POLAND:
HOUSING CHALLENGE IN A TIME OF TRANSITION

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Housing Policy in the United States:
The Intersection of the Public and Private Sectors in Housing Finance

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The popular folkloric axiom “Housing Matters” acquires a poignant significance in the context of countries that are engaged in a wholesale revision of their political, economic and social paradigms. This paper examines the state of Polish housing as a legacy of the socialist period and the transition of the sector to a market economy. It describes housing conditions at the beginning of the transition; uses the housing policy framework conceptualized by World Bank consultant Shlomo Angel to trace progress throughout the ensuing decade; and concludes by identifying current strengths and challenges in the emergent Polish housing system.

The Way Things Were

When the Berlin Wall toppled in 1989 symbolizing the collapse of communism, housing in Polish cities reflected the common characteristics of centrally planned economies in the Soviet bloc countries. Dreary four- and five-story apartment blocks constructed from industrially produced prefabricated concrete panels ringed the cities, constituting the largest part of urban housing. Sixty-three percent of the population was urban. There were three basic types of housing: units owned directly by the state or by state-owned enterprises (SOEs); cooperatives, usually constructed by state-owned enterprises; and private housing, primarily single-family dwellings in rural areas. By 1990 cooperatives were the most common housing type, comprising 50% of all new units. The development of cooperative housing was encouraged through policies that gave such projects preferential financing, land access, and allocations of labor and building materials.

Although housing was considered a social right, households had little choice regarding location or type of unit provided. The central government authority assigned units, and set not only design and quality but also production targets, with housing competing for allocations of labor and resources against higher priority industries. In 1990 Poland had the most severe housing shortage in Eastern Europe. Waiting time for an apartment in the cities could be 15 years.[1] With costs consuming about 5% of household income, housing as a right was affordable, but socialized units were generally small, averaging about 54 square meters, and the average number of occupants per unit – 3.6 persons – was the highest in the region.[2] Rents were set administratively with no relationship to production costs or operating expenses, resulting in the necessity for deep government subsidies as well as problems of seriously deferred maintenance. Further, more than half of the publicly owned housing units did not have separate bathrooms and central heating, most of those in buildings constructed before 1945.[3]

The Housing Policy Environment

Shlomo Angel defines the housing policy environment as "the set of government interventions that have a critical and measurable effect on the performance of the housing sector."[4] He describes five major components of the housing policy environment: 1) Property rights; 2) Housing finance; 3) Housing subsidies; 4) Residential infrastructure; and 5) Laws and regulations. Characteristics of the five components interact and modify each other to "motivate, enable, and constrain" housing activity.[5] The entire housing policy environment is itself in a

[1] Telgarsky, p. 119
[2] Telgarsky, p. 45
[3] Hosier, Matras & Banks, p. 7
[4] Angel, p. 11
[5] Angel, pp. 70-1

continuous feedback loop with that housing activity, its conditions and outcomes, all within the economic, social, and political contexts of a society.

For fifty years, housing policy in Poland was set in the context of socialist economics and authoritarian politics. The empirical results of these policies were:

- a stock of units inconsistent with household preferences and needs;
- severe neglect and undermaintenance of units;
- severe shortage of available units as evidenced by long waiting lists and the ratio of households to existing units.[6]

With the sudden collapse of the socialist economy, the new government was faced with reinventing the entire system of housing production, finance, and allocation *at the same time* as it was reinventing itself politically and socially in every other sphere of public life. How Poland responded to this challenge can be described in the context of the five components of the housing policy environment.

Property Rights

In 1990 the majority of urban land in Poland was, of course, owned by the State, and only 22% of urban housing was privately owned.[7] One of the first actions of the new government was to devolve ownership of public housing to newly established local governments, transferring the responsibility and the burden of development and maintenance. The government also pursued an active policy of privatization, encouraging the sale or transfer of housing units to their current occupants, often at extremely generous terms. In addition the government made state-owned

[6] Hosier, Matras, & Banks, p. 5
[7] Hosier, Matras, & Banks, p. 9; Telgarsky, p. 120

land available for private development. Early progress in privatization was moderately successful in spite of the fact that the legal institutional environment for recording and securing property rights was inadequate. For example, by 1995 48% of cooperative housing units were owner-occupied compared to only 16% in 1988.[8] Nevertheless private purchase of units was constrained by many factors, including high prospective costs for repair and maintenance. The result is that the most desirable units were sold first and much of the remaining public stock is communal housing of the lowest quality and condition.

The privatization trend was also evident in the building industry. Between 1990 and 1993, 67 state construction enterprises were privatized and 624 were liquidated. By 1993 private firms accounted for 85% of the total housing output and 70% of the total employment in the sector.[9] Because private firms were smaller than the SOEs (until 1992 private companies were restricted to 5 employees or less), their predominance also reflects the smaller scale of the new development projects as well as declining production.

Throughout the nineties the government improved the legal framework needed to support private property rights, amending many existing laws and passing new ones. Problems that were addressed included those identified by consultants from the Urban Institute who provided technical assistance to Poland under a contract with US AID: the absence of adequate, enforceable collateral and eviction laws; an antiquated, slow and often inaccurate title and mortgage registry system; the cumbersome reprivatization process, and the fact that the low priority of mortgage debt claims under Polish law [sixth position] leaves lenders without secure

[8] Hosier, Matras, & Banks, p. 9
[9] Hosier, Matras & Banks, p. 14

collateral.[10] Such a legal structure is also crucial for the evolution of a viable housing finance system.

Housing Finance

In 1990 important issues in the Polish housing finance system included the legacy of existing subsidies; affordability in an inflationary environment; the development of a private banking sector, competition, and appropriate loan products; and the borrowers' willingness to pay. Many loans on the books carried terms of 2-3% interest for up to 43 years. Consistent with Poland's "Big Bang" approach to the economic transition, in 1990 the entire outstanding housing loan portfolio was converted to market level variable interest rates.[11] With inflation in the first year of the transition at more than 600% as prices sought their market levels, and remaining in double digits for most of the decade, the government provided heavy subsidies to cushion the increases for households, resulting in a relatively high burden on the state budget.

Throughout the nineties Poland experimented with various types of loan products and housing programs designed to promote the development of a market-based housing finance and production system. Just one example is the dual-index mortgage instrument (DIM) that was designed to mitigate the risks of high inflation. Legislation authorized an expansion of the banking system itself, including the creation of mortgage banks, opening the way to expanded access to capital, increased competition, and diversity of products. From 1990 to 1996 Poland was the recipient of investment and technical assistance through a Housing Finance project collaboration involving US AID, the World Bank, the EBRD, and the Government of Poland.

[10] Hosier, Matras & Banks, p. 2
[11] Hosier, Matras & Banks, p. 21

The project created a Mortgage Fund program that allowed smaller banks access to capital for mortgage loans and helped to develop housing finance skills in a growing professional sector.

A description of the banking sector illustrates Poland's progress in this area. In 1990 there were basically two sources of funds for housing loans: the state-owned PKO Savings Bank, the sole source of mortgage lending to individuals, and Narodowy Bank Polski, which made construction loans to cooperatives. By 1996 a total of 18 banks were offering housing loans of various kinds.[12] In 2000 that number had grown to over 30 banks, although PKO BP, now privatized, still has the largest market share by far.[13] Also by 2000 over 800 credit officers from over twenty banks had participated in a professional mortgage-lending curriculum offered through bank training institutes initiated in 1996.

In spite of the positive developments in the housing finance system, interest rates remain very high, and the perception remains that mortgage loans are not affordable to the average citizen. Many Polish households that were accustomed to paying between 2 and 12% of their income for housing expense are unwilling to pay 25-30% for a mortgage loan, especially if that loan is to purchase the unit they currently rent for so much less. The attitude is a legacy of the socialist philosophy and is strongly influenced by the provision of government subsidies for housing.

Housing Subsidies

In traditional socialist economies housing subsidies are the keystone of government housing policy. Direct budget allocations, preferential financing schemes and tax treatments ensured the

[12] Diamond, p. 20
[13] OECD, p. 7

development of desired housing types. An administrative commitment to minimal rent charges necessitated ongoing operational subsidies as well. In the transition period attempts by the government to institute tighter discipline on state budget expenditures while maintaining rent controls interacted with rampant inflation and the introduction of market interest rates to create a precipitous decline in new housing production. The decline reflected and amplified the changes in the profile of the construction industry. Output fell from about 150,000 units in 1989 to a low of 55,000 units in 1996, before the trend reversed itself, climbing to 80,000 units in 1999.[14] In 2002 production was about 90,000 units.[15]

As dramatic as these declines are, Poland actually used the housing sector as an economic buffer during the transition more than other Eastern European countries. It continued to make subsidy commitments for hundreds of thousands of new (mostly cooperative) units to be constructed between 1992 and 1995.[16] Other subsidies included purchases of capitalized interest accruing to long-term housing loans, repayment of outstanding infrastructure loans taken by coops, and ongoing heating and hot water subsidies to tenants.[17] The government also instituted new housing "investment" tax subsidies in 1992 that allowed deductions for principal and interest expenditures for both new construction and renovation.

Although these policies prevented the total collapse of the housing construction industry, paradoxically the subsidies work to inhibit the consolidation of a market-based housing sector. Because most of the beneficiaries of the subsidies are moderate and upper-income households,

[14] OECD, p. 3; Hosier, Matras & Banks, p. 13;UNECE, p. iii
[15] Warsaw Voice, 11/18/2002
[16] Diamond, p. 17
[17] Hosier, Matras & Banks, p. 19

these households have a disincentive to participate in purchase programs that will significantly increase their housing costs. On the supply side, private developers cannot develop feasible rental projects when they are prevented from charging rents that will cover debt payments and operating expenses. The 1994 Law on Rents and Housing Allowances was the first attempt to remedy the situation. The law allowed progressive rent increases in an attempt to make rents cover more of the maintenance expenses of the properties, but provided for a social safety net for low-income tenants who could not afford the increases.[18] The tax reform initiative of 2001 abolished most of the construction tax subsidies, and the "Assumptions for state housing policy for 1999 – 2003" set a framework for more efficient targeting of subsidies in the future. New programs include mortgage interest rate subsidies for low-income households to purchase homes, direct lending from the National Housing Fund to support rental cooperative and social rental construction for low-income households, and state-supported credit arrangements for housing renovations.[19]

Residential Infrastructure

Some of the subsidies routinely provided by the government went to cooperatives and SOEs for residential infrastructure development. The preference for large multi-family housing construction projects in the socialist period required large land parcels. Local governments were required to provide land within areas designated for development in the master plans for housing development, and to ensure that developable housing parcels had access to infrastructure networks.[20] Invariably these parcels were located on the outer fringes of the cities, requiring

[18] Hosier, Matras & Banks, p. 30-1
[19] OECD, p. 6
[20] Hosier, Matras & Banks, p. 18

expensive extensions of trunk infrastructure and resulting in the donut-style development pattern that characterizes the former Soviet bloc.

Although the cities were responsible for infrastructure planning, they had to rely on centralized agencies for implementation. Because residential infrastructure was not a high priority in the command economy urban housing was often developed without connections to sewers and to gas and heating networks. Such development increased urban sprawl and air pollution because it required jumbo sites large enough to accommodate septic systems, and used coal for heating.[21] Although the system may not have resulted in the most efficient use of land and the most attractive landscapes, urban development did not occur in the socialist economies without a minimum provision of adequate infrastructure. Therefore Polish cities were able to escape the worst effects of rapid urbanization suffered in so many other places of the world: severe overcrowding, congestion, filth and disease, and high unaffordable rents. Nevertheless, with a return to smaller scale development and the growing preference for more single-family homes, urban in-fill development is more feasible, reducing the need for expensive infrastructure extensions.

Laws and Regulations

Laws and regulations affect both the supply and the demand side of housing markets. Many Polish regulations that impact housing performance have already been discussed in the context of their relationship to other components of the housing policy environment. On the demand side they include laws and regulations that impact property rights, condominium ownership conditions, rent reform, financing and collateral issues, bank regulation and tax law. On the

[21] Telgarsky, p. 121

supply side they include zoning and land use regulations, building codes, and licensing and permitting rules. Revising laws and regulations that were in place during the socialist period to those that are compatible with a free market economy is a formidable challenge in which Poland has made considerable progress.

On to the Future

The housing policy environment in Poland today is much different than it was in the twentieth century under socialism, reflecting significant changes in the way housing is produced, financed, and managed. The most radical transformation is the shift in the government's role from direct provision of housing to policy director and regulator of housing activity implemented by others.

The major accomplishments of the transition period include the privatization of the housing sector and the creation of a market-based housing finance system. In 1990 the ownership of all state-owned rental housing was transferred to local governments. State-owned business enterprises that owned and operated employee housing were similarly encouraged to transfer ownership of the projects. Many units in these government projects were sold or transferred to residents. Cooperative housing continued to be the most prevalent type of housing, but within the coops the balance shifted from tenancy to home ownership. Single-family housing development experienced resurgence in the cities. New financing programs and advances in the legal and institutional infrastructure regarding private property rights and laws governing collective ownership accompanied these trends. Private construction firms supplanted most of the large state-owned construction enterprises, and nonprofit Tenant Building Societies are taking on the responsibility of providing new income-restricted rental development.

Advances in the real estate and finance industries have created a professional sector where there was formerly none. New associations of mortgage lenders, appraisers, real estate brokers, home builders and property managers formed offering support and training to their members to enhance skills. The Housing Research Institute in Warsaw and the Cracow Real Estate Institute are addressing the lack of reliable information and market data. These groups also provide a voice for private sector policy advice to the government.

Although much progress has been made, there are many challenges that lie ahead. There are three major issues for the immediate future: 1) the poor condition of the existing rental stock; 2) the persistent housing shortages; and 3) the use and affordability of home mortgage products. There remains a large stock of poorly maintained housing in need of either demolition or renovation. Demolition would, of course, exacerbate the shortage. The government is designing a new credit program to promote housing renovation. New housing production still has not returned to pre-transition levels. The shortage of housing constrains labor mobility, which in turn contributes to the high unemployment problem.

The housing shortage also deters Polish households from giving up their current units in search of better housing. High interest rates create affordability problems in home mortgages that are a real constraint, but effective demand for private mortgages is far below potential demand. Both the system of housing subsidies and attitudes about the "normal" rate of housing expense inhibit demand, and are related to each other. Reforms in the system of housing subsidies have come slowly and are critical for continuing progress in privatization, increasing production, and promoting home ownership. Rent controls and tenant subsidies continue to make private rental development financially infeasible and to provide a disincentive to tenants to convert to home ownership. There have been some reforms allowing modest rent increases, but the abolishment of rent control has now been pushed out to 2005. On the positive side, the government has significantly reduced the portion of the state budget devoted to housing subsidies, and new subsidy and government housing finance programs are being targeted to the most needy.

The rent control issue is just one illustration of the difficulty involved in changing the fundamental principles of an entire political and economic system. The shift to a market economy has necessarily involved trade-offs in housing affordability, challenging deeply held attitudes about housing as a social right. However for Poland there is no turning back. Housing does indeed matter, and "choice in housing is a key component of any democratic society."[22] The housing finance and real estate sector will continue to evolve and become more sophisticated and professional, consumers will gradually awaken to new possibilities, and those factors will both shape and be shaped by the housing policy environment.

[22] Black et.al., p. 3

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