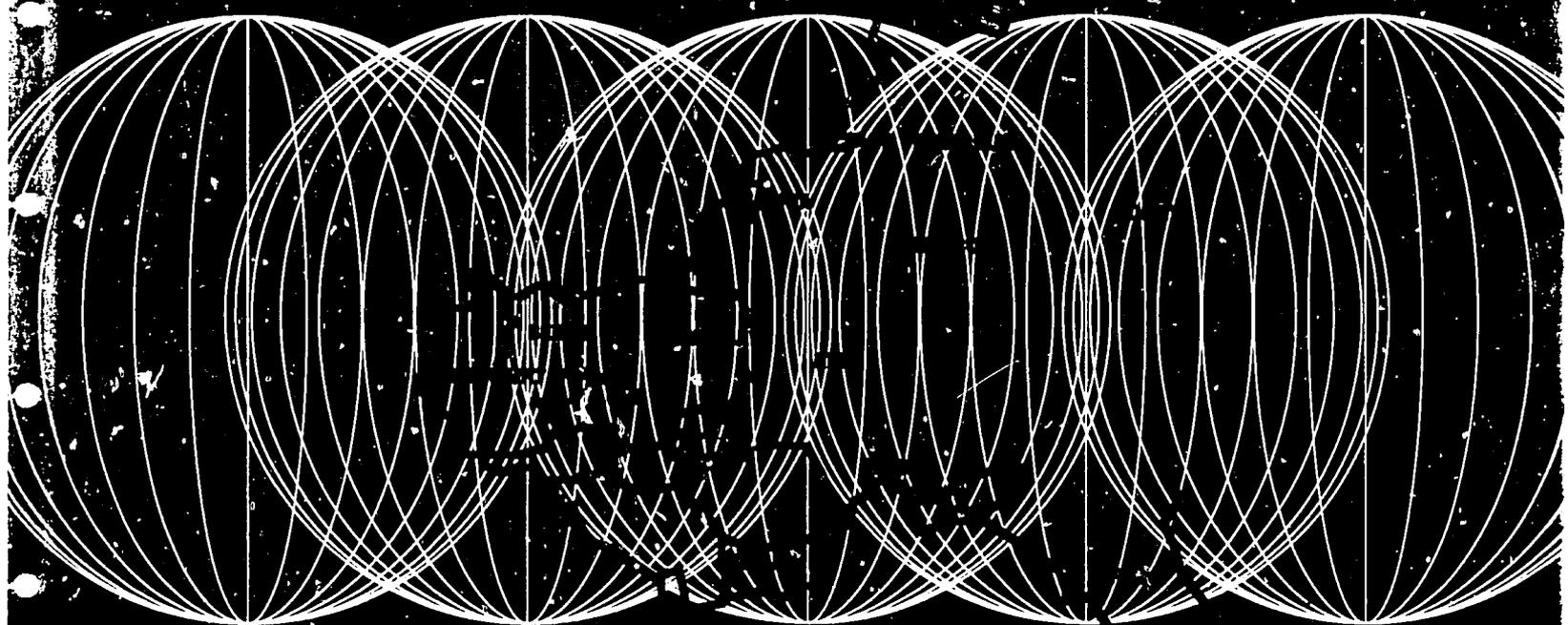
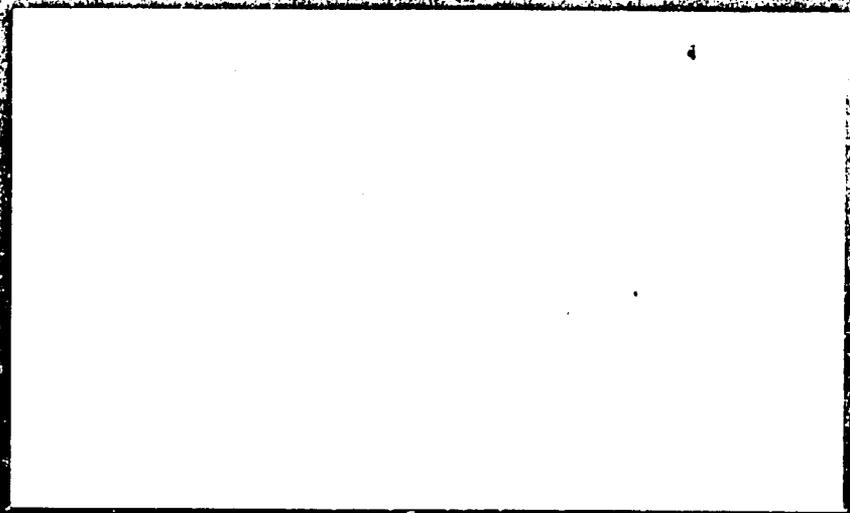


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AN INTERNATIONAL ACTIVITIES PROJECT

**FROM PLANNING TO MARKETS
HOUSING IN EASTERN EUROPE**



THE URBAN INSTITUTE

Prepared for the Office of Housing and Urban Programs (USAID)

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**POLAND'S COOPERATIVE
AND STATE-ENTERPRISE HOUSING:
OPTIONS FOR PRIVATIZATION**

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EXECUTIVE SUMMARY

INTRODUCTION

This report presents the findings and conclusions of a two-week advisory mission to Poland, February 17-28, 1992. As requested by Poland's Ministry of Spatial Environment and Construction (MOSEC), the major purposes of the mission were: (1) to examine alternative strategies for privatizing the nation's cooperative and state-enterprise housing stock; and (2) to outline an approach for designing and implementing a detailed strategy for these sub-sectors.

The analysis is based on a series of interviews with national level housing experts, managers of cooperative and state-enterprise housing, and local government officials, as well as information drawn from a rapidly growing body of documentation on Polish housing (see list of references in Annex A).

Section 1 presents an overview of Poland's housing problems, and the progress of its housing reform process to date. Section 2 describes the review of alternative strategies and Section 3 presents the suggested approach to more detailed design and implementation. The paragraphs below summarize the major conclusions.

PRIVATIZATION: WHY AND HOW?

Both the quality of Poland's existing housing and the volume of new housing it has been able to produce have declined markedly over the past decade. Yet, the per unit share of national income consumed by Polish housing has been among the highest in the world. Tenants pay an extremely small share of their incomes for rent, and massive subsidies are required to cover operating costs. It is now generally accepted that this inefficiency was caused by the institutional arrangements of the housing sector during the communist era: large, monolithic institutions, responsible for both housing

production and management, that had no incentives to work efficiently or to be responsive to the needs of households, and a legislative environment that stifled private initiatives.

Current policies call for a sharp break with the past and rapid movement toward a market-oriented housing system. A major theme is *privatization*: breaking down or eliminating the old bureaucracies and replacing them with smaller institutions (normally private individuals and firms as owners, producers, managers) forced to be both responsive and efficient by the pressures of competition.

While the goal is clear, there is much less consensus about the best path for achieving it. In government-owned (communal) housing, for example, there are good reasons why this change cannot be implemented immediately. First, rent controls and unreasonably strong tenant rights still make housing an unattractive investment for private entrepreneurs. Second, the approach of transferring ownership to the present occupants of multi-unit structures is frustrated by the fact that many of them could not now afford to pay the costs associated with ownership. The alternative of giving units to occupants at no cost (or well below market value) across the board would create major inequities, and would deny local governments an important potential source of revenue. The key is to design a process of transition that achieves privatization as rapidly as possible without creating major political or economic instabilities along the way.

STRATEGIES

It is likely that the transformation of the communal sector represents Poland's highest social priority in housing. Nonetheless, privatization of cooperative and state-enterprise housing may be easier to achieve. Expediting the processes in these sectors would promote efficiency in the housing system overall and indirectly (though importantly) ease pressures in communal housing.

Major Recommendations

Before suggesting options for these subsectors, we offer two major recommendations. They should be comparatively uncontroversial, but they are essential prerequisites for privatization of all components of the housing stock.

1. *Enact Condominium Enabling Legislation.* The condominium is one of the most popular forms of tenure for multi-unit developments in western democracies, but it does not yet exist in Poland. Condominium residents receive independent title to their own unit and can sell it without approval from any governing body. They can also independently secure mortgages from private lenders on attractive terms (since they can more easily foreclose, lenders see condominiums as less risky than cooperatives). A law

should be adopted that permits this form in Poland and removes restrictions that would unduly prevent families from converting to it.

2. *Implement a Properly Designed Housing Allowance Program.* A basic principle of reform is that housing residents should eventually pay the full costs of operating and maintaining their units. The public should not be disturbed when rents go up for wealthy households that have received substantial housing subsidies in the past, but there is a legitimate concern about rent increases for poor families who cannot afford them. The housing allowance approach addresses this concern directly by providing limited assistance only for the poor, through a formula by which subsidy payments decline automatically when household incomes increase. A basic program of this type has been established by the Ministry of Labor and Social Affairs. High priority should be given to (a) adjusting the subsidy formula as may be needed to assure proper incentives and controls, and (b) building the administrative capacity to implement the program effectively (including quality control to assure that household incomes are reported accurately). Analysis of a similar program in Czechoslovakia indicated that, even under pessimistic assumption about unemployment, the full cost of housing allowances would be less than one-fifth the amount the government now spends on operating subsidies.

Options for Cooperative and State-Enterprise Housing

The analysis possible in this mission was not adequate to support definite prescriptions for these subsectors, but it did suggest options that may be feasible:

1. *Cooperative Housing.* The option to be tested here focuses on the larger cooperatives (say, over 1,000 units). Smaller cooperatives seem to be comparatively efficient in their management and responsiveness to tenants--given scarce resources to implement reforms, it might make sense to exclude them from compulsory changes and just let them convert to condominium status when they desire to do so. The larger cooperatives, however, are a different matter. Because of their inefficiencies and restrictions on democratic action, it may be reasonable to force their division into smaller condominium units. This would be implemented by appointing an independent and professional Privatization Administrator for each large coop who would draw up a plan for the division of both housing and non-housing assets. Residents (in comparatively small groups) would vote to either accept or reject condominium status after being fully informed of the implications of the plan.

2. *State-Enterprises.* State-enterprises have strong incentives (1) to withdraw from the obligation of providing housing and other social services to their employees (so they can concentrate on transforming themselves into private ventures that will operate and generate employment successfully in a highly competitive international market); but (2) to do so in a manner that will not place unreasonable burdens on the residents of their housing (they would face substantial labor problems if they took any other course).

Once a condominium law and housing allowance program is in place, it should be possible to immediately remove rent controls and permit term leases (with evictions for non-performance) in this component of the stock. The enterprise staff should then be able to devise their own privatization strategies to fit the circumstances at hand. Tenants would be allowed to purchase housing (condominium form) at prices in the range of today's GMINA appraised values (i.e., still considerably below market) under a seller financing arrangement with the enterprise. Some buildings might then be purchased as a whole by private firms to operate as rentals. Others might be retained by the enterprise or transferred to the GMINAs.

DESIGNING THE TRANSITION

Short Term Program

Six projects are recommended in the short term to test the feasibility of the options suggested above and design a more detailed strategy. Each would require external technical assistance.

1. *Preparing the Condominium Law*--work with Polish lawyers to translate the condominium concept into a form compatible with Polish law and present it to parliament.

2. *Analysis of Income and Housing Expenditures by Housing Type*--using computer data files to provide information that will permit the estimation of impacts of different privatization alternatives (and housing allowance programs) by income level within housing types.

3. *Testing the Privatization Potentials of Large Cooperatives*--for two to four large coops with varying characteristics, collecting data on financial, physical, income attitudinal and other characteristics and devising and testing alternative privatization scenarios--then drawing implications for a national program.

4. *Testing Privatization Potentials for State-Enterprise Housing*--analysis similar to that in project 3 for state-enterprises.

5. *Strategic, Legislative, and Implementation Planning for the Privatization of Cooperative and State-Enterprise Housing*--more definite planning based on the results of the other projects noted above.

Longer Term Technical Assistance and Training

There is substantial demand in Poland for training in modern (business oriented) techniques for housing privatization and management beyond the needs of implementing

the privatization strategies outlined above. To meet this demand, the rapid development of indigenous technical assistance and training capacity (several new institutes or firms is proposed) is a priority. These institutes would provide seminars but would also work directly with GMINAs and cooperatives, providing handbooks on techniques and installing computer software (modeled after approaches already in development by USAID for Eastern Europe). Clients should be willing to pay for these services and the program should become financially self-sustaining in a comparatively short period of time.

Section 1

**HOUSING PROBLEMS AND THE
HOUSING REFORM PROCESS**

HOUSING PROBLEMS

The most pronounced characteristic of Poland's housing system under the communist regime was its *inefficiency*. Year by year, the 1980s saw marked declines in both the quality of existing housing and the volume of new housing produced. Yet, the per unit share of national income consumed by Polish housing was among the highest in the world. In 1985, state expenditures for housing represented 34 percent of all household subsidies, 13 percent of government outlays, and 3 percent of GNP. The equivalent of a market price for a new 50 square meter flat then ranged from 12 to 24 times annual income at the average wage (compared to ratios of less than 3, typical in countries like France and the United States). The average construction period in Poland's social sector was 27 months (compared to 9-12 then typical in Western Europe) (World Bank, 1990).

Private Family Housing

About 40 percent of the nation's 11.2 million unit housing stock remains in the ownership of private families. Almost two-thirds (64 percent) of this housing is located in rural areas (Table 1.1). While there are imperfections, this subsector operates in reasonably good condition and in a self-sustaining manner. It is now generally accepted that institutional arrangements in three other subsectors, owned or controlled by the state (the remaining 60 percent), were the cause of the inefficiency.

Table 1.1
POLISH HOUSING STOCK

	Total	Rental Communal	Ent.	Coop.	Priv Family
TOTAL HOUSING UNITS (in thousands)					
1988	10,717	2,078	1,356	2,606	4,678
1991	11,200	2,400	1,300	2,900	4,600
1988 HOUSING (in percent)					
By Location					
Urban	65.69	94.00	61.25	99.26	35.70
Rural	34.31	6.00	38.75	0.74	64.30
Total	100.00	100.00	100.00	100.00	100.00
By Year Constructed					
Before 1945	30.50	49.90	28.50	0.90	38.90
1945-1970	31.80	39.00	28.10	22.50	34.90
After 1970	37.70	11.10	43.40	76.60	26.20
Total	100.00	100.00	100.00	100.00	100.00

Communal Housing

Communal housing (2.4 million units, 21 percent of the total stock) is made up of older apartment buildings confiscated from private owners in the late 1940s (about half) and additional flats (mostly concrete panel construction) built and managed by the government since then. It exists mostly in cities and towns (94 percent). After 1961, the state attempted to limit the occupancy of communal units to lower-income households, and the communal share of the total stock has declined since then. Only 11 percent of all 1988 communal units were built after 1970.

The condition of communal housing is low: e.g., only 47 percent of the units in 1988 had central heating and separate bathrooms. Rents are strictly controlled--they represent a much smaller share of household income than is typically spent by tenants

in western economies. Rents in the aggregate are much below that needed to cover even current government outlays for operation and maintenance (O&M) which, in turn, are well below that needed to bring this housing into standard condition and keep it there. It has been estimated that share of total O&M outlays covered by tenant rents and fees dropped from 37 percent in 1981 to 15 percent in 1989 (Matras, 1991): (See further analysis of conditions, economics, and prospects for communal housing in Merrill et al., 1991.)

State-Enterprise Housing

State-enterprise housing accounts for 1.3 million units (12 percent of the stock). This is housing that was built or secured by state owned enterprises to house their employees. It is relatively new (43 percent built since 1970) and is mainly urban, although a significant share (39 percent) is located in the countryside. Comparatively little research has been done on characteristics of this subsector, although it generally thought to be of somewhat better condition and have somewhat higher-income residents than communal housing. Nonetheless, it functions under the same rent controls, thus also draws down enormous subsidies.

Cooperative Housing

Cooperative housing (2.9 million units, 26 percent of the total) is of considerably higher quality than the communal stock (93 percent of the 1988 coop units had central heating and separate bathrooms) and its residents also have higher incomes. Early cooperatives operated with considerable independence, but with the policy to limit occupancy in communal housing after 1961, the state took control of this subsector and made it Poland's primary vehicle for new housing production (77 percent of all current coop units were built after 1970). Virtually all coop units are in urban areas. Amounts households have had to pay for cooperative units are clearly less than full costs, but subsidies for O&M costs in this subsector have generally been negligible. (See further discussion in Section 2, as well as Matras, 1990, and Hermanson, 1990.)

Housing Production and the Housing Shortage

Poland's housing production in the communist era peaked in the late 1970s but declined precipitously during the 1980s. In 1989, for example, only 141,000 new units were completed while 10,000 were demolished or withdrawn for other reasons (Table 1.2). The net increases in the stock were extremely small: 1.5 percent in the social sector and 0.9 percent in the private sector. Overall, the units added (average of 76 square meters) were larger than those withdrawn (46 square meters), but the net addition still must be viewed as negligible in relation to the need.

The cumulative effect of rigidities that prevent adaptive use of the existing stock and these declines in new production has left Poland with a severe housing shortage.

Table 1.2
CHANGES OCCUPIED HOUSING STOCK, 1989

	Start Year	New const.	Stock losses	End year
TOTAL HOUSING STOCK				
Housing units (000)				
Urban	7,086	103	5	7,183
Rural	3,682	38	4	3,715
Total	10,764	141	10	10,899
Floor space (m2 000)				
m2/unit	59	76	46	59
SOCIAL SECTOR 1/				
Housing units (000)				
Urban	5,405	85	4	5,486
Rural	681	9	1	690
Total	6,086	94	4	6,176
Floor space (m2 000)				
m2/unit	48	60	41	48
PRIVATE SECTOR 2/				
Housing units (000)				
Urban	1,681	18	2	1,697
Rural	3,000	29	4	3,025
Total	4,681	47	5	4,722
Floor space (m2 000)				
m2/unit	73	108	49	74

1/Social sector: state, cooperative, and enterprise stock

2/ Private sector: privately own and private rental stock
in disposition of local authorities (rent-controlled)

Most households live with an average of more than one person per room; at least 20 percent have less than 10 square meters of useable space per person. The vacancy rate is negligible and it is common that three generations in a family live in the same unit. Housing waiting lists of 15 years are common in large cities and, because the market is so tight, there is now very little turnover in existing units. (World Bank, 1990.)

THE REFORM AGENDA TO DATE

Since 1989, Poland's government has strongly endorsed a market orientation in housing, as it has in the rest of the economy. It has recognized that the central problem has been the large and monopolistic bureaucracies that produced and managed state-owned and controlled housing and faced no real sanctions for inefficiency or unresponsiveness to residents.

It has favored a transition that implicitly links personal freedom to personal responsibility. Residents should be free to choose the type of housing and location that best suits them, but there should be strong incentives to prevent overconsumption. While there should be a safety net to protect the poor, most individual households should pay the full costs of the housing (as well as other goods and services) they receive.

The most important institutional reforms so far consistent with these themes have been the transfer of the ownership of all communal housing from the central bureaucracies to elected local governments (GMINAs) in May 1990, and the January 1990 act dissolving the central cooperative associations and facilitating the division of large cooperatives into smaller units. Initial rent increases in controlled units have also been implemented (the base rent of 300 zl per square meter was increased to 600 zl in February 1991 and another doubling to 1,200 zl was announced in February 1992--Matras, 1991).

Increases in rent are the highest priority in making this housing self-sustaining, and Poland has also taken a step that is essential to making further increases viable: establishing the framework for a basic *housing allowance program* to be administered by the Ministry of Labor and Social Affairs. The public at large will hardly be disturbed when rents go up for wealthier families that have received substantial housing subsidies in the past. There is a legitimate concern, however, about rent increases for poor families who cannot afford them. The housing allowance approach addresses this concern directly by providing limited assistance only for the poor through a formula by which subsidy payments decline automatically when household incomes increase.

In addition, legislation has been proposed that would offer broader reforms including reasonable limits on the present, virtually unrestricted, system of tenants rights, the eventual abolition of central rent control, and a number of measures to spur

private housing production and finance. (It must be noted, however, that the timetable for passage of a number of these reforms appears far from certain.)

Section 2

STRATEGIC OPTIONS

TENSIONS IN PRIVATIZATION

The reform process implicitly recognizes private ownership and operation of almost all of the housing stock as an eventual goal. The extremely high current costs of producing and operating Polish housing can only be brought into a more affordable range by transferring responsibility away from large public institutions that do not have incentives for efficiency to smaller competitive entities that do.

There are, however, good reasons why this change cannot be implemented immediately. First, rent controls and unreasonably strong tenant rights still make housing an unattractive investment for private entrepreneurs--serious market-oriented incentives for private rental housing will not exist until presently contemplated reforms in these areas are enacted. Second, the approach of transferring ownership to the present occupants of multi-unit structures is frustrated by the fact that many of them could not now afford to pay either full market value to acquire their units or rent levels needed to cover the full costs of subsequent O&M.

The alternative of giving units to occupants at no cost (or well below market value) across the board could create major inequities, and would rob local governments of an extremely important potential source of revenue (see further discussion in Katsura and Struyk, 1991). The key is to design a process of transition that achieves privatization as rapidly as possible without creating major political or economic instabilities along the way.

MAJOR RECOMMENDATIONS

Because of its poorer condition and concentration of lower-income households, it is likely that the transformation of the communal sector represents Poland's highest social priority in housing. Nonetheless, privatization of cooperative and state-enterprise housing may be easier to achieve. Expediting the processes in these sectors would promote efficiency in the housing system overall and indirectly (though importantly) ease pressures in communal housing.

In this context, what are the appropriate paths for the privatization of cooperative and state-enterprise subsectors? The analysis possible in this mission was not adequate to support definite prescriptions, but it did suggest options that appear attractive and might be implementable after further testing. These are described later in this Section. First, however, we present two major recommendations that are essential for privatization in all subsectors and should be broadly acceptable immediately without great risk or controversy.

1. Enact Condominium Enabling Legislation

The first is to enact legislation to create an attractive form of private ownership for multi-unit developments that does not yet exist in Poland: the *condominium*. In cooperatives, residents only own a share of the assets of the organization as a whole. In condominiums, residents receive independent title to their own unit, clearly defined in space. They can freely sell their unit without approval from any governing body. Condominium purchasers can also independently take on a private mortgage to finance the acquisition of their units, and this is a major advantage of this form.

Private financing for condominiums is generally easier to obtain than it is for cooperatives (and on better terms) because there is much less risk for the lender. If the individual family in a condominium does not make its required mortgage payments, the lender can foreclose and take over ownership of that particular unit. This also protects the other residents of a condominium--if one resident defaults, there is no effect on the financial position of the building overall. In cooperatives, by way of contrast, it is the cooperative entity as a whole that must make the mortgage payments. When a few residents default on their payments, the whole entity is threatened. Lenders see much greater risk in getting their money back when the whole cooperative has financial problems.

Condominium owners (commercial as well as residential) own a share of the public spaces and other assets of the development, usually in proportion to the amount of floor space in their own units. They form a Condominium Association with voting rights in proportion to ownership shares. Most often, they contract with a private firm to handle O&M (contractors know that the Association is free to fire them and hire another firm if their performance is inadequate).

Enacting a condominium enabling law by itself would not force any family to change their tenure status. But it would allow them to do so if they choose (and the incentives are such that many are likely to find this form attractive). The law should explicitly eliminate any legal barriers that would prevent families from making this change if they consider it in their best interests. (Suggested contents for condominium enabling legislation for Poland, based on experience in a number of countries, are provided in Annex B.)

2. Implement a Properly Designed Housing Allowance Program

The existence of an effective housing allowance program to protect the poor is essential to the decontrol of rents. The program now established by the Ministry of Labor and Social Affairs is a positive step, but improvements are needed. First, the formula should be adjusted to provide realistic incentives. Under the present formula, the subsidy payment makes up the difference between the full rent and 8 percent of the tenant's income regardless of the level of the rent. In a proper housing allowance program, a standard rent is set (based on reasonable costs to operate a modest unit) and the subsidy covers the gap only between a reasonable fraction of tenant income and that standard. This is an important difference that discourages overconsumption and puts sensible limits on total subsidy outlays.

Second, the program is now quite small and not well publicized. Administrative capacity building is a high priority to enable it to efficiently and effectively handle the substantial growth in workloads that it is likely to face over the next few years. Important in this is an adequate quality control procedure to assure that data on applicant incomes (used as the basis for the assistance formula) will be accurate.

It is natural for government to question the full-scale implementation of a program of this type, given that it is already making enormous subsidy payments for housing. An analysis was recently conducted, however, for a similar program in Czechoslovakia using fairly reliable information on household income distributions in different types of housing. Even under pessimistic assumptions about growing unemployment, the analysis showed that if the government were to increase rents in communal housing to their full market levels and provide subsidies to cover the gap between those rents and 15 percent of tenant incomes, the total cost would be around Kcs 1 billion per year. This would permit the government to reduce its total subsidy outlay for communal housing by about 80 percent; i.e., the net operating subsidy for communal housing over the past few years has been in the neighborhood of Kcs 5 billion (Telgarsky et al., 1992).

OPTIONS FOR COOPERATIVE HOUSING

One obvious approach for this subsector would be to enact compulsory legislation requiring the short-term transformation of all cooperatives to condominium status

(Czechoslovakia passed a law doing exactly that in January 1992). Information obtained during this mission, however, suggests on balance that so drastic a measure may not be necessary in Poland. In 1989, there were 4,021 cooperatives nation-wide: a large number of small entities and a comparatively small number of very large cooperatives that retain many of the problems of coop administration in the communist era. A possible strategy might be to differentiate between these types.

Small Cooperatives: Voluntary Conversion

Smaller cooperatives (perhaps those with memberships under 1,000 households) now operate in a manner that approximates private activity. Members with "owner" status are comparatively free to sell their units for market prices and management units are small enough to encourage responsiveness to resident demands. The administrative costs of compulsory transformation to condominium status for them (given the large number involved) would be high. For these cooperatives, it may be enough to enact the condominium enabling law, inform the residents about this option, and encourage (not require) them to convert when and if they feel it is appropriate to do so.

Large Cooperatives: Compulsory Division

Although steps have been taken to begin to break up some of the larger cooperatives under the January 1990 law, progress has been slow. It appears that new legislation to expedite the process, and link it to the condominium approach, might be warranted and feasible. The diversity of physical circumstances, and non-housing asset holdings, among such cooperatives, however, defies any simple formula approach. The law might require something like the following:

1. An independent and professional Privatization Administrator would be appointed for each cooperative larger than the specified threshold size (1,000 units was suggested above, but further study would be needed to select the most appropriate level) and given six months to develop a plan for its division. The Administrator would be guided by principles of sound financial and institutional management, but would also seek advice and information from cooperative members in the process of his work.

2. The plan would specify the division of the existing cooperative into a number of legally distinct condominium entities, each smaller than the threshold size. Normally, a resulting entity would consist of one building, or a geographically contiguous group of buildings, selected so that commonality of interests and management efficiency would be enhanced.

3. The proposal would include a definite plan for the division and future operation of non-housing assets (e.g., commercial space, central heating plants) designed to achieve allocative equity and efficiency in sustained operation. In some cases, for example, it might be that new condominiums with potentially lucrative commercial space

would be required to give up-front grants to compensate those that had no commercial space. In others, a new commercial space management corporation might be set up that would share profits equitably across several of the new condominiums. A broad variety of options is possible and the Privatization Administrator would be charged with designing the best approach to fit the situation at hand.

4. When the plan is complete, a series of education sessions would be held with the cooperative members in each of the newly designated subunits. They would be informed about the basic rights, responsibilities, and successful operating techniques of condominiums as well as about the specifics of the plan for the division of the cooperative as a whole.

5. The Administrator would then revise the plan if necessary (based on comments in these sessions), and submit it for a vote of the full membership of the cooperative. The plan would be implemented unless more than half the members vote to reject it.

Ground Rules for all Cooperatives

Successful transformation in the cooperative sector will require clear reinforcement at the outset (through setting examples and other actions as appropriate) of three basic ground rules that have already been accepted by government: (1) that no further government subsidy will be provided to cover any portion of O&M costs or any other liabilities; (2) that arrears in debt service payments to PKO will not be tolerated (when arrears reach a specified threshold level, PKO should have the power to dissolve the cooperative board, reallocate assets according to reasonable practice, and evict residents unwilling to meet their financial obligations); and (3) that housing allowance payments will be available only to the poor, on an income-adjusting formula basis as discussed above.

OPTIONS FOR STATE-ENTERPRISE HOUSING

Incentives of State-Enterprises

State-enterprises now themselves face the need to privatize. In the past, the housing they owned for their employees was a valuable asset, but it has since become a major burden. One enterprise interviewed on this mission, spent about 5.5 million zl per unit to operate and maintain its housing in 1991, but received only 2.2 million zl per unit in tenant rents and other revenues. The annual housing subsidy it had to provide was almost equal to its total monthly payroll. (It also estimates that, on average, an additional 14.2 million zl per unit should have been spent last year for repairs to bring its housing stock up to standard condition.)

A foreign investor is considering a possible joint venture with this enterprise and enterprise management is very much concerned that the deal will fall through, primarily because of the continuing housing liability that must appear on its books. State-enterprise housing is, therefore, more than a housing problem. It could stand in the way of enterprise privatization and have a far from trivial impact in slowing down Poland's economic recovery.

It seems highly unlikely, however, that state-enterprises would dispose of their housing in an irresponsible manner if given a free hand. Of the housing units owned by the example firm noted above, 37.5 percent are occupied by its employees, another 37.5 percent are occupied by former employees (now pensioners), and the remaining 25 percent are occupied by non-employees they were forced to house by the former communist regime. If the enterprise arbitrarily stopped the maintenance and operation of its housing stock, it would obviously face substantial labor unrest. State-enterprises have strong, natural incentives: (1) remove themselves from the obligation of providing housing and other social services to their employees (so they can concentrate on transforming themselves into private ventures that will operate and generate employment successfully in a highly competitive international market); but (2) to do so in a manner that will not place unreasonable burdens on their employees and former employees.

Strategic Options

Again, the option of a law that immediately transferred this housing into private ownership could create serious disruptions. Because of both their incentives and their capacity, it would seem to make more sense to let the enterprises themselves devise and implement privatization plans for their own housing (and housing related assets) in a phased manner (i.e., there is no need for any outside Privatization Administrator to chart the course). Government should take actions to facilitate this process and provide overall control to avoid abuses.

The most important requirements would be the assurance of a housing allowance program to protect the poor and the passage of the condominium enabling law. Once these are in place, it should be possible immediately to (1) eliminate rent controls on state-enterprise housing (poor families would be protected via housing allowances) (2) permit the creation of term lease agreements (the enterprise would be permitted to evict a tenant without providing substitute housing at the end of the specified term, or earlier where the tenant fails to pay the specified rent or otherwise violates the terms of the agreement--a reasonable tenant appeals process should, of course, also be provided for). Laws passed to transform this housing should also assure clear title to the enterprise (i.e., they would have no residual obligation to repay the national treasury for any net income they earn from housing privatization, even though subsidies may have been provided from the state budget indirectly in the past).

What would the state-enterprises do in this environment? The example enterprise noted above states that 44 percent of its present tenants have indicated they would like to purchase their units? The book value of these units averages 1.0 million zl per square meter. The present official appraisal methods used by the GMINA would yield values in the range of 1.2 to 1.5 million zl per square meter. Unconstrained appraisals conducted for the enterprise shows that true market values are in the range of 5 to 10 million zl per square meter. The enterprise indicated it would sell as many units to these tenants as possible (condominium basis) at rates close to those of the GMINA appraisals and would provide seller financing on reasonable terms. The tenants could not afford full market values and the enterprise sees itself as much better off by trading its current O&M subsidy liability for a positive cash flow, even if small.)

Buildings not sold to the residents would be retained as rentals, but they would be in much healthier financial status--the combination of tenant rents and housing allowance would cover O&M costs in full. In these circumstances, the enterprises might well be able to sell some of these buildings (as a whole) to private owners. The enterprise already contracts out management and maintenance work to a local cooperative, and it would probably continue to do so for any buildings it is unable to sell. At worst, the ownership of some of the buildings might have to be turned over to the GMINA, but that is surely what would happen anyway if the enterprise itself was forced out of business.

ISSUES RELATED TO RECORDING TITLES AND LAND OWNERSHIP

Two additional questions affect privatization in both of the subsectors discussed above: (1) How can the large volume of title transfer and creation transactions associated with condominium conversions best be handled given presently limited administrative capacity?; (2) How should the transfer of ownership be handled when the housing is located on land under a perpetual ground lease from government.

Processing Title Transactions. In the communist era, records of property ownership were maintained and updated by notaries who were employees of the state. Since then, the notaries have been privatized and the task of keeping the official records has been given to the courts. Given that the records are not automated and the courts administrative capacity is extremely limited, it would be difficult indeed to process a large volume of condominium transactions through this system without major reforms.

Fortunately, a new piece of legislation called the *Charges Act* has been proposed that would create an alternative system for recording the ownership of both real and personal property. Major processing functions would still be performed by the notaries--a group that, now that they are private professionals, should be relatively easy to expand through efficient training and certification programs. The official records, however, would be maintained by a new office at the local level (probably GMINA) rather than the courts. It should be possible to establish a streamlined computerized database approach to this

function from the start; i.e., it would be much easier to begin a new system in this way than to first have to reform the processes in the courts.

Conversions on Land Under Perpetual Lease. Many cooperative and state-enterprise developments now occupy land under a perpetual lease rather than under full ownership. There is no reason that this circumstance should constrain privatization. Cooperative units are now bought and sold freely under such arrangements. No doubt the market value of a unit on perpetual lease land is somewhat lower than if the cooperative owned the land outright, but the difference in the security of tenure offered does not appear to be viewed as substantial. Nonetheless, many condominiums on such land are likely to want to attain clearer title. Accordingly, an instrument should probably be designed to facilitate conversion to full ownership under what is, in effect, a GMINA seller-financing arrangement.

For example, title would be formally changed, based on the condominium's agreement to make regular amortization payments to the GMINA over, perhaps, a 20 year period. The amount of the loan would be based on the appraised market value of the difference between the two forms of tenure.

INEFFICIENCIES IN THE PROVISION OF UTILITIES

Utilities (ranging from the provision of heat and hot water to the collection of solid wastes) have grown as a percentage of operating costs for all housing over the past few years. Even with the privatization of housing itself, efficiency in the system over all will remain elusive unless reforms in utility systems serving housing are also implemented. In some cases, the solutions may not be difficult, but will require political will. For example, interviews noted cases where a cooperative could save money by contracting out solid waste collection to private firms, but such firms remain at a competitive disadvantage because government collection agencies retain the sole right to dispose of wastes at local sanitary land fill sites. In these cases, the rules need to be changed to encourage open competition.

The case of the production and distribution of heat from central plants is an example of a much more complicated arrangement. Undermaintenance and inadequate original technology (e.g., permitting substantial heat loss in transmission) represent one type of inefficiency. Another, arises from institutional monopoly in service provision.

Regardless of differences in characteristics, inefficiencies in utilities warrant high priority for analysis and solution.

Section 3

**DESIGNING/IMPLEMENTING
THE TRANSITION**

THE SHORT TERM PROGRAM

Six steps are suggested in designing a detailed strategy along the lines suggested above, and initiating its implementation.

1. *Preparing the Condominium Law*

The principles of the condominium concept as it might be applied in Poland were discussed in Section 2 and possible language for sections of a draft law are presented in Annex B. These materials, however, are only suggestive. As a next step, one or more distinguished Polish attorneys should be asked to review them and develop a draft condominium law that would be fully consistent with the legal framework of Poland. Normal reviews by the groups affected would then be conducted. After appropriate review and revision, MOSEC (and/or others) would present the draft for submission to parliament.

2. *Analysis of Income and Housing Expenditures by Housing Type*

The approach taken in this review was based on very limited data (in some cases rough assumptions) about household income distributions and housing expenditures in the four major subsectors of the Polish housing stock. However, a more exact understanding of income and expenditure classes is necessary for reliable estimates of the likely impacts of policy options--particularly those specific to the cooperative and

state-enterprise subsectors. Regular sample household surveys of the Central Statistical Office (GSU) may contain the necessary data, but they have not been tabulated in this way (i.e., separately for each housing subsector). An analysis along these lines is warranted. This analysis could easily be expanded to simulate housing allowance and other housing subsidy implications of alternative scenarios about future income change and rent increases (software, developed for a similar study in Czechoslovakia, already exists). If preliminary analysis of the computer files indicates that the requisite data are available, this analysis should be given high priority.

3. Detailed Analysis and Recommendations as to Privatization Potentials of Large Cooperatives

This work would entail selecting two or three large cooperatives with contrasting characteristics and, in effect, doing the types of analysis and planning required of the Privatization Administrator in the approach suggested above. This would require the assembly of data on income and other characteristics of residents, the characteristics of housing units, budgets and other information on cooperative management, and location plans and financial and other information on non-housing assets, such as central heating facilities. Surveys of residents, combined with other data would permit analysis of the housing desires of current residents and both their ability and willingness to pay to purchase their units and cover recurring O&M costs. The results could be used as the basis for workout plans for the cooperatives studied but would also offer substantial guidance on the preparing implementation strategies for the broader program.

4. Detailed Analysis and Recommendations as to Privatization Potentials for State-Enterprise Housing

This work would be similar to that described above for cooperatives. It would focus on two to three state-enterprise housing estates and lead to the development of draft privatization strategies for those estates as well as guidance for the broader program.

5. Designing Strategy/Legislation for the Privatization of Cooperative and State-Enterprise Housing

The step under this task would be to evaluate findings and progress under each of the tasks above to establish a feasible privatization strategy for these subsectors (including full analysis of costs). The next step would be to develop full plans for its implementation including, for example, the drafting of laws and implementing of regulations (and watching over their progress through the approval process), and the planning of the logistics of implementation (e.g., budgeting for, selecting, training, assigning, and deploying Privatization Administrators).

LONGER TERM TECHNICAL ASSISTANCE AND TRAINING

Clearly, professional training in modern (business oriented) techniques for housing privatization and management would be required for the Privatization Administrators to be employed in the cooperative housing option. This mission indicated, however, that there is substantial demand in Poland for such training among staffs of housing cooperatives, GMINAs, and state-enterprise housing estates as well.

USAID is already supporting seminars in housing management by the International City Managers Association (ICMA) of North America. It is likely, however, that a more comprehensive and penetrating approach will be required. In USAID's broader program for Eastern Europe, training modules are being prepared on several practical topics (each with its own handbooks and computer-based design/implementation support systems): (1) strategic planning (showing financial and other implications of options to support decisions on what to do with what projects on what time schedule; e.g., sell to private buyers, convert to private management, raise rents, etc.); (2) how to most efficiently go through the process of selling properties to private buyers (investors and/or tenants); (3) conversion to private for-profit management (and/or self-management) and methods of procuring services from, and monitoring the performance of, private management companies; (4) financial management; (5) occupancy management; and (6) facilities/maintenance management.

In a more complete approach, technical assistance teams would visit individual cooperatives and GMINAs to deliver these modules. Each module would begin with a seminar and then entail hands-on assistance in using the approach in real day-to-day activities (including implementing the software on their computers). Later follow-up visits would be held to assure that the computer-support systems remain in use (thereby assuring that the new approaches and methods introduced have become institutionalized) and to respond to staff questions that arise from real operating experience.

Clearly, it would not be appropriate or financially feasible for all of this work to be done by expatriates. The highest priority should be to **develop indigenous capacity to deliver technical assistance and training of this kind within Poland**. This means that one or more specialized training institutes would be formed and expatriates would be used only to advise and train the trainers. With the reforms now underway, experience suggests that the demand for knowledge of modern techniques (and associated systems support) in these areas is high throughout Eastern Europe. Analysis in other countries indicates that GMINAs and other housing management entities will be willing to pay for effective assistance of this kind. It should be possible to operate this type of technical assistance and training program on a self-sustaining basis in a relatively short period of time.

Annex A

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Annex B

**ISSUES TO BE ADDRESSED:
CONDOMINIUM LEGISLATION**

By Roman Rewald

This is a preliminary draft of some of the issues to be addressed by the Polish legislative in creation of a condominium statute. Based on this outline, the first draft of actual proposed legislation will be prepared and submitted for a discussion in Poland. The outline is based on the condominium legal experience from the United States and takes under consideration sample of recent legislative effort conducted in Czechoslovakia.

I. CONDOMINIUM LAW PROVISIONS

Here are some issues that must be addressed by a condominium statute in Poland:

1. Application of the Statute. The statute must specify what housing would be subject to this law. This will include newly constructed housing (multi-dwelling houses as well as groups of individual homes) and conversion of cooperative, communal, and company houses, where a separate ownership of apartments is established. The statute would make the conversion into a condominium an alternative to the form of a cooperative, but would limit the size of cooperatives to a certain limit.

2. Definition of a condominium.

(a) A form of common ownership of real estate. Consists of condominium unit, which is an air space located and defined within the structure a building, and common elements which are the portions of the common building or land necessary to sustain the unit but not included within the unit.

(b) Condominium has the same legal attributes as other forms of real property. They may be sold, mortgaged, and leased, subject to restrictions that may be included in the condominium documents and contracts entered into at the time of creation. The restrictions stemming from the specifics of locality may be imposed by the local administration or by the statute.

(c) The owner receives a title to his/her individual unit and an undivided interest in the common elements.

3. Creation of Condominium.

(a) Type of documents necessary to create the condominium to transfer (or create) interest in the units. Due to a fact that establishment of a condominium is an act of one party (there is no contract), it should be in a form of a Declaration of Condominium.

(b) In the Declaration, the share in common elements and participation in common expenses is determined by the size of the individual unit or its proportional value. The interest of each unit owner in the common elements is inseparable from title to his/her condominium unit.

4. Condominium Governance.

(a) Determining what entity will repair, maintain, and regulate the use of the common facilities of the condominium. The statute should create a new legal entity of Condominium Association with all the attributes accorded the "legal person" under the Polish law. The association should be vested with proper powers to assess its members maintenance and repairs fees and to impose liens on their units in case of non-compliance.

(b) Adoption of by-laws establishing the structure, control, and financing of the owner's association should be mandated by the statute. The law should contain a list of key regulations that must be included in the by-laws.

(c) Determining the degree of liability of the association and its directors or individual members in contract and in tort and providing them with an indemnification by the association.

(d) Gradual transition of condominium governance from originator to association pursuant to sale of units. The original governing board is selected by the originator. The non-originator co-owners should be permitted to elect certain number of directors to the board of directors of the association, depending upon the percentage of units which have been conveyed to them. As the non-originator co-owners purchase their units, they may elect more directors, proportional to the percentage of units they hold. As long as 10 percent of the units remain that may be sold, the originator may designate at least one director. Until the power shifts to inhabitant-owners, the originator of the condominium must behave in accordance with a standard of a landlord in rental units.

(e) The first meeting of the condominium association must be held no later than x-days (120 usually) after conveyance of ownership title to 25 percent or more of the condominium units or x-months after the first conveyance of title to a non-originator co-owner of a unit in the project.

(f) Unit owners will have to comply with the bylaws and administrative rules adopted by the governing bodies of the condominium. Failure to comply shall be grounds for action to recover sums due, for damages, or for injunctive relief.

(g) Imposing on owners an obligation to comply with the assessments and rules of the Association of Condominium governing body.

5. Providing that the tax authorities must assess each unit individually, rather than the entire condominium as a whole.

6. Establishing a recourse in case of destruction or condemnation of the condominium project or its portion.

7. Condominium maintenance. Operating revenues of the association come from assessments against the units in the condominium project, determined through its governing body.

The assessments are divided as follows:

- Repair and replacement assessments - adoptable by the decision of the governing board;
- Additions to common elements - adoptable by the vote of 3/4 of owners

8. Legal description. Legalizing the use of maps and plans of the project as a reference in legal descriptions of individual units for the recording of their ownership in the register of deeds.

9. Security interest in Condominium.

(a) Establishing of a condominium unit, a *hipoteka*, or any other recording of mortgage or lien that is in existence in the law. This will constitute a change of the Civil Code and other laws.

(b) Establishing collateral subordination under which the mortgage of the owner will be subordinated to a construction mortgage until the latter is paid in full, regardless of when recorded or otherwise instituted. Accordingly, a lien on the unit securing payment of condominium assessed obligation is prior to all other liens except (i) tax liens on the apartment, and (ii) all sums unpaid on a first mortgage of record (presumably a mortgage securing the purchase money loan).

10. Defining basic rights of the owner. Each unit owner shall be entitled to the exclusive ownership and possession of his/her unit and hold an undivided interest in the common areas in the percentage provided for in a document creating the condominium. Such percentage, once set, may not be altered without the consent of all the members as may be expressed in an amended document creating the condominium.

11. Non-separation of interests. Creating non-separation of the unit ownership from the ownership of the apportioned land and common areas. Providing that individual members will not be allowed to seek a court action for a partition of their interest in common areas if such are a tenancy in common.

12. Registration of condominium. The registration should be accomplished by entering a subdivision plan dividing the land into parcels applicable to each future unit of condominium in the land register and creation of *ksieya wieczysta* for each unit separately. The detailed architectural plans and specifications for the condominium project will have to be filed with the local governmental agency responsible for the project approval and issuance of permit. The documents establishing the condominium, including condominium bylaws and other necessary acts, will have to be filed with the same agency.

13. Approval of the condominium by the administration. The originator notifies the local administration about the condominium project at least x-days before receiving first order from a purchaser or before the construction commencement. If the local administration does not object to the project before such a date, the project is deemed to be approved and the permit is considered issued.

14. Establishing different types of condominium's common elements:

Limited Common Elements - common elements that will be used by less than all of the condominium co-owners; the responsibility for their maintenance may belong to these co-owners who derive benefit from them or all the co-owners;

General Common Elements - maintained at the expense of all the co-owners (through the condominium association) in proportion to the percentage of space or value each owner has in the condominium project.

II. STRUCTURE OF THE STATUTE

The following organization of the condominium statute is most prevalent and tested as most practical:

Chapter I. Definitions, provisions for applicability, and preliminary matters.

Chapter II. Provisions dealing with the necessary documentation to create a condominium, make changes in the documentation, or, ultimately, terminate the condominium.

Chapter III. Provisions dealing with the management and operation of the condominium and the unit owners association.

Chapter IV. Provisions dealing with consumer protection.

Chapter V. Optional articles establishing an administrative agency to supervise the condominia.