

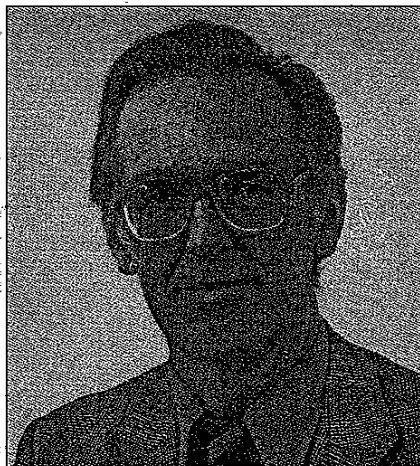
Housing Finance in Albania : On the Path of Reform

by Gian Carlo Guarda

OVERVIEW

The Legacy of "Social" Housing

Over nearly five decades, those Albanians who live in cities had grown accustomed to regard the provision of housing as a responsibility of the State. Virtually all urban workers expected their employer (in most cases a state enterprise or the government) to give them a flat in perpetual use against payment of a monthly rent equivalent to the wage earned in one or two days' work. This fringe benefit was not enjoyed by the majority of rural workers who would instead obtain free access to farmland. In fact, except for a few farm-cooperatives which were financed by the state, most of rural dwellings were built and owned by the villagers themselves, and generally are a bit larger than those available in the cities. The latter are small, overcrowded multistory flats with little amenities and very poor finishes. Consistent under-pricing of urban housing had the obvious consequence of generating excess demand. Rapid demographic increase and urban growth were concomitant factors in frustrating the public sector's sustained effort to provide rental housing for all applicants. The results were ever growing waiting lists, enduring shortages and very low turnover rates. These problems were aggravated by rigid rent control, administrative allocation of living space and very poor maintenance of the buildings.



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THE HOUSING STOCK

Albania's housing stock is estimated currently at 675,000 dwellings, virtually matching the number of households recorded in the 1989 Population Census. About 290,000 dwellings are located in cities and some 385,000 in the countryside. Although this would suggest that there are very few homeless families in Albania, the census uncovers housing characteristics which are probably the worst in Central Europe. The aver-

age urban household lives crammed into a 30 square meters flat where four and even six people of multiple generations are crowding into two or three rooms. One dwelling out of three has no piped water connection and barely half of the flats have an internal W.C. with flush-discharge. Despite the harsh winters, central heating is virtually unknown and homes are only intermittently warmed-up by burning coal or wood in cooking stoves. Poor insulation, lack of finishes, shoddy workmanship and a total neglect of needed repairs result in substandard conditions and rapid obsolescence.

Public Housing

Seventy percent of urban housing (202,000 DU's) were rent controlled dwellings owned by the State but managed at the local level by District Housing Agencies (Banesa). Over 80 percent of this public stock (166,000 DU's) is relatively recent, having been built in the form of five/six-story walk-up apartment buildings during the last twenty-five years. Yet, many of these dwelling were not endowed with modern amenities and their general conditions are very poor. Nearly half of the flats (78,000) were built with the voluntary, part-time labor of enterprise workers, who are not necessarily skilled in construction works. This approach was favored by the past regime in the presumption that it would reduce overall costs (nobody accounted for poor performance or interest foregone during the protracted construction period). Economic considerations were lacking also in the allocation of the dwellings

with the result that little correlation existed between the actual income of the households and the characteristics of the flat they received.² Flats were given out on annual leases which were renewed automatically, granting a "de-facto" perpetual tenure, since eviction is only possible when the renter fails to pay or abuses the dwelling. The rents are still established by central authorities according to a complex set of rules.³ In spite of recent adjustments, the yield of housing rents falls way behind the expenditures which would be needed for proper operation and maintenance of the stock.⁴ In practice, repairs are virtually not carried out and there are no signs of maintenance on those parts of the buildings which are held in common use (stairs, entrances, yards, roofs, facades, etc).

Private Housing

Most of the private housing stock consists of farm-houses and is found in rural or semi-rural settings. In terms of relative endowment with amenities, rural dwellings score poorly but they tend to be roomier and better maintained than the urban dwellings (the average floor area is 40 m² instead of 30 m²). Basically they consist of small single family detached units or one/two story row-houses which were built with traditional techniques and local materials. In the cities, nearly one half of the 86,000 dwellings that are privately owned dates back to the pre-socialist era. Several thousand other units were nationalized in 1945 and might eventually revert to their former owners in virtue of the restitution policy currently under consideration. The past regime did not encourage the construction of private dwellings in urban areas: less than 15,000 of those were produced over forty-five years (1945-1990). The households which intended to erect their own dwelling had first to obtain a location permit from the Executive Committee governing their District, which would grant it for a specified site, only after payment of the full cost of construction to the State Bank (or one-half when credit was given for the other-half). Investors were issued vouchers to pay for the execution of the works by a state enterprise or for the

purchase of the necessary materials from suppliers, if constructing themselves. Lately, households were also expected to team-up in pairs for the application because of a government drive to build at least two flats on each parcel in order to offset the perceived shortage of developable sites. Additional disincentives were the facts that land would remain in public ownership and that the compensation that would be paid in case of expropriation of a building bore little relation to its actual value.

TRENDS IN HOUSING SUPPLY

State Investments

For over four decades, the GOA has devoted about 1.3 percent of GDP to subsidizing the supply of rental dwellings in the cities. This type of expenditure accounted for more than 4 percent of gross fixed capital formation each year. Returns on such investments were nil because the rents being charged would not even cover the operating costs of the District Housing Agencies responsible for administration and maintenance. Yet, providing a home to at least some of the workers on the waiting list was viewed as a "social" commitment which was warranted by the generalized low-wage policy. Also, the State investment in rental housing was - and continues to be - seen as an important source of urban employment, which has significant multiplier effects on the rest of the economy. In fact, the complementary activities of producing building materials accounted for more than ten percent of the total industrial output, albeit the quality of the products was poor because of obsolete technologies and lack of competition. Housing supply peaked in 1989, a year in which both the state-owned enterprises and the private home-builders (mostly self-help operators in rural areas) produced some 8,000 dwellings each.⁵ During 1990, the output of the construction sector started to decline and fell dramatically during 1991 (only 548 public flats and 500 private dwellings were produced) coming to a virtual halt

in 1992.

Unfinished Housing

Due to the lack of funds, work had to be interrupted on an estimated 13,300 dwellings which were under construction in urban areas. Half of these unfinished units are located in the country's six largest cities and show various degrees of completion (the average is 46%). About 7,450 of the unfinished dwellings were being built by economic enterprises and are promised to their own workers who are continuing a trickle of voluntary work on the sites. The other 5,850 units were built instead by the State and have no pre-assigned occupants.⁶ The average stage of completion on this part of the unfinished stock is higher (57%) and the quality of workmanship somewhat better. However, some flats in the more advanced buildings have been invaded by squatters or have been occupied by people who ranked high in the waiting lists. Before construction work can be resumed on those buildings one would have to relocate the present occupants.

Council of Ministers' Decree No.46

Of the 13,300 unfinished dwellings, 1,000 have been requisitioned by the Army for its own dependents. This left 12,300 units, which the Council of Ministers divided into three categories with its decree of January 29, 1993:

- constructions nearly completed (an undefined number of dwellings, possibly 500, which were not severed out from the following group);
- constructions relatively advanced (8,630 DU's); and
- constructions barely started (3,670 DU's).

The decree ruled that budgetary funds should be used to complete those dwellings that are nearly finished and mostly occupied by squatters or have been pre-assigned to enterprise workers or other beneficiaries. The relatively advanced

buildings initiated by economic enterprises (comprising 4,900 DU's) would be offered to those enterprises or to their workers who should complete them with their own resources. If they are not accepted by May 29, 1993 (about half entail considerable investments), those buildings should be handed over to the respective Municipalities. The remainder (7,400 DU's) is to be completed by the newly established National Housing Agency (NHA) with credits obtained from the banking system, external borrowing and with the proceeds of the privatization process.

HOUSING FINANCE UNDER AN ADMINISTRATIVE ECONOMY

Fiscal Issues: the Subsidies

Up to now, the State has covered all the construction costs of public housing. Although the beneficiaries pay some rent, the amount is only nominal and is totally used up in providing whatever little maintenance can be paid with it. The difference between the rents actually paid by the resident households and those which should be charged if the invested capital were to be remunerated at full opportunity cost constitutes the most important subsidy to the existing stock which goes unmeasured. Traditionally, subsidies have been financed through an implicit tax, which kept the wage of all workers uniformly low. However, the corresponding benefits accrued only to those households who actually became residents of public rental housing. Except for a few members of farm cooperatives, rural dwellers did not enjoy housing subsidies. Among the beneficiaries, those obtaining larger dwellings received also the greatest implicit bonus. Finally, the net benefit of what they received depended also on the building's physical conditions, available amenities and relative location, all factors which, in a market system, would be adequately reflected in the level of rent being charged.

Financial Issues: Past Housing Finance

In 1990, some form of housing finance was established for individual investors, reviving the right of private dwelling ownership which had been repressed in Albanian cities since 1972. Individuals could borrow from the National Commercial Bank of Albania up to fifty percent of the money they needed to acquire or construct a house for their own residence. Relatively few of such loans were made, financed out of the budget and repayable over 5 years at a fixed rate of interest of 3 percent. More popular were the loans for housing additions or improvements which were available for terms of 15 years at 1 percent interest with no down payment required. In both cases, the bank reserved the right of repossession if an investor failed to make monthly payments. However, the steep rise in domestic interest rates which occurred in 1991/1992 made these low interest loans unaffordable for the lender. The outstanding credits continue to be paid at the prior - by now highly negative - amortization rate, while macro inflation has rapidly eroded the principal and rendered this portfolio practically insignificant.

A STRATEGY FOR THE HOUSING SECTOR

The Implications of Economic Reform

The democratic government elected in March 1992 inherited the economy in total disarray. The only feasible option was to undertake a radical program of reforms aimed at stabilizing conditions while laying the foundations for economic recovery in the medium term. At the end of August 1992 the GOA reached agreement with the IMF for a stand-by arrangement based on the following key policies:

- reducing the budget deficit;
- limiting nominal wage increases;

- liberalizing prices;
- approximating real positive values of interest rates;
- curbing the expansion of domestic credit;
- liberalizing external trade and currency exchange; and
- commercializing and privatizing the state enterprises.

For the housing sector, these general policy guidelines implied the total rejection of a traditional system of production which was centrally planned and supply driven in favor of one that should become market-based and largely private.

The collapse of the activities of the construction enterprises, the persisting shortage of housing and the decline of real wages are in strident contrast with the high rates of urban unemployment, the visible overhang of unfinished flats and the recent hikes in rent and utilities charges. These contradictions may unleash popular pressures for a renewed policy of public housing subsidies, which would clash with the adjustment process in several ways: it could accelerate inflation by breaking through agreed budgetary and credit ceilings; it could absorb fiscal resources otherwise needed to restructure the economy; it could keep households tied to administratively allocated dwellings whereas one should facilitate the mobility of labor. One immediate challenge of the government is to provide the housing sector with sufficient liquidity to resume a minimum level of activity, and to refrain from introducing interest rate distortions in a financial system that is still in its infancy. In this respect, external aid can play a critical role. It is all important, however, that the supply of additional funds for housing be based on a well coordinated strategy of sector transformation as outlined below.

Intersectoral Coordination

The process of restructuring the housing sector is strictly linked to reforms in other

areas of the economy. It may be accelerated or delayed by the progress of those reforms. In fact:

- the state enterprises cannot be privatized and transformed into entrepreneurial and competitive agents of supply, unless some stabilization is achieved in effective demand;
- public housing cannot be privatized and the housing market cannot develop without the security of clear ownership and foreclosure rights;
- housing rent and land development policies cannot be improved without effective collaboration between the central and local governments;
- one cannot mobilize and use long term resources for housing unless sound monetary and credit policies are in place; and
- an efficient housing finance system cannot be developed without prior improvement of banking skills and practices.

Reducing Budget Subsidies

State supported housing investment should be discontinued. In fact, all construction activities were halted on public housing which was in progress and no new investment program was undertaken. Obviously, this caused a sudden drop in the activity of the State construction enterprises and of the industries of building materials. It also caused great dissatisfaction among potential home recipients and among construction workers who were idled or are fearful of losing their jobs. An additional effect was a cascade of inter-enterprise arrears because the banking system ceased to supply credit to finance purchases of much needed imports. Even more important, the Government began to question the use of scarce budget resources for housing subsidies, and to redefine the role of the Ministry of Construction from that of principal investor to one of mere coordinator and facilitator of sector activities.

Privatization of Public Housing

The Housing Privatization Act, approved December 23, 1992, was designed to appeal to the present occupants of state-owned rental housing, to facilitate rapid and simple acquisition of title, to minimize the required outlay for the household and to accomplish the operation without substantial demands on the national treasury. The basic purposes of the law are:

- to improve housing maintenance by transferring decisions on repairs to the owners/occupants;
- to improve utilization of the housing stock by enabling owners and renters to move freely between dwellings by paying their full costs;
- to create a market for new dwellings, by allowing new owners to cash-in the acquired equity and to use it as partial payment for new homes; and
- to enable private individuals and enterprises to provide and manage housing, relieving the government of these responsibilities.

In order to achieve these objectives, a number of decisions had to be made:

- a claim to state-owned housing was granted to all present occupants who chose to become owners, either for free (in the case of small or old flats) or for a nominal payment for the excess space above a minimum standard;
- various incentives were offered to promote the change in tenure (low purchase price, unconditional right to sell or rent dwellings, exemption from rent control, joint control of operation and maintenance);
- the condominium form of tenure was adopted for all privatized flats;

- multi-unit buildings would be managed through self-elected governing boards after privatization; and

- the privatization process would be terminated within a date set by the decision of the Council of Ministers.⁷

De-Controlling Rents

No privatization scheme can work without rent-reform. To begin with, rent control has been abolished on all units being privatized in order to offer some incentive for private ownership. This action might start already some turnover of dwelling units, as residents that are under-or over-housed should be induced to trade their flats for other homes that better fit their needs, budget and desires. On buildings that remain in state property the rents should be progressively raised to a level that cover the prorated share of building operation and maintenance costs. It is important also to index rents so as to factor-in the cost of inflation.

Rent-Voucher Schemes

The adoption of an aggressive policy of rent de-control would call for simultaneous increases in real wages, which are inappropriate in the current circumstances of the economy. On the other hand, increasing rents sharply in an environment of real wage decline involves high social risks because a large proportion of the population may be unable to meet the required payments. This suggests the parallel development of a scheme of financial assistance for those households or individuals, who cannot afford the rent increases. One possible scheme could be to finance the distribution of rent vouchers by local authorities in order to complement the contributions that poor tenants can afford to make (e.g. pensioners, unemployed, invalids, etc). However, it would be important to coordinate this with other forms of social assistance based on a means test.

Financing Housing Purchase

Given the unfavorable proportion between

the cost of housing and the current income of the average household, some long term repayment scheme must be introduced to make the purchase of a home affordable. The privatization program itself includes a scheme of deferred payment allowing the owners to use the property as a collateral security (mortgage credit). The beneficiaries of the privatization program are also allowed to liquidate the interest acquired in the home they occupy and to use it as equity payment for a new, larger home. Given the primitive condition of the Albanian financial system, and the volatile level of inflation, such repayment schemes should be denominated in foreign currency, carrying an interest rate sufficient to cover the transaction costs of the lender. One should avoid introducing distortions in the domestic interest rate. In those cases in which some form of subsidy may be socially desirable and justified, such subsidy should be made explicit in the budget and well insulated from the credit operations.

Reducing Fiscal Subsidies to the Housing Sector

The successful privatization of the larger share of the public housing stock and the progressive adjustment of rents on the remainder should reduce drastically the current subsidies to the sector. Other savings should come from the privatization of State construction enterprises, the losses of which had to be covered by the budget. Finally, the adjustment of interest rates and the strict rationing of concessionary credit would also free resources for alternative uses. The total halt imposed on new housing investment activities by the State may be tempered by a certain activity of completion of those unfinished dwellings in which part of the investment capital has been sunk already. The recommended transition strategy is to start with charging home buyers only the cost of incremental investments, and move only later into a stage in which the full prices of new housing starts can be charged as the economy stabilizes and popular acceptance is gradually gained of the idea that homes must be paid for. Eventually, one can expect that the private sec-

tor may take over the function of principal supplier when adequate credit for housing construction and mortgages becomes available. The role of the State would then shift to that of facilitator and coordinator of sector activity, while the main actors would become the households themselves, the bankers, the developers, the contractors and the suppliers of building materials.

Institutional Reform

The above suggests that the role of the traditional sector authorities (the Ministry of Construction, its Institutes and Enterprises as well as the District Housing Agencies) would be substantially modified. Substantial savings should be achievable in payroll and overhead costs, if the State enterprises are privatized, the District Housing Agencies are greatly reduced and decentralized at local level and MOC responsibilities evolve into mere guidance and monitoring of a large number of sector operators. Such transition requires careful study, and the elaboration of a schedule of new activities and suitable personnel. Staff re-deployment, requalification and training should support the new institutional perspective.

Legal Issues: Needed Legislation

The transition from a centrally directed system of housing supply to one that is demand- and market-driven requires several innovations in the legal system. The rights of perpetual tenancy must be converted into fixed-term contractual agreements, protecting the interest of both owners and renters. Restrictions on the exchange of housing units and their sale price must be removed as well as any limitations to the rights of home ownership. Shared ownership of apartment complexes must be regulated by the new condominium law. Rent control legislation will be gradually phased out, beginning with privatized or newly constructed units. A rent allowance system might become necessary to shield the needy from undue hardship. New legislation is also necessary to address issues facing the

local governments in the areas of land use planning, investment permits and provision of serviced residential land. Finally, new legislation will be needed to set up procedures for competitive procurement of goods and services in those investment projects which bear a contribution from the central or the local government.

It is worth mentioning that the substantial progress has already been made in developing a new regulatory framework for the housing sector. In most cases the basic legislation has been introduced although some bylaws and procedural guidelines are still lacking. *Establishment of the National Housing Agency* took place with the original Decree No. 431 of the Council of Ministers on December 10, 1992 which has been recently amended by Decree No. 198 of May 4, 1993. New laws were passed on the *Privatization of State Housing* (Law No. 7491 of December 23, 1993, later complemented by Council of Ministers Decisions No. 1, 46, 48 and 49, all dated December 29, 1993) and on *Condominium Property* (Law No. 7683 of March 17, 1993) completed by the Decree No. 214 of May 10, 1993, establishing "Procedures for the Creation of Condominia and Transfer of Privatized State Housing to Private Households and Municipalities." A law on *Restitution of Expropriated Properties* has been adopted on April 15, 1993. One of the main outstanding issues include the definition of public purpose as a basis for expropriation and of clear foreclosure rules to support a viable system of housing finance. Also, in view of the fact that most real property transactions are to be ruled by civil law, there is the need to strengthen the judiciary and to provide adequate procedures of appeal and independent review. The large scale transfers of state assets to local governments require development of *Land and Mortgage Registries* and Notarial Offices along the lines suggested by USAID consultants. A *Procurement Act* is also under preparation, which should set out the ground rules for competitive bidding on publicly financed works. A certain measure of decentralization was envisaged in the *Local Government Law* (June 10, 1992) which

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the reforming economies compound the problems associated with establishing the basic property rights that must underpin real estate transactions. Nevertheless, the need for reform is very real, and its successful prosecution can play an important part in providing typical households with some of the tangible benefits of moving to market. These gains go well beyond important objective of improving the functioning of the sector.

This reform program is a topic that will require years of effort and we present these papers to give readers of *Housing Finance International* a sense of the beginnings that have been made, and the agenda before those interested in housing finance. ■

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transferred considerable authority over urban development matters to the new local councils, but it still remains to be defined what services should be provided by the local governments and what sort of fiscal autonomy they will enjoy in paying or levying charges for them. The draft *Land Use Law* has not been approved yet but is needed to better define the powers and authorities concerned with territorial and urban land use planning and zoning regulation, with the occupation of land for construction, with the issuance of building and demolition licenses, as well as with guidelines for environmental protection and pollution control especially in coastal, tourist and vacation areas. ■

NOTES

¹ Albania has an average of 7.5 square metres of living space per capita and very poor sanitation levels, against 15m² for Romania, 17 for Bulgaria, 20 for Poland and 26 for Hungary. Dwellings with piped water are 84% in Hungary, 85% in Poland and 59% in Romania. In Albanian cities,

63% of dwellings have piped water, but for the entire country, the figure is only 5%.

² Public housing used to be allocated to beneficiaries by local committees following 3 basic criteria :

- loss of dwelling (e.g. because of emergencies, requisition or demolition by public authority);
- insanitary living conditions ;
- disproportionate household size (over 90% of the applications for alternative housing fall in this category).

³ Rent is calculated on the basis of 1 percent of the recorded (subsidized) cost of construction plus insurance modified by several coefficients relating to the amenities, location and floor space of the dwelling and to the building type. Rents varied little in the past 45 years. They were doubled in August 1992, bringing the base rate from 0.36 to 0.72 leks per square metre. Current estimates put the average rent in the order of 1.55 to 3.0 percent of household income and the cost of utilities (electricity, water and telephone) in the same order of magnitude.

⁴ Originally the operating costs of the maintenance enterprises accounted for about 25% of the rents they collected. However, the recent escalation of their current expenditures relative to the poor yield of rents leaves less and less room for maintenance activities.

⁵ The average annual production in the 1981-1990 decade was about 14,700 DU's of which 7,900 were financed by the state (3,300 for enterprise workers) and 6,800 by the private sector. During the whole decade only 2,470 privately financed dwellings were built in cities or towns (an average of 250 per year).

⁶ Old waiting lists exist with each district housing agency also for this category of dwellings but their validity is arguable

once it is decided that the State can no longer afford to invest in housing unless the beneficiaries are willing and able to pay for its cost.

⁷ By the end of 1993, payment had been made on 187,000 flats (97% of the total) and the equivalent of US\$ 16 million had been deposited in the accounts of the National Housing Agency. The whole process was carried out in about seven months, leaving only about 6,000 units in public ownership nation wide. An excellent account of this success story has been written by Ira Lowry in *Housing Privatization in Albania*, Washington D.C., PADCO, January 1994.

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surprising that acute observers of the reform process, such as Kornai, now suggest that due to the lack of market-oriented institutions in the housing sector that a low level macroeconomic equilibrium trap may well have been achieved in Hungary.

Macro conditions in stabilizing economies always necessarily constrain housing demand. However, when this result is as long lasting as it has been in Hungary it can cause a vicious circle to occur. In this cycle the stabilization-induced secular decline in housing conditions generates less legislative momentum to create the kinds of institutions that reward individual decision-making. This result, in turn, may then lead to a further deterioration in macro circumstances, as fewer job shifts occur and less savings can be mobilized. Then, because of this result, the cycle regenerates itself in further macroeconomic deterioration.

There are, of course, no simple ways to break this cycle, but Kornai's basic conclusion "it is desirable for a sizable part of the savings by households to be used for financing housing construction," is consistent with our perspective. Exactly how market-based institutions can be developed to accomplish this objective is an important issue with consequences that go well be-