József Hegedüs: Housing affordability issues in Eastern and Central European countries[i]

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Introduction

The presentation attempts to give an overview of the affordability issue (defined later) in the region of Eastern and Central Europe being aware of the limitations of generalisations for the whole region. Our approach can be categorised as "soft structuralist", which means that the analysis always takes place on two levels (macro/global and national/local), and it also tries to reveal the relationships between these levels. While global challenges (structural factor) can be more or less easily identified at regional level, to understand national/subnational level relations requires more country specific research and knowledge. This is why my presentation will necessarily be constrained to the case of Hungary, and other countries are used mostly for illustration of certain trends and relations.

The housing affordability problem in the region is embedded in the complexity of the social and economic transition process. The housing sector (housing policy, housing market, etc.) is part of the transition in the sense that a new housing model (or at least one that is different from the EEHM) has emerged in the region, but it has an effect on the social and economic relations as well, such as income/wealth inequality, poverty, employment, pension system, etc. The housing affordability problem will be showed in this context.

Main institutional response in the process of transition after 1990 – and its constraints

After the political changes in 1989/1990 economies of the countries in East and Central Europe went into a deep recession, which was localized to the region, but was as serious as the Great Depression in terms of the GDP decline, and lasted 5-10 years. Despite the differences in economic strategies ("shock therapy" or soft reforms), widespread privatization of state companies and price liberalization took place, which led to a new economic/political system with a strong interest representation of big employers and investors.

The hegemony of the communist party has been replaced by a multi-party political system based on democratic election. However, due to lack of democratic traditions, the danger that political forces use demagogy and will play populist and nationalist "cards" was high (a kind of danger of "south-Americanization"). The policies related to the welfare sectors (housing, education, health care, pension systems, etc.) have always been an easy target of demagogic attacks rooted in socialist norms and ideas (which has little to do with the reality of the "existing socialism" in the past). Unrealistic (unfounded and unsustainable) public policies are relatively short lived in the period of the revitalization of the economy, but no real room at the time of austerity. Consequently, depending on economic and political factors, public policies were very volatile and changed considerably several times.

The region can be characterized by "weak government", which means various things. First of all, governments are under the strong influence of private interests interlocked with banks and entrepreneurs; they have little capacity to balance between the different social groups. Secondly, the role of trade unions is a crucial issue. Trade unions in the privatized sector are more or less powerless. In the public sector they are more powerful and tend to protest against reforms. Thirdly, the capacity of governments to introduce and monitor reforms is limited as well because of the fiscal pressure on the budget and competition with the private sector. Fourthly, the effect of decentralization is controversial as well. On one hand, decentralization has led to the creation of a public administration which is more responsive to local interests, but on the other hand the efficiency of the fragmented public sector has decreased. Lastly, the integrity of the public sector has been damaged as well. Corruption cases (especially un-revealed and forgiven cases) made the government weak to be a champion of reforms.

Economic and social consequences

As a consequence of the economic recession, the living standards of the population dropped sharply and have not recovered before the turn of the century, a few years after the economy started to recover. Though the living standard had been below the pre-transition level for almost a decade, supply side control was replaced by demand side control, and the system of "dictatorship over needs" by consumer freedom.

Unemployment (an unknown phenomenon in the socialist period) became one of the most difficult social and economic problems. The government could keep the official unemployment rate relatively law offering early retirement packages, which led to a very low employment rate. In Hungary, income benefit programs for families with children foster this trend (which resulted the lowest level of employment in Europe).

A rapid shift in demographic trends took place in most of the transitional countries, which is demonstrated by a decrease of population (fertility, mortality figures), ageing and migration processes. The population is projected to decline in most countries (except Albania); the fertility rates are lower than the reproduction level, the share of older people increases fast. The ageing of the society is taking place at a much lower level of economic development than in the western world. Ageing puts an extra burden on fiscal policies in welfare societies (pension system, health system etc.), creating political tensions around public finance issues even in developed countries. Transition economies will face a lot larger problems, because not only are they poorer than developed countries, but their population is shrinking and the out-migration of young and educated workers slows down the economic growth as well.

During the 90s poverty became one of the most crucial social issues. While the average income decreased, income inequalities increased dramatically in the first part of the 90s, and remained stable over the last decade. For example, in Hungary the ratio of average income in the lowest percentile to the average in the highest percentile increased from 4.6 in 1987 to 7.6 in 2004. The economic recession associated with transition increased regional inequalities in Eastern and Central Europe, as well. In Hungary the net income per capita is 50 percent higher in the most developed region than in the two less-developed regions.

Poverty became a huge problem, which affects 10% of the households even in the accession countries.

The informal economy was estimated to be as large as 25-33 percent of GDP between 1990 and 1999, and informal transactions are still widely accepted today by consumers (VAT tax evasion), employees (as wages are often paid directly into "pocket", 25 percent of all employees are affected), service providers (tax evasion), etc. The existence of the informal economy is a sign of the weak state, and is a cause of inefficient welfare programs on two folds: firstly, tax revenues provide limited resources for the programs (while the tax rate is very high); secondly, the targeting of benefit programs is very poor due to lack of accurate information. Moreover, this fact influences household strategies and it leads to social conflicts generated by the allocation of scarce welfare resources at local level (social exclusion etc.) .

Transformation of the housing system

Privatization and restitution had an important effect on housing systems in transitional countries. Privatization was a typical response to social conflicts during transition ("shock absorber" – R. Struyk). The social rental sector has basically disappeared from most of the transitional countries. It is not clear whether the exceptions (e.g. Czech Republic, Poland, and Russia) represent another model, or it is only that privatization in those countries has a slower pace. Privatization had a regressive social effect: financial gains were proportional to households' wealth, thus low-income households were trapped in the residualized social rental sector and were not able to buy their homes at a discount price. The social rental sector has become a residual sector, which concentrates the most vulnerable groups of the society. The sector is changing in terms of tenure rights, rent regulation and allocation rules, but for political reasons these changes do not seem to move towards a transparent and sustainable system. As a consequence of restitution, a new private rental sector emerged (most significant in Prague), which has become a very conflicting arena between the "windfall" private tenants and private landlords. In most of the countries the owners were successful enough in increasing rent and putting the burden on the tenants and the governments (rent subsidy). (E.g. in Slovenia, Slovakia, Poland and, to a smaller extent, in the Czech Republic).

The state dominated housing finance system collapsed in 1990 and it took 10-15 years for a market based housing mortgage market to develop. The new privatized banking system started lending after 2000, and it grew very fast, indicating that new EU member states are on the path to catch up with the more developed countries of Europe. The development of the mortgage finance system has become important all over the region after 2000. The share of the outstanding mortgage loan to GDP ratio increased substantially. In some of the countries (Estonia, Latvia, and less in Lithuania) the mortgage finance development was influenced by a speculative demand heated by the house price increase. In other countries the growth of the market was fast but it seemed to be more balanced (e.g. in Czech Republic, Hungary, Poland, Slovakia, and Slovenia), and in other countries the development of the market has only started in the past 4 years (Romania and Bulgaria). In most of the countries of the region foreign currency loans have been popular using Euro and the Swiss Franc, e.g. in Croatia, Poland, Romania, and after 2005 in Hungary. The interest rates of loans issued in foreign currency were lower than the loans offered in national currencies, but the exchange rate risk and interest rate risk remained with the households (the related affordability issues became obvious only with the 2008/9 recession, e.g. in Hungary). As a result of these processes, from the beginning of 2000 households' indebtedness has increased very fast in the region. But even the most developed transitional countries are a long way behind EU countries, because in the CEE countries the average share of the outstanding loans to GDP is 7%, while in the EU zone it is 38%. House prices increased, especially in capital cities, and globalization and speculation (fuelled by the newly emerged mortgage markets) led to a housing price bubble in some of the countries.

In almost each country in the region, politics (and housing policy) realized the need for social housing after mass privatization and recovery of the economy. There were several programs aimed at the increase of the social rental sector, but none of them seem to have led to a real break-through in this area. (A frequently quoted good example is the TBS (special housing companies involving also local governments) in Poland, but in Czech Republic, Slovakia, Romania, Hungary and Serbia also there were some programs with interesting, but sometimes questionable results.) The extension of the sector has been typically nominal, but what is more important, the social and financial sustainability of the new social housing stock has been very weak. The pure operation of the sector needed huge subsidies (to bridge the gap between market rent and "social" rent), extensive tenure rights remained, allocation principles were not transparent, down-payment requirement as a pre-condition to enter the sector made an indirect regressive selection among possible tenants, and a number of negative elements (e.g. non-payment, deterioration, etc.) emerged. (One of the main purposes of this workshop is to overview the results of the programs.)

Under the global structural conditions (partly mentioned before) transition countries developed a specific institutional structure for housing, which included different government agencies, private sector organizations (banks, developers, construction companies, etc.) and non-profit institutions. However, the programs and networks based on the cooperation of the different housing sector agencies have not been stabilized, which is the basic reason why it is very difficult to make generalizations with regards to the nature of the new housing regimes. In the adjustment process there are certain important developments in "governance of housing": institutional models for social housing, housing funds at national level, different forms of condominiums, models for housing allowances, housing programs for rehabilitation of high rise housing estates.

Housing cost and income distribution -- affordability 1.

After the transition, as a result of price liberalization, housing related cost has increased much more than household incomes. Because of the privatization and residualisation of the public rental stock, rents are a negligible share of the housing cost. Energy and utility (water services, garbage collection, district heating) prices increased much faster than households' income. The reason for this is partly the price liberalization, but partly the monopoly position of public sector companies and their strong power to represent organisational interest. (The other side of the problem is the weak state, which is not in the position to regulate these companies efficiently.)

The share of housing typically increased from 10% to 20%, but at the same time the income differences increased as well, which raised the need for a housing allowance system. The increasing housing costs put a huge burden on households both in the owner-occupied sector and in the shrinking public sector. As a consequence, a relatively wide share of households is facing the problem of arrears because they cannot cover the fees for water service, district heating, electricity, communal services and – in the public rental sector – the rent. Contrary to western countries, affordability problems till now have largely derived from the increased utility costs. The problem in privatized multi-unit buildings is more serious because the burden of the non-paid utility cost has to be shared among the owners.

Different income benefit programs (including housing allowance programs) were introduced in most of the countries to help low-income households. However, because of limited resources and a lack of institutional capacity, benefit programs could not bridge the increasing gap between housing cost and income. As a consequence, the number of households who had difficulty to pay housing cost increased. At the end of the 1990s, the Hungarian government introduced a special debt consolidation program for households who accumulated arrears. Then inefficiency of the housing allowance programs can be explained by the fact that governments set the eligibility income ceiling too low, which does not guarantee the payment of housing costs for households which have to make special efforts to survive. Households' strategy includes several elements: applying for additional income benefits (using other programs such as childcare benefit, medicine grant, etc.), getting informal jobs, or getting help from the family. However, those who are not able or not willing to take these options end up with accumulated debt.

One of the possible consequences of accumulated arrears is that households have to move to a less valuable home and use their equity to pay back the debt to the utility companies, or, in more and more cases, the utility companies start foreclosure procedures. This type of "downward mobility" was rather new in transition countries, and it is typical for households that could not adjust their housing consumption to their budget constraints.

In Hungary, a special type of crime is closely related to the affordability issue. Households with high utility debts (typically struggling with other social problems as well) are cheated by the so called 'real estate mafia', which offer an inhabitable home (typically in a dead-end village or slum area of a city) in exchange of the apartment with debt. (The registered number of these cases was more than 400 between 2001 and 2003.) These cases are the tips of the iceberg, and the downward mobility contributed to the problem of slumification of remote villages and part of the urban areas.

Housing market and access to housing – affordability 2.

After the collapse of the centrally planned economy the reported P/I ratios in transition countries were very high at the beginning of the 1990s but tended to decrease afterwards. The hypothetical reasons were decreasing demographic pressure, privatization that increased the supply of units on offer, decreasing real income, macroeconomic insecurity and similar factors. As a consequence of these processes, the reported P/I ratio in the second half of the 1990s went to 4-6, a great improvement but still high compared with some market housing systems in developed countries. The number of transactions started to increase at this time – a sign of a healthy housing market – but reported mobility rates remained quite low in comparison with Western countries.

At the end of 1990s, housing prices started to increase again as a consequence of economic stabilization, but other factors played a role in each case. Because the increase in average income was lower than price increases, the increased P/I ratio pointed to an affordability problem. It is not easy to demonstrate this trend as price information is quite unreliable in transition countries. In Hungary the average price increased from 1999 to 2003 by 56 percent in real value.

Housing affordability can be improved either through subsidies or through improving accessibility to mortgage loans. Decreasing interest rates after 2000 have made housing loans more affordable in most of the countries in the region. The decline in interest rates led to an increased demand for housing. However, there was a concern that augmented demand could generate house price increases (and even a house price bubble), which would again worsen affordability. Overall, the case studies provided a contradictory picture in terms of the effects of increased loans on prices:

1. Initial house price increases can be explained by factors exogenous to the housing system, such as saving behavior and macroeconomic changes. Real house price increases made housing investments profitable and generated demand for housing loans. As the housing finance system responded to these demands, house prices increased, and the possibility of a house price bubble disappeared as demand was chocked off.
2. House price increases are a response to economic growth and increased availability of housing loans, where, because of inflexible housing output, supply cannot keep pace with demand. In the case of Slovenia, researchers found a strong

relationship between the volume of loans issued by the National Housing Fund and price increases.

3. Development of house price bubbles in Baltic States was related to the speculative demand for housing without substantial increase of the supply.

Rigid supply could cause price increases, which can control excess demand as in the cases of Poland and Slovenia. However, in Hungary excess demand did not cause a sharp increase in house price inflation.

The housing finance sector revived after the macroeconomic stabilization, and in almost every country the market based housing finance system with different institutional frameworks started to develop. The level of mortgage loans (ratio of the outstanding mortgage loan to GDP) increased but it still lags behind the EU level. The mortgage repayment costs however are very close to those in developed countries, because of the higher interest rate and spread in transitional countries. By 2007, the share of outstanding housing loans to GDP had increased above 10 percent of the GDP in the more developed transitional countries.

The house price increase with flexible mortgage banks led to an extreme increase in outstanding loans in the Baltic States, especially Latvia and Estonia, where the loan to GDP ratio surpasses 30 percent. The share of FX loans, which very much increased the vulnerability of these countries, was typically about 40 percent in 2006, but there were some important exceptions (e.g. Czech Republic). The crisis of 2008 will slow down the development, but financial institutions will continue with mortgage finance in a more prudent way.

The 2008 worldwide economic crisis hit Hungary, which had to take emergency loans from multi-national institutions. The Hungarian currency has fallen about 40 percent against the EUR, which increased the payments for FX loans sharply, and the mass defaults of FX loans have become a real danger. The number of clients in the Central Adverse Credit Database (KHR) increased from 498 thousand to 609 thousand (by 20 percent) in 2008. The number of defaults is expected to increase fast in the year of 2009. The Hungarian housing market did not have a price bubble before the 2008 crisis. Therefore we cannot expect a huge decrease of prices due to the supply shock caused by the increasing number of foreclosed flats on the market. The process of the development path was stopped by the loan crisis of 2008.

The social consequence of the affordability problem in regards to access to housing was the increasing role of intergenerational transfers. This is the only explanation how housing market could exist with so high P/I ratio and low housing affordability index. Sociological survey shows evidences that in housing finance intergeneration transfers (transfers of family savings and inheritance) play an important role. In the case of Hungary, 50 % of the households (recently moved) had help from the family.

Housing market processes contribute to the exclusion process of the disadvantaged social groups, not only of the roma or other ethnic groups, but of low-income groups in general as well. This is the point where the two types of affordability problem connect to each other. Social exclusion by the housing market agents (local governments, banks, developers, etc.) adds to the result of the market exclusion. This is illustrated by cases when urban local governments offer cash grants to roma people in order to move them from their jurisdiction to rural, remote areas. Moreover, there are cases when developers use subsidy programs and build new but very poor quality houses in segregated areas in villages.

Conclusion: toward a new welfare regime?

The social and economic conflicts of the transition coerced governments into introducing changes in the welfare system, as the old soviet type of „social safety net" collapsed and new measures were needed to manage the challenges of the transition. The question is what kind of welfare regimes transitional countries are moving to. Is there a new model that combines the elements of the modern European welfare regimes with the 'socialist tradition'? There is no agreement among researchers whether it is possible to draw any general conclusions related to the development of welfare systems in transition countries. The problem is that public sector reforms (education, health care system, etc.) are unfinished, the measures and institutions in different areas of welfare sectors follow different principles even within one country, and there is a big gap between the rhetoric of programs and their actual implementation. Most of the research is non-conclusive, which is a clear sign of the ongoing conflicting processes in welfare politics. There are too many inconsistencies among the different policy areas to make it possible to put them under the same regime category.

The main trend in CEE countries is that the housing system seems to move towards a housing and welfare regime in which the state (public housing) plays less and less role. Social institutions did not have the capacity and resources to operate an efficient safety net in the new environment (low level of employment and unemployment, informal economy, etc.) and it provided help only to the neediest families (very low income households and in crisis situation). While this seems to be close to a combination of the liberal and "rudimental" welfare regimes, the institutional structure of the welfare regime is still in the process of change.

Our overview of housing affordability showed that the housing sector contributes to the reproduction of social inequality caused by the labor market and the education system both through market processes and institutional mechanisms (deficiencies in the legal framework and the discriminating behavior of the housing market agents). Further research is needed to understand the behavior of the different actors in the housing system with respect to the welfare system, and to explore further what social mechanisms lead to the strengthening or weakening of inequity and conflicts among different groups of society. The major challenge for housing policy in transition countries is to provide institutional assistance to the social groups who have ended up in vulnerable situations because of the structural changes in the economy (privatization and commoditization of public services).

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[i] The presentation is based on research conducted in the EU 7th Framework Program DEMHOW Demographic Change and Housing Wealth (Grant Agreement Number 216865). The paper draws on studies and research MRI has been involved in (Hegedüs and Somogyi, 2005, Hegedüs and Teller, 2005, 2006, 2009, Hegedüs and Struyk, 2005, Hegedüs, 2007, 2008). Hegedüs, J. (2008): Will the social rental sector emerge as a pillar of the social welfare system in transitional countries? Presentation at the workshop on "Options and Perspectives of Social Rental Housing in the Central and East European Region" Budapest, 6-7 October, 2008; Hegedüs, J. and Teller, N. (2005) 'Development of the housing allowance programs in Hungary in the context of CEE transitional countries', In: *European Journal of Housing Policy*, 5(2): 187–209; Hegedüs, J. and Teller, N. (2009) 'Past and future development in public policies towards homeownership and the use of housing wealth, The Case of Hungary', manuscript DEMHOW Demographic Change and Housing Wealth (EU 7th Framework Program, Grant Agreement Number 216865) February, 2009; Hegedüs, J. and Struyk, R. (2005) 'Divergences and Convergences in Restructuring Housing Finance in Transition Countries', Hegedüs, J. and Struyk, R.J. (ed.) *Housing Finance: New and Old Models in Central Europe, Russia and Kazakhstan* LGI Books, Open Society Institute, 2005, pp. 3-41; Hegedüs, J. and Somogyi, E. (2005) Evaluation of the Hungarian Mortgage Program 2000-2004, Hegedüs, J. and Struyk, R.J. (ed.) Housing Finance: New and Old Models in Central Europe, Russia and Kazakhstan LGI Books, Open Society Institute, 2005 pp 177-208; Hegedüs, J. and Teller, N. (2006): Managing risk in new housing regimes of the transition countries (The case of Hungary) in: Doling J and Elsinga M (eds) (2006) Home Ownership: Getting In, Getting From, Getting Out, Part II, IOS Press: Amsterdam, (175-200 pp); Hegedüs J. (2007): Social Housing in Transition Countries, edited: C. Whitehead and K. Scalon) LSE (London School of Economics), 2007, pp 165-178