Jolanta Bondarczuk
Alina Muzioł-Węcławowicz
Bank Gospodarstwa Krajowego

Polish social rental housing. Dilemmas of the program.

Options for Social Rental Housing in Central and Eastern Europe
Budapest, October 2008

1. Model of social rental housing in Poland

The social rental housing program came into existence in 1995, and first flats were built in 1996. The purposes of the program is to provide the foundation for meeting housing needs as rented accommodation in good technical condition against affordable rent. The program was implemented as a tool for local municipal housing policy, whereby municipalities are obliged to provide conditions for meeting housing needs. Since its inception, the program has been subsidized by the state, by applying preferential interest rates for loans granted using the funds of the National Housing Fund[1]. .

The thirteen years of operation allows to analyze and draw conclusions from experience. Numerous municipalities arrange their housing programs based on investment programs of social housing construction associations and KFM loans. The demand for social rental housing in all local markets practically exceeds the crediting possibilities of the Fund.

The social rental housing program is often called "KFM" or "TBS" for short. The National Housing Fund operates at Bank Gospodarstwa Krajowego (BGK). The main business of the KFM involves crediting to social rental housing, delivered on preferential terms. The crediting activity of the Fund, apart from system preferences in terms of price and loan conditions and regulations applicable to the purpose of crediting[2], is subject to all standards governing banking activity in the property financing market. Between 1996 and 2008 (until June 30) Bank Gospodarstwa Krajowego extended a total of 1,735 loans worth PLN 6,336.2 million in total using the KFM funds, incl. 1,646 loans worth PLN 6,237.6 million for construction, upgrade or adaptation of 86.6 thousand flats for rent. 80.6 thousand flats were given for use. Other 89 loans worth PLN 98.6 million were extended for municipal technical infrastructure purposes accompanying housing development.

Social housing associations[3] are limited liability companies or joint stock companies, whose main purposes is to build and operate social rental premises. Their activity is subject to certain restrictions and detailed regulations, however they are eligible for preferential loans for social rental housing[4] using KFM funds. Loans using KFM funds have been granted to 436 borrowers — 231 TBS (incl. 191 are companies with majority share of public capital), 156 housing cooperatives and 49 municipalities (loans for infrastructure related to housing development). Over the past few years, a downward trend in the housing cooperative and private TBS activity and construction concentration in major cities are seen. This is important

[1] NHF in English, KFM in Polish.
[2] Only buildings or parts of buildings with flats dedicated for rent can be credited, however housing development may consist in building new houses, rebuilding or adapting the existing ones.
[3] SHA in English, TBS in Polish.
[4] Housing cooperatives are also equally eligible for such financing. Because of very small share of cooperatives in the program's new developments, these are not to be covered.

for construction cost and support of development using public funds. On the one hand, the costs are higher, whilst on the other, such cities are potential labor markets, and the development of rental housing is justified by social policy.

Tenants residing in social dwellings are people/families with moderate income, who are not able to buy a place in the open market or rent a flat. The maximum income per person per household is defined by the law. The statistics concerning tenants' income, social and family standing are quite limited, still the research has shown that majority of social rental housing users are families, incl. families with children, which are mostly young, whose source of income comes from work or private business. Most TBS inhabitants have previously lived in the same municipality, often sharing the place with parents. Social rental flats were built in 313 municipalities with a varied number of inhabitants, economic potential, various local housing policies. The majority of flats are being built in major cities; in 17cities with population exceeding 200,000, 36.8 thousand flats were credited.

2. The context of social rental housing program

In addition to the KFM, other governmental housing programs are benefiting from public resources available from other funds managed by BGK. All of them, despite significant variation, were modified to suit the current needs and modest public funds.

After KFM, next comes the Thermomodernization Fund (FT) that started off in 1998, which supports renovation and upgrade of housing facilities by paying a bonus being repayment of 25% of loan dedicated to upgrade or renovation, to bring the energy use for vital purposes down. Such bonus BGK pays to commercial banks, which extend loans for thermomodernization, after confirmed fulfillment of assumed energy saving parameters (energy audit). The attractiveness of the program observed over recent years is brought by: improved economic situation and easier availability of bank loans, increased energy costs and change in provisions aimed at a broadly understood environment protection. From January 1999 to the second half of 2008, 11.9 thousand bonuses for thermomodernization were granted, and the value of upgrade investment came to PLN 3,792.4 million. 87.6 % of thermomodernization bonuses were granted for multifamily housing undertakings.

Since 2003, BGK has been managing the Subsidy Fund (FD), which currently supports two housing programs.

The program of financial support of social rental housing construction[5], protected housing, boarding homes and homes for the homeless has been in place since 2004, initially as a pilot program, now a few-year project. The purpose of the program is to increase the number of flats and facilities for the needy. The beneficiaries of the program are mostly municipalities[6], which may be eligible for a subsidy of 20 to 40 % of costs of construction or reconstruction, adaptation of social rental housing, provided they meet the cost, technical and other applicable criteria.

So far, the FD funds co-financed 226 undertakings. Subsidies worth the total of PLN 77.1 million went to investment for upgrade or construction of 3,500 social premises (215 undertakings) and worth PLN 4.7 million to investment covering 260 places in boarding homes and homes for the homeless(11 undertakings). It is assumed that the social rental

[5] I.e. social rental dwellings for very low-income people.

[6] The beneficiaries of the program may also be inter-municipal unions, delivering social rental housing goals, sub-regional local governments (poviats) providing social care, NGOs caring for e.g. the homeless, social rental housing associations implementing housing policy of a given municipality. It seems that the existing scale of activity of these entities in the short history of the program does not call for a detailed description in this study.

housing program will last until 2014 and will provide for 100,000 social premises and protected housing and ca. 20,000 places in boarding homes and homes for the homeless. The total state budget support will come to ca. PLN 2,500 million.

At the start of 2007, as part of FD, a social privately-owned housing program called "Family at Home" — "Rodzina na swoim" was launched. As part of the program, families (married or single-family members bringing up children), who took their first property loans, will receive a subsidy toward their interest for 8 years. Loans must be in PLN and housing development must meet the construction cost and flat surface limits.

The subsidy is equivalent of 50% of interest calculated at the reference rate of WIBOR3M[7] plus 2 %. Until present, **7.9 thousand** preferential loans worth altogether **PLN 910.1 million** for financing developments worth altogether **PLN 1,314.2 million** were extended. The subsidies transferred from the FD to financial institutions came to PLN 12.2 million.

In Poland, tax subsidies for housing promotion were given up. The exceptions are: continuation of entitlements to the so-called loan interest concession for individual housing development investors, lower VAT rate for building supplies and services and reimbursement of some portion of VAT to individual investors that build their houses themselves, and cannot discount a lower VAT rate. Also, subsidies from the budget guarantee premiums to housing investors continue, who were saving in the old system of the so-called building society books. Low income people, residing in very small flats/houses receive housing allowances. Since 2004, the payment of said allowances has been lying with municipalities.

It should be stressed that despite high housing deficiency, all existing programs supporting housing and housing development with the use of public funds are complementary to the housing market, and also the market system for financing housing demand in Poland. Current trends in the mortgage market favor such approach. Consumer debt with banks between 2002 and June 2008 grew from PLN 20 billion to PLN 137 billion. At end-2007, the mortgage debt ratio to GDP was 10% against the average for EU-15 standing at 50%.

The number of mortgages grew from 102,000 in 2002 to 314,000 extended in 2007. In the first half of 2008, 165,000 agreements were signed. The reasons for such growth include falling unemployment (from 20 % in December 2002 to 11.4 % in December 2007) and increased personal income (over 10% in 2007). The average housing loan increased from ca. PLN 60,000 in 2002 to PLN 217,000 at end-June 2008, chiefly because of higher property prices, lower interest (until the second half of 2007), crediting period extension for as many as 45-50 years. A diversified fashion of banks' approach to setting creditworthiness creates a situation where in May 2008 a 4-person family with net income of PLN 3,500 in metropolitan areas could obtain a loan from 195,000 to PLN 351,000, with 1sqm of the flat surface price standing at 3,200. – PLN 6,800 and the share of loan in the flat cost of at least 75% against down-payment[8].The specificity of Polish mortgage market is keeping demand for FX loans, brought by more favorable interest rates.
In the first half of 2008, banks granted loans worth ca. PLN 11.5 billion and FX loans being equivalent of PLN 20.8 billion to consumers. The prevailing currency is the Swiss franc, whose market share is 77.6%.

According to the Central Statistical Office, between January and June 2008, thousand planning permissions were given for building 138.9 flats (a 1.9% rise over 2007), and the

[7] Warsaw's 3 Month Interbank Exchange Rate.
[8] Data according to Gazeta Wyborcza daily.

average usable area of a flat ready for surrender was 103.7sqm. Currently, a slightly smaller turnover in flats is visible, and there are symptoms of a crisis in the higher quality housing market.

3. The key dilemmas of the Polish social rental housing.

Over 10 years of the program have brought forth a well-working organization of housing investors building rental flats against a moderate rent, using KFM loans. Simultaneously, a series of issues calling for specification, or review in the laws that define detailed principles governing the program, emerged. A widely articulated need for such changes is the best evidence that the program is "live" and accepted by all stakeholders. The program is accepted by the parliament, which for over a dozen years has been approving annual funds in the budget to be dedicated for KFM, local governments, which intend to increase the housing base of social rental housing, giving TBS own capital (cash and non-cash). The program was won popularity also among the end-beneficiaries — tenants. Future tenants enroll on long lists, and often participate in financing a flat that comes to even as much as 30% of flat construction cost.

Vital issues calling for modification.

a) changing the manner of using financial support coming from the state budget,
b) ensuring the primacy of economic effectiveness with access to financial support as part of the program,
c) reduction of participations paid by tenants that reinforce pressure on privatizing a portion of social rental housing base;
d) increasing access to social rental housing for low income households.

Re: a). The main source of capital for disbursing loans for rental flats are subsidies for KFM coming from the budget and KFM own income. Between 2002 and 2004, in view of budget constraints, the funds were replenished with long-term loans contracted by BGK from the European Investment Bank and Council of Europe Development Bank, entirely collateralized with the guarantee of the State Treasury. Since 2000, the amount of financial support for KFM coming from the budget has been insufficient compared to the demand for new loans reported yearly by investors. Between 2005 and 2007, the amounts of annual contribution for KFM from the budget came to PLN 164 million, PLN 408 million and PLN 280 million, respectively, with average loan per flat worth PLN 80,000.

Searching for optimal solutions for spending the budget funds is connected with the public finance reform prepared since 2007. What is important is that the reform does not assume restriction of financial support for the program, but only changing its form of use. One of the solutions being discussed is the dedication — in place of the existing system — of the budget funds meant for subventions to interest on loans extended to TBS for the first 8 years of repayment. This would mean allowing other banks to join the crediting program of social rental housing based on loans with interest subvention.

Such change may be favored in the case of entities of good financial standing, which so far have constructed a substantial number of flats with the use of KFM loan (e.g. over 1,500). The possibility of further crediting of these entities using the KFM funds has been blocked by the banking law, which provides for maximum 25% share of debt of one entity or related entities in BGK own funds. It must be stressed here that in the program legal regulations, the lawgiver restricted the debt, which may not exceed 15% KFM funds per entity. Such limit is approved by the banking supervision authority as the second criterion after the limit provided for by the banking law. So it may be stated that for the most active and development-minded

social housing associations, access to financial support for building social rental houses (with possible further crediting by KFM), now relies directly on the BGK own capital increase.

Re: b). Legal regulations of the program so provide that the financial support from the budget may account for no more than 70% of the flat construction cost. This is the share of preferential loan in the construction cost. In banking reality, access to the maximum support depends first and foremost on the ability of a given TBS to repay such loan and the already existing liabilities. At present, we can distinguish two groups among KFM loan applicants: The first group comprises entities which, having met additional conditions, do not or will not have the ability to contract a new debt, set according to the banking law standards. The key impediments to the continuation of participation in the program are: unsatisfactory economic and financial situation of an entity, poor management of the housing resources held, no collateral adequate for the risk for the existing and new debt. Further active participation of these entities in the program will then rely on taking rectifying activities, pre-agreed with BGK. The second group comprises entities whose economic situation and manner of managing resources held raise no reservations, and they stand out with their effective cooperation with the local governments, their own shareholders. Further active participation of these entities in the program relies then and most of all on relations with shareholders — local governments. These serve as a basis for decisions on increasing TBS own capital by shareholders, setting standards for resources collateralizing BGK loans, proper ownership supervision and other forms of support adequate for the adopted development strategy of the associations and housing strategy followed by a given municipality.

Re: c) Legal regulations allow for covering flat construction cost in the TBS portfolio by legal persons (municipality, work place, poviat, inter-municipal union) without limiting the share and by individuals (future tenants) with the restricted maximum 30% cost of flat construction. The down-payment is called participation, and the majority of TBS finance the construction of rental flats in terms of participation by entering into participation agreements at the stage of flat construction. An institution or an individual that have entered into a participation agreement may assign the right without TBS' consent. Such assignment of a participation agreement by individuals has recently become a source of earning money on resale of such rights, due to the material increase in housing prices. A new tenant agrees then to pay the higher (if this is a metropolitan area, this is a much higher amount) amount than actually spent by the existing tenant — participant. This participant's assignment privilege limits the role of TBS in selecting the tenants and raises social objection. The voices for withdrawing these rights from market practice, assigning the rights to indicate successors only to TBS, and most of all their reduction, are getting ever stronger.

For each of these solutions, it will be necessary to indicate alternative sources of financing the participation of investors involved in social housing.

For the past six months, there have been disputes in the media over the demand concerning selling flats whose construction was funded by KFM loan. Currently binding regulations exclude such possibility. So, the tenants, who participated in flat construction cost, raise demands to overrule this ban, referring to the fact that as part of their rent they also cover repayments of loans contracted for construction of the rented flats. The state administration representatives also point out that this would be a good alternative for the program, save for proper pricing for the return of the preference cost. Additionally, a possibility of early regaining of the funds paid for the flats for further program financing, than the loan repayment (30 — 50 years) is also indicated.

Re: d). Numerous factors impacting TBS role and tasks of are local issues and these depend on the municipal policy vs. the company. Some municipalities launched special housing programs as part of TBS formula, such as building revitalization or protected housing. The leader of such activity is TBS based in Stargard Szczeciński[9], using substantial support of the parental municipality, collaborating with poviat local governments in the region and social organizations. The company launched a program called "House needed" — "Potrzebny dom", with 4 operational programs. Two of them carry important effects. The "No barriers" — "Bez Barier" program is meant to deliver new flats fully adjusted to special needs of disabled persons. Thanks to the cooperation with the Polish Association for the Mentally Handicapped in Stargard Szczeciński, between 1999 and 2006, 33 flats for people disabled intellectually, and in cooperation with Association of the Physically Disabled and Friends "Pomost", between 2004 and 2008, 11 flats were delivered to physically disabled people. The "For Start" — "Na Start" program is to create conditions for young people's independent functioning in the society and obtaining a flat, who were raised in children's homes. As part of the program in Stargard Szczeciński, in the years 2006 to 2008, three "Incubators" originated — flats for fifteen young people leaving children's homes. Their carers and social workers will live in the vicinity.

It is worth well remembering that the recent legislative measures are heading toward broadening the range of TBS activity in protected and social housing. For some time, a municipality may rent flats from TBS and sublet them to individuals, against e.g. social rent. Also, FD subsidies for municipalities supporting the social housing are larger if the program operators is the local TBS.

All the above activities lead to broader accessibility of the social rental housing program for low or very low income people/families and people with special needs because of their life circumstances, such as disability or orphanhood. Still, it must be admitted that activities aimed at increasing the accessibility of flats held by TBS for lower income people, the elderly, the disabled (who can apply for municipal or social premises) are financed by the municipalities, as part of their obligatory duties in housing, or a pre-planned, pro-housing program, often in cooperation with social policy institutions.

Demand for social rental housing by far exceeds supply, practically in all municipalities, in which TBS operate. Current program conditions, based on affordable rent assumption, incl. investor's loan repayment, cause a situation where households with stable income and close to the maximum income threshold that limits access to the program, are becoming attractive tenants.

4. Summary — Program reform directions

The issue regarding the need of transformation of social rental housing program has been raised many times for several years. The Ministry of Infrastructure in charge of housing policy, when preparing for the audit of the social rental housing program, took up a study on municipalities, investors of social rental housing and tenants. Works on program changes are to cover, among others, the following:

1. Optional solutions of the financial support system from the state budget and local government budget to develop social rental housing,
2. Increasing the availability of rental of premises form the social rental housing base for low income households and indicating activities that increase the role of social rental housing in the social and economic segregation policy and exclusions,

[9] Poviat town in West Pomerania with ca. 70,000 inhabitants. Municipal TBS operating since 1998 r., delivered ca. 500 flats with participation of KFM loans.

3. Possibility to reduce participations brought in by tenants and indicating alternative sources of participation financing of social rental housing investors along with analysis of legal and social effects, operating risks in the case of privatization of a portion of social rental housing base,
4. Technical and procedural issues such as elaborating alternative methods of construction cost reduction when building flats under TBS, the rationale for keeping the existing limit of rent rate, changes in conditions for applying and crediting social rental housing investors in correlation with the subsidy form change.

Warsaw, September 2008.