied, everyone was entitled to register on various lists to await allocation of a flat, usually rental, at a very low regulated rent, and this entitlement was supposed to be satisfied for everyone – that is another reason why citizens relied generally on the state to solve housing needs (or on state subsidies in the case of alternative forms of tenure, such as cooperative housing), instead of relying on themselves and their own means. This reliance was general among the population as a whole, not just among the unemployed (who officially did not exist), the homeless (who officially did not exist, but even in reality were few in number owing to constant police surveillance), people in financial difficulties or the poor (whose existence was officially denied), or people who were socially non-conforming (whose existence was officially downplayed). State housing (state rental flats, state company flats, semi-state cooperative flats, and other housing) was intended for anyone who lacked “qualitatively adequate” housing. And because state housing was for everyone, it was particularly quickly allocated among those people who, through their acquaintances, clientele networks, or even straightforward corruption, were more skilful in the process of acquiring housing than others – that is, usually for people who did not rank in the category of the most socially needy.

As mentioned above, after 1989 and the changes that ensued, what happened was that the governments in transition countries tried to retain the existing “housing privileges” for those who already enjoyed them (e.g., those already occupying public housing) – doing so either by privatising public flats into the ownership of the tenants at very low prices or at no cost, or by retaining the strong security of tenure for tenants and low rent. Whenever a country opted for the first strategy, then over the course of several years the proportion of owner-occupied housing often rose to over 90% of the housing stock. If a country chose the second strategy, then the public housing stock remained relatively large, and was usually no longer owned by the state but by the municipalities. According to a simple principle commonly applied in comparative studies of social housing, in the countries that opted for the first strategy “social housing” suddenly ceased to exist in practical terms (for example, according to Scanlon & Whitehead 2004, in Hungary 4% of the housing stock was in the category of “social renting”), while in the countries that chose the second strategy “social housing” constituted a significant

portion of the total housing stock (for example, according to Scanlon & Whitehead 2004, in the Czech Republic it was 19% of the housing stock). A fatal error in these comparisons is that it lacked the perspective of the flat-users.

From the practical outlook of the occupant it makes no difference if he/she acquired ownership of the flat for a small fee (and pay a small contribution into the common budget) or if, without any fee, he/she on the contrary retains the privileges of a protected tenant and he/she (and maybe even his/her children) continues to pay low rent. Moreover, in the second strategy the position of the municipality as landlord is largely a distortion, as while the municipalities do own the flats, in practical terms they are not free to dispose of them as other owners would be (owing to tenant protections). In some transition countries the sector of rent-controlled housing came to be called “quasi-ownership”, and it is therefore right to ask whether this kind of housing stock really ought to be included in the category of “social housing”, or whether it is instead a category of “owner-occupied housing”, as the official owner of the flats (registered in the land register) is not the same person as the one who exercises most of the rights associated with ownership of the flat. Moreover, considering the income structure of tenants in these municipal flats, “social” was certainly not the appropriate adjective.

Thus altogether, taking very broad definition of social housing, that would count all existing rent-regulated municipal housing (constructed before 1989), all new municipal housing with cost rent constructed during the transition (even some “quasi-rental” municipal flats), all municipal housing with social care with cost rent constructed during the transition, the total would reach 610,000 municipal dwellings (17% of housing stock). However, taking more serious definition of social housing as rental housing with rents below market rates and allocated administratively according to income and social situation of applicant, then we would count only that existing municipal housing, that was vacated and rented out again during the transition for regulated rents to those in need (by very rough estimate about 8,000 flats), only that new municipal housing that was constructed since 2003 when the programme of the Ministry for Regional Development stopped to be abused, the new supported housing and the new housing with social care (altogether about 30,000 flats) – in this case the total would be only about 38,000 dwellings, i.e. about 1% of housing stock. Though it is hard to see any housing stock as “social housing”, using more serious definition that incorporates the condition on targeting of subsidies to those in need we would find out that social housing represents very marginal part of the Czech total housing stock.

### **Housing support from the European Regional Development Fund aimed at localities threatened by social exclusion**

Through the centrally administered Integrated Operation Programme, problematic parts of Czech bigger cities (i.e. cities with more than 20 thousand inhabitants) can be renovated while using the co-financing from the European Regional Development Fund. To be eligible, such a problematic part of a city must be characterized by social problems (higher unemployment, higher poverty rate, etc.) and has to comprise at least 500 dwellings. Then public spaces as well as residential buildings situated there can be refurbished with grants provided through the Integrated Operation Programme. It is possible to subsidize the refurbishment of blocks of flats in these problematic locations – i.e. environment-friendly and energetically effective reconstructions of residential buildings; removal of structural defects in the supporting structures of these buildings, and repairs of the structural or functional defects in the building

structure, repairs and reconstruction of the building technical facilities, provision of modern social housing facilities during the reconstruction of existing non-residential buildings (only in buildings owned by municipalities). There are also several pilot projects being prepared with the aim to verify the options of connecting the regeneration of houses in problematic housing estates inhabited partly by socially excluded Roma households to activities in social inclusion, human resources and employment. The state aid limits have to be applied when renovating the residential houses; i.e. till the successful notification, public support (i.e. European plus state) for the refurbishment of the residential buildings (regardless the type of their ownership – whether public or private) is provided up to the “de minimis” limit.

### **Future prospects of supply-side subsidies**

Demand-side subsidies directly increase the purchasing power of their recipients allowing them to cover their necessary housing costs. It is behind of the logic of demand-side subsidies that they are effective only if the housing market is also economically effective, i.e. the supply-side of housing market flexibly reacts on changes in housing demand, influenced by demand-side subsidies. If supply remains inactive on changes in housing demand, then growing housing demand is going to be “capitalized” to house prices (rents). In such case, the demand-side subsidies inflate housing costs and are redistributed to generally well-off landlords and house sellers. It can be demonstrated by many research studies done in the world (Meen 2001, Malpezzi & Vandell 2002, Malpezzi & Wachter 2002, others) and in the Czech Republic (Lux et al. 2008) that price elasticity of supply is inelastic at least in short term and that there are many different justifiable (externalities, high costs, high risks) as well as unjustifiable (oligopolization of housing development, oligopolization of manufacture of building materials, land speculations) factors behind implicit inefficiencies of housing markets. Despite of many negative consequences of mass application of supply-side subsidies for construction of social housing in the past, the one-sided orientation on demand-side subsidies need to be also ineffective. The challenge for housing policy makers and housing researchers is therefore to find some viable and sustainable mix of both types of subsidies that would respect particular social and cultural norms of particular society.

As there are no private developers of affordable rented flats in the Czech Republic, there is a need to satisfy housing needs of the group of socially disadvantaged persons because of aging population as well as because of the existence of families with low incomes. The new proposed system of subsidized social rental housing, prepared by the Ministry for Regional Development, will consist of two elements. The first programme will be aimed only at new social housing construction, while the second one will be aimed primarily at the existing housing stock. It means that the first programme consisted in “one-off investment subsidy” will encourage the construction of new “temporary social rented flats” (at least for ten years) by various investors – public (like municipalities) as well as private ones. The Ministry for Regional Development has pre-notified the draft programme at the European Commission and after the official notification, the programme will provide subsidies in 2009 or 2010 and beyond.

The second programme will encourage provision of existing (either new or older) rented flats, owned by various landlords, to socially defined households while the state will pay the compensation to landlords. The reason is that the provision of social rented flats with limited rents will be classified as a “public service of general economic interest”. The compensation will be paid to a given landlord every year (for ten years) according to real expenditures on

renting the flat. The whole system will be based on a special legal measure - the Governmental Regulation on Renting Social Rented Flats. Therefore, the programme of compensations granted to "social landlords" within the framework of the Decision of the European Commission 2005/842/ES will not have to be notified. The compensation grants will be available for all kind of landlords without any discrimination and the level of subsidies will depend on real costs while the system of prevention of "overcompensation" will be incorporated into the system before it is in force.

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