Hungary’s changing housing finance system

By David Parry

HUNGARY is in a state of political and financial flux. Areas particularly impacted by the change include the housing markets and the mortgage finance system. The current events in Hungarian housing finance should be closely observed as they can provide a model for other totalitarian socialist economies moving towards democracy and economic freedom, for example the USSR, Poland, Yugoslavia and even Czechoslovakia. The success or failure of restructuring of the Hungarian housing market and mortgage finance system may determine whether political reforms may be implemented in the nation and is crucial to the further integration of Hungary and all of central and eastern Europe into the world economy.

Geography and demographics

Hungary has a land area of approximately 36,000 square miles (93,000 square kilometres) and is about the size of Ireland or the US state of Indiana. Population, reduced by an exodus of young adults due to the 1956 revolution, increased slowly during the 1960s, reaching nearly 10.5 million in 1970.

There was a further population increase in the 1970s, to 10.7 million, but the 1980s have seen an absolute decline in population due, in part, to the consumer orientation of the economy and the concern of households to increase their possessions and income per household member. As shown in Table 1, it is estimated, some feel optimistically, that the population has stabilised during the 1980s at approximately 10.6 million and will now increase gradually through the 1990s.

With a population density of 296 persons per square mile, Hungary ranks 12th among the 27 European nations. This density will not change substantially, but urbanisation trends are strong and the nation will continue to become more urban. Without a solution to the current housing crisis this may create future political and economic problems.

The population is presently considered to be 56% urban with slightly more than 30% of the population residing in the nine cities with populations of 100,000 or more, while two-thirds of that (19% of the total) is in the capital city of Budapest.

Despite government policies that, at least nominally, encourage suburban and exurban locations, the trend is for population movement to the major cities. In 1960 only 39.3% of the population lived in the cities and towns while in 1989 nearly 60% do. Urban population has increased by over 2% during the 1980s while total population declined. One recent aspect of the urbanisation pattern is the development of close-in suburban areas consisting largely of single family homes and low-rise condominium flats, as contrasted with the development during the 1960s and 1970s of mid- to high-rise congested apartment buildings that have a propensity to turn into tenement slums. Complementing this is an increase in suburban industrial locations.

There are less than 2.5 persons per household, but there is more than one household in some dwelling units, and the size of dwelling units is still small by Western standards. Overall in Hungary, there are 2.7 persons per dwelling, but 1.2 persons per room, excluding bathrooms.

The Hungarian economy

The change in the Hungarian economy is dominated by the increasing growth of the private sector. This is occurring because of three interrelated trends. The first is the creation of private business establishments, primarily in the agricultural, retail, service and building construction sectors. The second trend is the establishment of joint venture operations with Western individuals and business firms. Too often the joint ventures are in agribusiness or personal services with existing Hungarian collectives or Tanacsoi. Some are in financial services or tourism which help the domestic economy and balance of trade, but what Hungary needs most are joint ventures in the manufacturing and processing industries where
the foreign partner can supply investment capital and technology and use Hungarian labour, land and resources.

The third trend is the privatisation of state- or Tanacs-owned industry. This has begun with the commercial banks which issue stock shares of ownership and is likely to occur in many of the national or Tanacs-owned enterprises when the next government, which should not be controlled by the MSZMP, takes power in 1990. Even the co-operatives are currently complaining about the amount of control the national government exercises over their production, pricing and financial affairs. When the next government assumes office there will be pressure to allow the collectives to privatisate.

The collectives, primarily in the agricultural, transportation, manufacturing and construction industries, argue that the only control the national government should exercise is through taxation. In that regard Hungary implemented an income tax in 1988 for both business enterprises and individuals. The rate is highly progressive and private businesses feel that it is somewhat discriminatory in favour of public sector employees.

At this time there is no real estate transfer tax. If a taxpayer sells his dwelling and does not buy another he pays a capital gains tax; if he buys another then the tax does not have to be paid. A value added tax is levied on new dwellings at the time of purchase, but there is no property tax for the first 20 years of a property’s life. There is presently no deduction of mortgage interest payments in the income tax structure, although this is being considered.

As privatisation continues it is likely that there will be more inflation, dislocation and inequities. In housing, for instance, the retired population, like all tenants in the Tanacs-owned housing, pay rents below market. The low rent reflects their previous below market wages. How can they be treated equitably if and when rents are allowed to go to market rates, which will they? Pensions have been increased during the past decade, but the government is facing something of a financial crisis at this time, however, because of inflation.

Increasing pensions would be inflationary, and with the early retirement age there is currently one retired person receiving a pension for every two persons employed. This load, along with the other welfare programmes, makes privatisation difficult and puts upward pressure on prices and taxes and downward pressure on wages, while limiting funds available for investment.

Privatisation will put both inflationary and deflationary pressures upon the economy, resulting in sectoral inequities necessary because of the past inequities inherent in the former non-market pricing, production and allocation systems. If the nation can weather the economic trauma without the state interfering in sectors such as housing, this may determine the interest of Western investors. Hungary must improve productivity if inflation is to be avoided or at least kept low. Improving the structure of the building industry and the real estate and finance sectors will be one way to generate improved productivity.

Residential real estate markets

The real estate market in Hungary as a free market institution is still evolving. With privatisation, new institutions are being created for both the marketing and financing functions. The real estate industry even has its own weekly publication, Ingaatni Plac (Real Estate Market).

Until January 1989 the market was controlled monopolistically by the Hungarian Savings Bank (OTP), the Tanacsok and the State. This is still the situation in other Eastern bloc nations with the exception of Poland.

Despite the fact that more than 75% of Hungarian households own their dwellings, the market has not been free. Ownership has been restricted to one home per adult over 16. It was also necessary to get the permission of the local Tanacs to rent a dwelling. Ownership of rental housing was predominantly the responsibility of the Tanacs, the State and some employers. As of July 1989, these restrictions were lifted, but the market still is dominated by State-owned institutions.

Until 1987, OTP not only was the primary mortgage lending institution, but also set home prices and was the only agency making a market for real estate. The only competitors until 1989 were other state-owned banks, state-controlled co-ops or the Tanacsok. It was illegal for individuals or other institutions to receive income from assisting or acting as an agent in the transfer of real property, and supplemental

Table 2. Gross Domestic Product 1982-1988

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross Domestic Product (HUF billions)</th>
<th>Percent Annual Change</th>
<th>Consumer Price Index</th>
<th>Real Gross Domestic Product (HUF billions)</th>
<th>Percent Annual Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>718.5</td>
<td>-0.5</td>
<td>100.0</td>
<td>718.5</td>
<td>-0.5</td>
</tr>
<tr>
<td>1981</td>
<td>736.5</td>
<td>2.5</td>
<td>104.6</td>
<td>704.1</td>
<td>-2.0</td>
</tr>
<tr>
<td>1982</td>
<td>847.9</td>
<td>15.1</td>
<td>111.1</td>
<td>763.9</td>
<td>8.5</td>
</tr>
<tr>
<td>1983</td>
<td>896.3</td>
<td>5.7</td>
<td>120.0</td>
<td>746.3</td>
<td>-2.2</td>
</tr>
<tr>
<td>1984</td>
<td>978.5</td>
<td>9.2</td>
<td>130.0</td>
<td>752.0</td>
<td>6.8</td>
</tr>
<tr>
<td>1985</td>
<td>1,033.7</td>
<td>5.6</td>
<td>139.1</td>
<td>743.3</td>
<td>-1.2</td>
</tr>
<tr>
<td>1986</td>
<td>1,088.8</td>
<td>5.3</td>
<td>146.5</td>
<td>743.2</td>
<td>-0.0</td>
</tr>
<tr>
<td>1987</td>
<td>1,226.4</td>
<td>12.6</td>
<td>159.1</td>
<td>770.8</td>
<td>3.7</td>
</tr>
<tr>
<td>1988</td>
<td>1,406.0</td>
<td>11.5</td>
<td>184.1</td>
<td>764.0</td>
<td>-0.9</td>
</tr>
</tbody>
</table>

Source: Hungarian Statistical Office.
mortgage financing was under the control of OTP and the other state institutions.

If an owner wanted to sell a home or flat he would contact OTP (or, possibly, one of the other banks). The OTP branch officer would establish the price (value) of the property and OTP would buy the property at that price. The seller could appeal to a board if he disagreed with the price, but an increase in the price was unlikely. The only alternative to the seller was not to sell the property or to attempt to find another property owner willing to trade.

After OTP purchased the property, it would be advertised for two weeks and then offers would be accepted. Since all potential buyers were required to make offers at the same OTP predetermined price a non-price mechanism was necessary to allocate the homes among the buyers. The allocation was made by a board appointed by the local Tanacs. The criteria were based upon household income, the number of people in the family, their current housing (if they were vacating a unit within the Tanacs they had a higher priority), the down-payment and if it was in hard currency and, unofficially, the buyer’s position in the Tanacs, the Party or the importance of his job.

To buy a dwelling, the prospective purchaser would first contact his employer or the local Tanacs to see if they had anything available. (A significant portion of Hungarian housing was and is owned or made available from the employers, especially the co-operatives.) If they did, he would rent it or make an offer, securing financing through OTP or through funds made available by the employer or co-operative. If, as was usually the case, they did not, he would contact OTP to determine what was in stock. By making an offer, he became one of the queue being evaluated by the Tanacs committee.

If he was single or married without children and in Budapest or a major city, had no hard currency, was working in an unimportant job and had no influential contacts, his probability of securing housing approached zero. There are horror stories of individuals or young families waiting for as long as seven years to secure a small dilapidated flat to buy or rent in Budapest.

While vacancy data are not reported, it is known that there is a surplus of housing in the rural areas and villages and a shortage in Budapest. The larger the size of the town or city the greater the queue applying for housing. The Budapest Tanacsok recently advertised 60 small, older flats (lakás) in poor condition and had 6,000 applicants.

Hungary has an urban housing shortage and especially a shortage of habitable and quality housing. But as the Nobel laureate economist Milton Friedman is often quoted as saying, there is no such thing as a shortage, only a failure in the pricing system. With a good that is a necessity, like housing, this observation becomes somewhat cruel, especially in a market and economic system where in the past supply and price had been severely controlled.

Table 3 reports residential units built in Hungary from 1961 to 1989. Construction activity was low in the 1960s, reached a peak in the late 1970s and has been declining since. While Budapest and the towns did not receive their fair share of housing prior to the 1980s, they have since. During the 1980s new residential units constructed in the cities have increased at a more rapid rate than their share of population.

While the volume of housing constructed has declined, the quality and size of the dwelling units have improved. The majority of units built in the 1950s and 1960s were one-room flats, many with incomplete plumbing, the multi-storey grey buildings so common to Communist cities and the low-rise courts in the villages. The design quality of housing improved somewhat through the late 1960s and into the 1970s. This improvement has accelerated in the 1980s. To some degree this phenomenon can be observed in Table 4, which reports the average number of rooms and the size of units built.

The last column of Table 4 is construction costs per square metre. While construction costs have increased, they have not increased more rapidly than inflation, which would have been expected in an economy moving towards a free market. The reason for this is two-fold. First, government continues to control wages, especially in certain enterprises. Second, there is an
increasing share of private construction (see Table 5) and the private sector tends to be more efficient. Note also that the private builders tend to work as much as seven days a week and often employ workers in the second economy. Construction costs have shown substantial increase in the last two years, however, and would have increased even more if government had not put a cap on construction industry incomes.

Home prices have been rising at about the rate of inflation, slightly above this in Budapest and below it in the remote villages. With OTP controlling prices by making a market, however, price increases were limited and price differentials in underdemanded/oversupplied remote markets are not substantially below those in the cities. The result was that homes in the smaller cities and villages would often remain on the market, i.e. in the OTP inventory for months or years, while dwellings in the major cities sold immediately, especially “affordable” housing. Still OTP did not increase home prices in Budapest as housing was viewed as a right. Unfortunately, it was an often unattainable right.

In the 1980s the Tanacsok and the State found that being a landlord of subsidised rental housing was an onerous burden, especially when they were the institutions doing the subsidisation. Some Tanacs housing was made available for purchase. Most of this was the small inferior flats described above. The more run-down and the fewer the amenities in the units, the slower they sold, but even inferior well-located units sold rapidly in Budapest. Occupants of the rental housing were given the option of purchasing the rental unit they occupied, often at a discount as 50% of “market” value (as determined by OTP). When 50% of the tenants elected to buy, the building would be converted to ownership tenure. If a resident elected not to purchase his flat, then the Tanacs could sell the unit to OTP or to a non-resident given they had other Tanacs-owned housing available for the current occupant.

This did little to resolve the housing shortage, but did result in the reported home ownership rate increase. Home ownership had always been high in the villages, but in the major cities it had been as low as 33% because most of the housing developed and converted during the 1950s and 1960s were Tanacs-owned rental flats.

In January 1989 the housing market apparatus changed. Private real estate brokers were allowed to augment the brokerages housed in OTP and the other banks, in co-ops and Tanacsok. In mid-1989 there were 55 private brokerage companies licensed, 30 in Budapest and 25 in the other cities and towns.

Home sellers now have an option. If they do not feel the price OTP or the other banks offer is sufficient, they can list their home with a private broker. In fact, OTP, MHB and the other banks prefer to take a listing and act as a broker rather than purchase and inventory the home.

The typical brokerage contract is a 90-day Exclusive Right to Sell Listing, similar to those common in the UK and US. There is no multiple listing agency and signage is not used except in the store fronts of the broker’s office if he has that type of location. A potential buyer will contact the many banks and brokers handling property listings.

The commission rate is not universal, varying between 1% and 7%, with 2% to 3% the norm. If a broker represents the seller he will collect his commission from the seller; if he represents the buyer from the buyer, and if he represents both, a slightly reduced shared commission from both. For example, if a homeowner signed a listing agreement at 3% for a flat priced at HUF2 million, the broker would receive a commission of HUF60,000 when the property sold. If he represented a seller who purchased the flat with a similar agency agreement he would receive the same, but if he represented them

<table>
<thead>
<tr>
<th>Table 4. Size of Dwelling Units Built 1976-1989</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year/Period</td>
</tr>
<tr>
<td>1976-1980</td>
</tr>
<tr>
<td>1981-1985</td>
</tr>
<tr>
<td>1986</td>
</tr>
<tr>
<td>1987</td>
</tr>
<tr>
<td>1988</td>
</tr>
<tr>
<td>1989 Estimate</td>
</tr>
</tbody>
</table>

*Source: Hungarian Statistical Office and interviews.*
both he might lower his commission to both by a third, receiving HUF80,000 or 4% of the purchase price.

Competition in the brokerage market has seen a 15% to 20% increase in home prices. A change in banking laws and the mortgage system, however, has somewhat dampened demand and kept prices from increasing even further. It is now more difficult to qualify for a loan.

The Hungarian banking system

Hungary reformed and restructured the banking system in 1986. The reform allowed private ownership and operation of commercial banks. Many of the functions of the existing state-owned National Bank of Hungary (the Hungarian Central Bank) and the National Savings Bank (OTP) were transferred to the new commercial banks, most of which still have substantial shares of government agency ownership. Some of the new commercial banks are beginning to provide mortgage loan financing to the private sector, but OTP is still the largest mortgage lender.

Hungarian financial institutions, their age, capitalisation, ownership and functions, are summarised in Table 6. The institutions most concerned with real estate are OTP and MHB, although other banks such as EIB, BHB and K&H are also marginally involved in residential mortgage financing and are likely to become more so.

OTP, with deposits of HUF280 billion and capital of HUF1.3 billion, is the largest financial institution in Hungary, other than the Central Bank. The bank carries out a broad range of functions in addition to the typical savings bank functions of collecting deposits and making mortgage loans, which include consumer lending for household goods, automobiles, etc; lending to co-operative and private retail stores; lending to manufacturing, distribution and production co-ops and private companies; foreign currency operations; operating a travel and touring service in a joint venture with a private Austrian firm; running the football pool and national lottery; leasing and factoring; and real estate related functions, eg building tenement housing; financing state, Tanacs and private housing, commercial and industrial buildings; constructing, refurbishing, buying and re-selling flats and homes; acting as an estate agent; and managing residential and other property.

The bank has 800 branch offices throughout the country to serve the eight million individual, partnership, co-operative and Tanacs depositors and has additional deposit collection branches in 3,300 post offices and 5,000 co-operative mutual assistance societies. Some of the new Hungarian political parties feel many of the functions performed by OTP should be private. Changes in this institution are likely next year.

The largest of the new commercial banks is the Hungarian Credit Bank Ltd (MTB). Founded in 1987, the bank has nearly HUF14 million in registered capital. While the Hungarian government still participates in ownership, the majority of the stock is owned by the 900 non-governmental shareholders which includes Tanacsok. The ownership includes foreign companies, co-operatives and middle and small size enterprises. This year individuals are also acquiring stock.

MHB has performed so well in the real estate sectors that they are splitting off the real estate operations' arm and forming a separate company. Bonds and stocks are to be issued and, while MHB will retain some ownership, the new entity, to be known as the Real Estate Bank Ltd, will not be a subsidiary. The new bank will operate a real estate brokerage, provide residential mortgage financing, manage real estate investment partnership funds and develop commercial and industrial properties. The REB arm of the MHB currently claims to have 20% of the real estate brokerage and mortgage finance market, equivalent to OTP, and is a significant competitor to the state agency.

Other institutions may also be planned that will create additional competition and improve the real estate marketing and finance functions. The Bank for Innovation for the Construction Industry (EIB), for instance, has a brokerage operation but is currently limiting lending activities to commercial and industrial properties for Hungarian citizens. BHB has a brokerage, but is not particularly active in residential real estate. Banks in Hungary not listed in Table 6 include Citibank of New York and the Central European Bank, referred to in Hungary as an "offshore" bank.

At present the Hungarian banking system could still be considered somewhat primitive. Except for limited consumer, auto and mortgage loans, the banks primarily serve the state co-operatives, Tanacsok and some small enterprises with short- and long-term credit. There are only 50,000 householders with cheque book accounts and bank credit cards, and automatic teller cards are just being issued and nearly all companies pay their wages in cash. If and when Hungary begins to increase the number of personal cheque book accounts and credit cards, the money supply impact may be inflationary without significant credit limitation policies.

The mortgage finance system

The residential mortgage interest rate until 1989 was 3% for a fixed rate 10- to 25-year loan with a 30% down-payment. This rate held even when inflation moved to double digits. The low interest rates relative to inflation further stimulated housing demand and exacerbated the shortage. They also encouraged borrowing, as interest rates paid on savings accounts were more than three times the mortgage rate.

Higher interest rates were some-
### Table 6: Financial Institutions in Hungary

<table>
<thead>
<tr>
<th>English Name</th>
<th>Magyar Acronym</th>
<th>Year Founded</th>
<th>Capitalisation (million HUF)</th>
<th>Ownership</th>
<th>Chief Functions</th>
</tr>
</thead>
<tbody>
<tr>
<td>National Bank of Hungary</td>
<td>MNB</td>
<td>1924</td>
<td>1,500</td>
<td>SO</td>
<td>Central Bank, Monetary Auth, Supervise CBs &amp; Set Int Rate, Ag &amp; Food Processing Finance &amp; Co-op &amp; Private</td>
</tr>
<tr>
<td>AGROBANK</td>
<td>A</td>
<td>1984</td>
<td>1,500</td>
<td>JS 458 Co-op SH</td>
<td>Small &amp; medium sized Co-op &amp; Private Business Financing, Joint Venture Financing</td>
</tr>
<tr>
<td>Budapest Bank Ltd</td>
<td>BHB</td>
<td>1986</td>
<td>6,400</td>
<td>JS State-61% 394 SH</td>
<td>Short Term Crdt., Some Cons &amp; Mortgage Finance (See Text)</td>
</tr>
<tr>
<td>Commercial &amp; Credit Bank Ltd</td>
<td>K&amp;H</td>
<td>1987</td>
<td>10,600</td>
<td>JS State-50%+400 Ag Ind &amp; Trd SH</td>
<td>Foreign Trade &amp; Currency</td>
</tr>
<tr>
<td>Hungarian Credit Bank</td>
<td>MHB</td>
<td>1987</td>
<td>14,000</td>
<td>900 SH Co-op/Int/Ind</td>
<td>Commercial/Ind RE Cons/ Mortgage/Prop Mgt</td>
</tr>
<tr>
<td>Hungarian Foreign Trade Bank Ltd</td>
<td>MKB</td>
<td>1950</td>
<td>6,000</td>
<td>Primarily SO</td>
<td>Develop Financing Import/Export</td>
</tr>
<tr>
<td>Innovation Bank for Construction Industry</td>
<td>EIB</td>
<td>1983</td>
<td>1,200</td>
<td>JS 61 Const/Coml/ Ins &amp; Bank SH</td>
<td></td>
</tr>
<tr>
<td>INTERBANK for Foreign Trade Ltd</td>
<td>I</td>
<td>1980 (pvt 1988)</td>
<td>2,200</td>
<td>JS SH Foreign Trd &amp; Co-op</td>
<td></td>
</tr>
<tr>
<td>General Banking &amp; Trust Co Ltd</td>
<td>(original 1922)</td>
<td>1952 (pvt 1986)</td>
<td>1,500</td>
<td>JS</td>
<td></td>
</tr>
<tr>
<td>General Bank for Venture Financing Ltd</td>
<td>1985</td>
<td>2,200</td>
<td>JS Ag &amp; Co-op</td>
<td>Ag Co-op Financing</td>
<td></td>
</tr>
<tr>
<td>MEZOBANK National Banking Inst of Agri Co-ops Co Ltd</td>
<td>MB</td>
<td>1986</td>
<td>2,000</td>
<td>JS Ag &amp; Co-op</td>
<td></td>
</tr>
<tr>
<td>National Savings Bank</td>
<td>OTP</td>
<td>1949 (deposits 280,000)</td>
<td>1,300</td>
<td>SO</td>
<td>Res RE Constr, Mktp/Fin PLUS (See Text)</td>
</tr>
<tr>
<td>Post Bank</td>
<td>PB</td>
<td>1988</td>
<td>2,200</td>
<td>SO</td>
<td>Collection of Deposits &amp; Loans to other banks</td>
</tr>
<tr>
<td>Savings Co-operatives</td>
<td>T</td>
<td>1957</td>
<td>10,000</td>
<td>SO</td>
<td>Analogous to Credit Unions</td>
</tr>
<tr>
<td>Real Estate Bank Ltd</td>
<td>Being Formed</td>
<td>1989</td>
<td></td>
<td>JS</td>
<td>Formerly Subsidiary of MHB for RE Brokrg/Devel/Lending</td>
</tr>
</tbody>
</table>

Source: National Bank of Hungary
SO = State Owned; JS = Joint Stock (private); SH = Shareholders; Ag = Agricultural; Co-op = Co-operatives; Ind = Industrial; Trd = Trade; Cons = Construction; Int = International Firms

*times charged for larger or more expensive housing, as measured by square metres or rooms per house- hold member, but the higher interest was easily avoided by simply listing additional family members at the new address. Privatisation of the construction industry and the general financial reforms encouraged the construction of larger homes. OTP also made a conscious effort to build and make loans on higher quality housing.*

*Often this resulted in an upward transfer of income as it was the more affluent homebuyer who could afford the new, more expensive homes. The 3% mortgage rate was available to all buyers and was subsidised by the state through OTP, which was a state agency. At this time the other banks making mortgage loans were also state owned, fully or partly. As for the real estate broker system, the mortgage system also changed in 1989. Government, which had directly given subsidy through the state-owned banks at a 3% mortgage rate, allowed or caused interest rates to rise to 18.5%. They also permitted a loan fee, which is currently one point. Clearly, an increase from 3% to effectively 19.5%, an increase in interest of 617%, was a shock to the economy and the housing markets.*

*The new mortgage instrument was for 25 years and the rate was no longer fixed, but was variable with the current rate being set by the central bank. As of this writing, it has not been possible to determine the index or mechanism used to adjust the rate. Hungary does not yet have a truth in lending law. Wages have not kept pace with inflation. The 1988 household income was estimated to be HUF220,000. With the average price of a dwelling at more than HUF2 million, the income-to-home price ratio was nearly 10. With a 70% 25-year loan the monthly mortgage payment on an 18.5% mortgage loan would be 117% of reported average household income. With the 3%, 25-year loan the monthly payment was only 52% of income. Even the 3% ratio was high, but the 18.5% ratio, which is more than 100% of income,*
is intolerable and unworkable in an economy that encourages home ownership and especially in an economy that is moving away from subsidies and toward privatization.

Government anticipated this situation and has established mortgage subsidy programmes. A programme known as a Socio-Political Subsidy provides assistance for the down-payment to keep the mortgage amount low and affordable. There are several mortgage payment subsidy programmes which are described below. Essentially all the programmes modify the earlier allocation schema, but were intended to eliminate some of the previous inequities and discrimination by position, association, wealth and income and make home ownership available to a broader spectrum of the population. The conditions for qualification for the subsidy programmes include:

The household does not own a dwelling or;
If a home is owned it must be sold and all proceeds of the sale be used for the new subsidised purchase; and
The dwelling meets a reasonable need criterion based upon rooms per person.

Several programmes could be considered forms of social engineering, in that they encourage families to have two or more children. This may be in response to the declining birthrate and population of the country.

Unlike the 3% subsidy programme, where the state-owned banks, especially OTP, absorbed the loss from the below market interest rates, under the new programmes funds are given directly to the home buyers or the banks by the state. Most of the programmes have size of dwelling unit or price restrictions associated with them so there will not be as much upward income transfer to more affluent households buying more expensive homes.

The socio-political or down-payment subsidy programme is available to all households meeting the criteria listed above for use in purchasing an existing dwelling, constructing a new dwelling or purchasing and remodelling state or Tanacs-owned flats or homes. The subsidy is available to all qualified home buyers whether they are financing their home or not as a function of the number of children or dependants in the family, but has limitations as to the number of rooms per person, excluding kitchens and bathrooms based on a previous government criterion for allocating the Tanacs lakas. If a qualifying household had sufficient funds to purchase a home without borrowing they could conceivably receive the down-payment subsidy in cash. If they sold a home, however, they could only receive a subsidy up to the difference in the price of the new dwelling and the cash received from the previous sale.

In addition to the socio-political down-payment subsidy, an additional HUF30,000 for each dependent is available to households earning less than HUF3,500 per month (HUF42,000 per year). The total subsidy is available up to a limit of 55% of the home price or value.

More than children qualify as dependants. Dependents include all natural and adopted children up to the age of 16 and all students up to the age of 25. Others included are family members with a 67% or higher disability and parents or grandparents with incomes of less than HUF3,500 per month. Future children can also be included in that a couple under age 35 can receive the subsidy by contracting for future children (one within three years or two within six years) and receive the down-payment assistance now. If they do not meet their contract on time they must pay back the advance with 18.5% interest, but if the wife is pregnant when the due date arrives then the contract will be extended.

The Mortgage Interest or monthly payment subsidies fall into three categories. The first, the Général Subsidy, is available to the entire population regardless of family size and is limited only by the general criteria listed above and the size and price of the dwelling. Qualifying buyers receive a mortgage payment reduction of 30% of the monthly mortgage payment, after all other subsidies, for the first five years of the mortgage and 15% of the payments for the next 10 years. It is also available for buyers qualifying for other subsidies, but takes a subordinate position.

The Dependant Subsidy is a function of the number of children or dependants in the household and is limited to buyers qualifying for the Socio-Political Subsidy. Payments

<table>
<thead>
<tr>
<th>Number in Household</th>
<th>Down-payment Subsidy HUF</th>
<th>Cumulative Subsidy HUF</th>
<th>Rooms Allowed Under Reasonable Need*</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>—</td>
<td>—</td>
<td>1 to 2</td>
</tr>
<tr>
<td>3</td>
<td>50,000</td>
<td>50,000</td>
<td>1½ to 2½</td>
</tr>
<tr>
<td>4</td>
<td>150,000</td>
<td>200,000</td>
<td>2 to 3</td>
</tr>
<tr>
<td>5</td>
<td>400,000</td>
<td>600,000</td>
<td>2½ to 3½</td>
</tr>
<tr>
<td>6</td>
<td>100,000</td>
<td>700,000</td>
<td>3 to 4</td>
</tr>
<tr>
<td>7</td>
<td>100,000</td>
<td>800,000</td>
<td>3½ to 4½</td>
</tr>
<tr>
<td>8</td>
<td>100,000</td>
<td>900,000+</td>
<td>4 to 5½</td>
</tr>
</tbody>
</table>

Source: OTP and Ingatlan Plac.

*Dwelling Unit can exceed the Reasonable Housing Need Criteria by one room and still receive the subsidies which increases the right hand side of the column by one room. Rooms do not include the kitchen or bathrooms.
from this programme are summarised in Table 8. It is available for up to 15 years on a declining scale and may be augmented if dependants are added during the subsidy period. A family of three would receive a subsidy on the amortised payment of 40% of the first HUF300,000 of their mortgage; a family of four, husband, wife and two children, a subsidy of 70% of the first HUF400,000.

The General and Dependant Mortgage Subsidy programmes can work in tandem for qualifying households. Table 9 demonstrates how the tandem plan would work for a childless couple and a couple with one, two or three dependants. The childless couple would get no Dependant Subsidy so would have relief on 30% of their mortgage payment, HUF10,952 per month during the first five years and 15%, HUF5,296 (not shown), from years six to 15. A family of four would receive a 70% subsidy on the first HUF400,000 in amortised payments and a 30% subsidy on the remaining 70% of the full mortgage payment. Their total subsidy would be HUF16,698 or 36.6% during the first five years and be reduced to 33% from years six to 10 and 31% from years 11 to 15 (not shown). All subsidies cease after the 15th year or when a property changes hands. Changes in dependants must be reported and will result in adjustment of the subsidy schedules.

Banks licensed by the state to receive the subsidy payments, eg OTP and MHB, determine the qualification of the mortgagor when he makes an application for the mortgage loan. They use an income to mortgage payment after subsidy ratio of three to determine if they will grant the loan. The subsidised loan is not assumable by other parties and the total subsidy cannot exceed the full monthly mortgage payment.

The third Mortgage Payment Subsidy programme is related to a savings account. Prospective borrowers establish a savings account with one of the licensed banks designated as pre-mortgage savings. After five years they are eligible to borrow up

<table>
<thead>
<tr>
<th>Number in Household</th>
<th>Percentage of Monthly Payment 1-5 years</th>
<th>6-10 years</th>
<th>11-15 years</th>
<th>Amortised Amount Subsidised Limit HUF</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>40</td>
<td>15</td>
<td>15</td>
<td>300,000</td>
</tr>
<tr>
<td>4</td>
<td>70</td>
<td>35</td>
<td>15</td>
<td>400,000</td>
</tr>
<tr>
<td>5</td>
<td>80</td>
<td>40</td>
<td>15</td>
<td>500,000</td>
</tr>
</tbody>
</table>

Source: OTP and Ingatlan Plac
to 200% if they qualify for the Socio-
Political Subsidy and 100% if they do not. The total amount of loan that
can be subsidised under this pro-
gramme is HUF300,000. The subsidy
can be up to 70% of the amortised
mortgage payment during the first
five years, 40% during the second
five years and 15% to year 15. The
account can remain in the bank dur-
ing the loan period earning interest.
There is no limitation as to the price
or size of the home and the subsidy
can be used with the General or
Tandem Subsidies.

Other subsidy programmes are
still available in the form of interest-
free loans from the Tancsok and
employers often give mortgage pay-
ment subsidies to present or new
highly valued employees. The
employer gets a 50% rebate on the
subsidy from the state.

The government and the National
Bank officials are worried about the
potential expense of the subsidy
programmes. Were there a way to
do it, they would be phased out
tomorrow. The programmes may
provide a smooth transition to a
privatised housing finance market.
The question is at what cost in terms
of inflation, taxation and capital
consumption.

Conclusions
It is still too early to see if the
various subsidy programmes will be
effective or how much they will cost.
It is clear that the major problem for
Hungarian housing is supply, both of
quality habitable dwelling units and
mortgage funding. If the subsidy
programmes make the development
of housing profitable to the emerg-
ing private sector, then it may assist in
alleviating the current problems.

Directing resources to housing
may, however, prevent the rapid
expansion of the economy necessary
if the market economy, privatisation
and integration into the international
economic community are to be suc-
cessful. Hungary is capital short,
especially in hard currencies. Housing
is not the only type of real estate
development that is sorely needed
and agriculture, industry and the
public infrastructure all require
investment funding. The construc-
tion technology lags behind the
West, and if Western methods were
employed they would use up capital
for equipment and international cur-
currency for materials.

A potential partial solution, so
far as housing finance is concerned,
is the development of secondary
mortgage markets. Currently none
exist. Even those, if they captured
domestic capital, may drain
resources from other necessary
investments. Foreign investors
would be reluctant to invest in
Hungarian secondary mortgage
markets because of the tenuous con-
vertibility of the forint. If the capital
investment in the country promised
by the Western community of
nations is realised, then the value of
the forint may solidify and become
as convertible as the Austrian
schilling.

What exists are chicken and egg
conundrums. Housing, and other
consumer goods, are necessary to
provide incentives for the population
to accept the hardships that will
be experienced during privatisation.
Privatisation is necessary to provide
the incomes and products, both from
imports and domestic production the
population demands. Capital invest-
ment is necessary to provide
employment for the presently under-
employed labour force. It is also
needed for the investment in hous-
ing and to provide housing finance.

The inflation rate during the first
half of 1989 is down slightly from the
1988 rate. Some of this may be due
to postponed demand, both because
of the new high mortgage and con-
sumer interest rates and the uncer-
tainty and expectations of the public
concerning the policy changes after
the upcoming elections. In any case,
if the inflationary pressures lessen it
may be possible to lower the 18.5%
mortgage interest rate, and phasing
out of the subsidy programmes will
be less painful. ■

DAVID PARRY is Professor of Real
Estate at the California State Poly-
technic University in the United
States and Visiting Lecturer, Eotvos
Lorand University, College of Law,
and the International Training Centre
for Bankers, Budapest, Hungary.

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<table>
<thead>
<tr>
<th>Persons in Household:</th>
<th>2 HUF</th>
<th>3 HUF</th>
<th>4 HUF</th>
<th>5+ HUF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum Purchase Price with Subsidy:</td>
<td>3,400,000</td>
<td>3,850,000</td>
<td>4,280,000</td>
<td>4,650,000</td>
</tr>
<tr>
<td>Loan Amount (70%):</td>
<td>2,380,000</td>
<td>2,695,000</td>
<td>2,975,000</td>
<td>3,255,000</td>
</tr>
<tr>
<td>Full Monthly Mortgage Payment @18.5%:</td>
<td>38,605</td>
<td>41,337</td>
<td>45,632</td>
<td>49,926</td>
</tr>
<tr>
<td>26 years: Dependant Subsidy:</td>
<td>0</td>
<td>1,804</td>
<td>4,295</td>
<td>6,135</td>
</tr>
<tr>
<td>(40% of 300,000)</td>
<td>(70% of 400,000)</td>
<td>(80% of 600,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>General Subsidy:</td>
<td>10,952</td>
<td>11,860</td>
<td>12,401</td>
<td>13,137</td>
</tr>
<tr>
<td>(30% of 36,505)</td>
<td>(30% of 49,533)</td>
<td>(30% of 41,337)</td>
<td>(30% of 43,791)</td>
<td></td>
</tr>
<tr>
<td>TOTAL Monthly Subsidy:</td>
<td>10,952</td>
<td>13,664</td>
<td>16,696</td>
<td>19,272</td>
</tr>
<tr>
<td>Adjusted Monthly Mortgage Payment (first 5 years):</td>
<td>25,653</td>
<td>27,673</td>
<td>28,936</td>
<td>30,654</td>
</tr>
<tr>
<td>Subsidy as a % of full Monthly Mortgage Payment:</td>
<td>30.0%</td>
<td>33.1%</td>
<td>36.6%</td>
<td>38.6%</td>
</tr>
</tbody>
</table>