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The Bulgarian Housing Sector: An Assessment

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Exchange Rates

In December 1991 the exchange rate was approximately 21 leva per U.S. dollar.

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I. The Setting

Bulgaria, like a number of other ex-centrally planned states, is undergoing major change and restructuring as it moves toward a market-oriented economic system. This involves the resolution of many long-standing distortions and imbalances in the economy and the process is causing a variety of dislocations including high inflation; falling aggregate demand; blockages caused by an inefficient financial sector; and, bottlenecks created by labor immobility.

Housing has an important role in alleviating these problems while responding to the demand of Bulgarians for better shelter and a higher quality of life. This report provides an initial assessment of the current state of housing in Bulgaria; it is hoped that it will form the basis for a more comprehensive study of the emergence of the Bulgarian housing market.

THE ECONOMY

Before 1945, Bulgaria was known for its high output agricultural sector, a sector that was capable of providing positive growth for the entire economy, but the industry mix changed starting in 1946. Under communism, the objective was to create new industry and devalue agriculture by collectivizing small land holdings. During the 1960's and 1970's, several industries expanded under this scheme of planned investment. The more prominent of these included: engineering, metallurgy, chemicals, and domestic appliances. The construction industry also grew, due not to housing investment but to industrial expansion. Side effects of this approach were an increase in the rate of urbanization and a marked deterioration of environmental quality.

The above pre-1989 developments, which were instituted according to successive five years plans, resulted in large changes in the structure of the national product. Bulgarian national income figures point to a substantial shift between the manufacturing and agriculture sectors. In 1939, 15 percent of output was attributable to industry while 65 percent was accounted for by agriculture. In 1988, these figures were 61 percent and 12 percent respectively. This shift from the agricultural sector, where Bulgaria enjoyed a comparative advantage, contributed to the economic downturn Bulgaria experienced in the late 1980's.

As a former socialist country, Bulgaria belonged to the Council of Mutual Economic Assistance (CMEA) - the trading block of socialist countries. Its trade was predominately in heavy industrial materials (valued in rubles), the bulk of which went to the Soviet Union (63 percent). Bulgaria's second largest trading partner was the former East German state. Tradable goods that entered the country largely consisted of raw materials, especially oil from the U.S.S.R., Libya and Iraq. Access to cheap raw inputs from the 1960's through the later part of the 1980's provided stability to the economy during this period, although investment was oriented towards capital goods and away from consumer products.

Like all centrally planned economies, the Bulgarian economy grew rigid and unresponsive. With the drop in world oil prices in 1986 and concurrent with the political revolutions taking place in the socialist countries in 1989, the economy deteriorated. In 1989, there was negative growth due to the contraction of virtually all sectors of the economy. In the first half of 1991 the economy slid even further downward, producing 23 percent less than in the same period of 1990. Consumer goods production contracted even more, falling by 36 percent, and the once buoyant construction industry decreased production to its lowest level in the last five years.

Table 1 shows Bulgaria's growth in per capita gross domestic product during the 1980's in both real and nominal terms. In 1989 and 1990 growth decreased sharply -- real GDP shrinking by 5.1 percent in 1989 and 12.6 percent in 1990. Preliminary figures for the early part of 1991 point to a continuing fall.

Table 1
Gross Domestic Product Per Capita
(annual growth in percent)

	1985	1986	1987	1988	1989	1990
Nominal	4.3	15.1	10.0	14.0	-50.2	-54.2
Real*	1.8	5.1	5.0	2.3	-5.1	-12.6

* Based on 1980 prices and exchange rates
Source: WIS Country Data Forecasts, March, 1991

While some reform orientated economic adjustments have been made, the pace of creating markets in Bulgaria has been uneven and slow -- at least prior to the recent (October, 1991) elections -- when compared to other Eastern European countries. In the short time since the elections -- which resulted in Bulgaria's first non-socialist government since World War II -- the pace of reform has increased. For example, the restitution of retail shops is currently underway, and the privatization of small state holdings has begun.

While inflation has been difficult to measure, most observers claim an average inflation rate of 5 percent through the 1980's, rising to 64 percent in 1990 (BNB Annual Report, 1990). During 1991, inflation was extremely erratic, and monthly inflation rates ranged from a low of 0.8 percent to a high of 122.9 percent. For

September and October of 1991, the rates were 3.8 and 3.3 percent respectively and the government expects the November rate to show a further decrease to 3.2 percent. The country's base interest rate of 54 percent, while extremely negative in real terms for much of 1991 has nevertheless been considered very high by consumers and investors and has led to a sharp decline in credit demand.

Bulgaria's limited range and poor quality of consumer goods and its paucity of financial instruments contributed to a critical monetary overhang problem by the end of 1990 (Thorne, 1991) posing a serious threat to monetary and price stability. Nevertheless, extremely high inflation coupled with negative real interest rates over the last nine months has largely eliminated this problem by decimating the real value of monetary holdings.

The sharp fall in national income has led to a proportionally large increase in the number of unemployed Bulgarians. According to recent trade union estimates, the number of unemployed persons in June was 206,000 and is expected to rise to 300,000 by the year's end for an expected unemployment rate of over 10 percent. A more recent estimate by the Minister of Labor and Social Welfare states that this figure may rise as high as 450,000 by the end of 1991. This will place a serious burden on the already strained social security system, which as a share of total government expenditure is already over 24 percent, a high figure compared to almost any other country.

Bulgaria suffers from external as well as internal macro-economic instability. Exports in the first half of 1991 declined precipitously, falling by 56 percent when compared to the same period in 1990. Imports, led by raw materials, fell even more drastically in the first half of 1991 -- dropping by 63 percent over the same period last year. The country has also experienced a rapid decline in its ability to service external debt. Its debt-to-export ratio, a reliable measure of capacity to repay past loans, increased over the last four years from 175 in 1988 to 339 in 1991. One of the major constraints for Bulgaria's ability to service debt was its lack of convertible currency earnings from its trade with former CMEA countries. Compounding this problem, the U.S.S.R. asked for hard currency payments for all of its oil exports to Bulgaria. Balance of payments problems caused Bulgaria in March of 1990 to declare a moratorium on the service of its external debt and enter into negotiations for re-scheduling its borrowings with the Paris Club of western government creditors. More recently, it was announced that Bulgaria would not seek debt forgiveness but was considering a debt swap as a possible solution (BBN, Dec. 9, 1991, p.1).

In August of this year, the World Bank announced it would lend Bulgaria 250 million dollars to help it import basic goods and structurally re-adjust its economy. The loan is to be released in two tranche: 150 million dollars now and 100 million dollars later if the Bank is satisfied with the progress of economic reforms. The International Monetary Fund (IMF) as well is contributing to the Bulgarian re-adjustment process by approving two loans to support an external payments and price liberalization program. One loan is a stand-by arrangement of 394 million dollars and the other loan is for 133 million dollars drawn from the Compensatory and Contingency Financing Facility. The European Community has also pledged to lend 400 million dollars.

Demographic & Social Factors

Two factors characterize the demography of Bulgaria in the post World War II period. First, the country has changed from having 28 percent of its population in its cities and towns in 1950 to over 68 percent in 1990 (Table 2). Second,

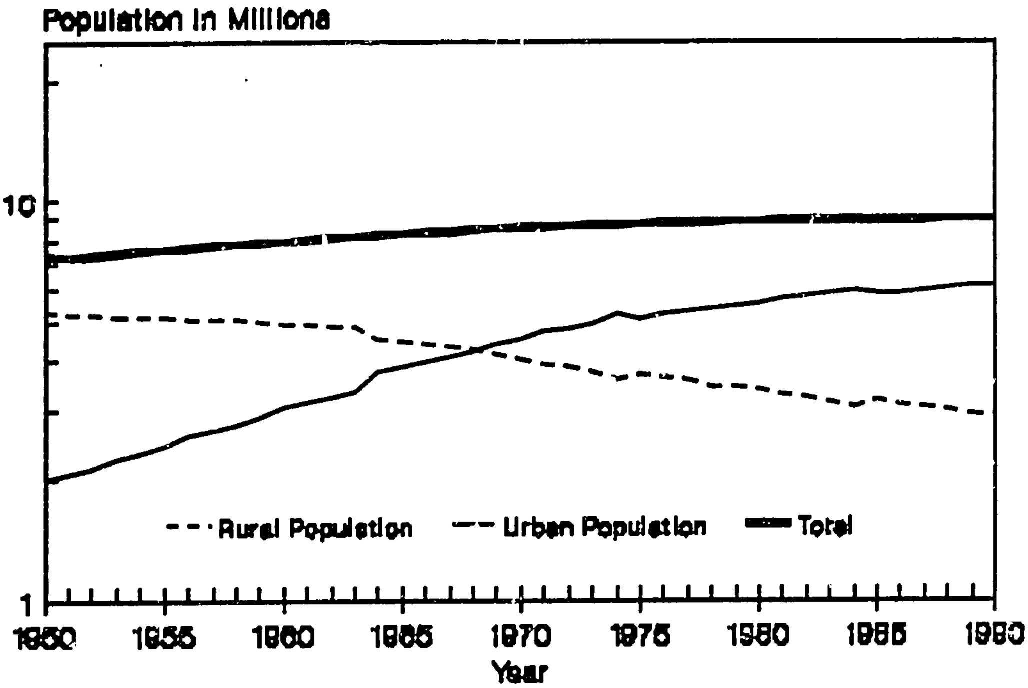
Table 2
Population of Bulgaria

	1950	1960	1970	1980	1985	1990
Population (1,000's)						
URBAN	2,000	3,005	4,510	5,546	5,808	6,116
RURAL	5,273	4,901	4,005	3,331	3,142	2,873
TOTAL	7,273	7,906	8,515	8,877	8,950	8,989
Percent Urban & Rural						
URBAN	27.50%	38.01%	52.97%	62.48%	64.89%	68.04%
RURAL	72.50%	61.99%	47.03%	37.52%	35.11%	31.96%
TOTAL	100%	100%	100%	100%	100%	100%
Annual Average Growth from Preceding Date						
URBAN	--	4.16%	4.14%	2.09%	0.93%	1.04%
RURAL	--	-0.73%	-2.00%	-1.83%	-1.16%	-1.77%
TOTAL	--	0.84%	0.74%	0.42%	0.16%	0.09%

Source: Bulgaria, Annual Statistical Reports.

population growth rates, while never high, declined from over 0.74 percent per year in the 1950 to 1970 period to 0.09 percent since 1985. While rural areas have continually experienced negative rates over the last forty years, urban areas which had rates of over 4 percent in the 1950 - 1970 period, have grown at an average annual rate of around 1 percent since 1980 (figure 1). In absolute numbers, the urban population has increased by an average of 61,000 persons per year over the last five years whereas the country as a whole increased by less than 8,000 persons per year during the same period (table 2). Recently, these generally low rates have been compounded by increasing levels of migration out of Bulgaria and the next census may well show a decline in total population.

Figure 1
Population Growth



Source: Bulgaria, Statistical Yearbooks

Sofia, with an estimated current population of 1.3 million people had 13.5 percent of the national population in 1985. During the 1980 - 1985 period it grew at annual rate only marginally above urban areas as a whole -- 0.96 percent. Outside of Sofia the urban structure of the country includes 10 cities with populations of over 100,000, the largest being Plovdiv, and the government counts 237 settlements with populations of over 10,000 (see Ganev, 1989 for a more detailed discussion of urbanization in Bulgaria).

The Institutional Framework

Until recently, Bulgarian housing policy had the goal of providing every citizen over the age of 18 an independent dwelling unit; every family a dwelling with a garage and a second (week-end) home with garage. In addition, the nation's housing policy emphasized sheltering young families (one spouse under thirty, the other under thirty five) and 30 percent of State production was supposed to be allocated to that group. The state also pursued favorable credit policies for young families (see further discussion under housing finance).

By 1986, the state had recognized a number of the problems inherent in its approach to shelter and set out a new housing policy as part of a its new approach to the development of human settlements. In particular, this approach emphasized the provision of infrastructure and services over the construction of new units, the provision of lower density housing with housing blocks being confined only to areas of greatest housing deficiency, greater reliance on owners' efforts to upgrade units, fewer one and two room units, and higher construction standards (Grigorov, 1987:30). While the need for a realistic and achievable housing policy was recognized, the potential solutions were incompatible with the already heavy levels of subsidization and the rigid housing production system. In the end, little change occurred before economic and political circumstances brought about the current hiatus in housing development.

Now, the recent (October, 1991) change in government has resulted in the reorganization of the Ministry of Construction into the Ministry of Regional Development, Housing, and Construction and the appointment of a new Minister who has long pursued the establishment of market oriented policies for Bulgaria's housing sector. Obviously, this should be the beginning of a marked change in Bulgaria's approach to shelter policy.

II. Tenure & Markets

The Tenure Pattern

One of the distinguishing characteristics of housing in Bulgaria is the high degree of private unit ownership. In 1985 the state rental sector was approximately 15.2 percent of the national housing stock, 22.5 percent in urban areas (10.2 percent under municipal council management, and 12.3 percent under state enterprise management). In anticipation of the transition to unsubsidized housing, many families took advantage of their right to purchase their rental units at the old prices and loan terms. In the larger cities and towns, over 50 percent of the rental units were sold in 1990 and the first quarter of 1991. The sale of these units was stopped in March of 1991, but a telephone survey conducted by government officials in mid-April, 1991 indicated that state rental units now comprise less than ten percent of all dwelling units.

While the above addresses the state rental sector, the rental sector as a whole (that is both public and private) is also relatively small. Giorov and Koleva (1990) citing 1985 census data state that for the whole country, 18.2 percent of the households in occupied units are renters. This leaves a private rental market of 3 percent, and other estimates give figures in the same range. In November, 1990 a national housing survey indicated that 11.7 percent of all households are renters (see table 3); if the figures are indeed comparable, this represents a significant drop since 1985, and one which would have only included part of the recent sell-off of state rental units.

Rents for state units are set by a tariff approved by the Council of Ministers in 1968 and not changed since then, although municipalities have some leeway in adjusting rents to reflect the amenities of the individual unit. For 1985 it was estimated that the rent paid for a 59 square meter dwelling was 4.5 percent of the average household income, while overall costs (including utilities) amounted to 11 percent (Grigorov, 1987:27).

Table 3. Tenure by Location
(in percent of occupied households)

	Sofia	Reg'l	Small	TOTAL
Renters	19.2	17.9	6.4	11.7
Owners	80.7	80.0	92.3	86.9
Unknown	0.2	2.1	1.3	1.4
TOTAL	100.0	100.0	100.0	100.0

Source: Bulgaria, National Household Survey, 1990.

Private Rental Housing: Private rental housing has always existed in Bulgaria although during different periods of the socialist regime its legality and the degree of government control varied. Until 1990, the state set rent levels for private contracts and the procedure to rent a private unit usually involved an inspection of the unit by a Municipal Housing Office official, who assessed the unit and certified the rental rate after adjusting it according to municipality-specific criteria. These circumstances made renting cumbersome and many parties either circumvented the entire process or made an arrangement where the legal rent was supplemented with informal payments.

Little systematic empirical data is available is available on rent levels in the private sector, but interviews indicate that rents in Sofia in late 1991 were in the range of 15 to 20 leva per square meter for average residential units rising to as much as 40 leva per square meter for good, not luxurious, residential space suitable for office use and in the center of the city. Currently, activity in the rental market is increasing and rents are becoming more sensitive to unit quality and location.

When private units are rented for a period exceeding three years, a notarized contract is required by law. In practice, it is usual to rent for a shorter period without a notarized contract even if occupancy is anticipated for three years or more. It is also a common practice for tenants to sign a contract which understates the actual rental rate since private landlords must pay a heavy tax on rental income. Maintenance responsibilities are almost never explicitly stated in these contracts, and in general, by U.S.and western European standards, the contracts are vague and incomplete. In contrast to some other ex-socialist countries, rental contracts are enforceable in Bulgaria and tenants may be evicted for non-payment of rent, damage to the premises, and, at the end of the term, without being provided or shown another unit. Interviews with lawyers and others indicate that such evictions do occur. The only limitation in the law is that tenants without alternative housing may not be evicted during the winter months.

Public Rental Housing: Public rentals are divided among three types of owners: municipalities, government agencies or departments, and socialist organizations (trade unions, state enterprises et. al.). Recent laws have changed the property rights of some of these entities but as yet this does not affect the rights of tenants.

Department rental housing is located mainly in Sofia and was never a significant form of shelter; according to estimates from personnel at the National Statistics Institute, it probably totals less than one percent of the national housing stock. Housing owned by socialist organizations -- largely state owned enterprises -- is also numerically small (estimates place it at approximately 0.2 percent). This type of housing was a result of a directive from the government in 1983 which stated that such organizations should take the responsibility for housing their members. This, in turn, was a response to the nation's inability to meet its five-year plan housing targets and was based on the assumption that these agencies would be able to succeed where the state itself had failed. In practice it simply placed an additional burden on institutions which already had economic problems and did not contribute significantly to solving the housing problem. In both of these cases -- departmental and socialist organization housing -- maintenance and rent collection are contracted with the local municipal maintenance firms save for a few of the larger enterprises which have their own maintenance companies.

The majority of the rental units in Bulgaria are owned by the municipalities and managed through the local municipal maintenance firms. While the ultimate responsibility for this housing lies with the Municipal Council, each city has a small housing office with anywhere from one to a dozen staff who are responsible for the administration of housing construction, the allocation of units, and the sale of stock. The exception to this is the City of Sofia which supports a large housing office, some ninety staff members, and which coordinates the activities of the 24 municipal housing offices within the city.

Allocation of rental units is based on waiting lists, sorted by a complex set of criteria relating to housing need. In practice, political and other informal considerations appear also to have played a prominent role in determining a household's position in the queue. Once a unit is allocated, tenants are referred to the municipal maintenance firm for contract signing and subsequently pay their rent directly to that firm.

All rental units, except for private units, are rented at a fixed base tariff of 1.65 leva per square meter per month adjusted according to amenities (e.g. furnishings, electricity, piped water, etc.) and location. This tariff was set in March of 1991; the previous base tariff, 0.19 leva per square meter, had been in effect since 1968. While this is a major increase -- slightly less than 9 times -- municipal rents remain approximately one-tenth those of the private sector in Sofia. Outside of Sofia the discrepancy is not as great, but it is still substantial.

The new rental tariff retains 15 adjustment coefficients from the previous scheme which are used to alter the rent of a unit depending on its quality and location. Under this method, the price of a public rental unit can vary from a minimum of 1 leva to a maximum of 3 leva per square meter. Municipal Councils can also increase the rent of their units by an additional 15 percent independent of quality or location. Further, in an attempt to prevent over-consumption of housing, the recent changes in the rental regulations also imposed an automatic doubling of rent for all public units exceeding 20 square meters per person.

While these adjustments allow public owners some flexibility in managing their stock, the leeway is small compared to the discrepancy with private rent levels. It also appears that few municipalities are taking full advantage of these options.

Concurrent with the increased base tariff for public units and general increase in prices, rental default rates have increased dramatically. Some inner-city municipal maintenance firms in Sofia report defaults on rent as high as 20 to 30 percent, while firms in more rural areas report much lower rates. In the past, defaults were almost nonexistent. Some of the new default is due to the fact that often municipal maintenance firms were delinquent in notifying their tenants of the recent rent increase, and this was compounded by the time it took to have tenants sign new leases. Thus, some tenants accrued arrears of more than three months' rent. At present it is unclear whether defaults will lessen when the new rents are better known and the administrative processes have adjusted or whether they will stay high due to the increased payments.

The contract between the municipal maintenance firm and the tenant defines the terms of the rental more explicitly than the one generally entered into in the private market, particularly with reference to maintenance. As in the case of the private sector, evictions are legally permissible for nonpayment of rent and other breaches. In practice, however, evictions rarely occur, although as in the private sector eviction for non-payment of the rent is legally permissible without the need to provide alternative housing. Municipalities are, however, required to provide alternative rental housing when the tenant is forced to vacate for reasons such as redevelopment or other state actions.

Municipal Maintenance Firms: Until recently, municipal maintenance firms were responsible for the repair and management of all municipal and most of the other public housing. Management responsibilities include signing the contract with the tenant, enforcing the contract, and collecting the monthly rental payments. Maintenance firms themselves do not have the right to rent under the law, but only enter into contracts with persons allocated a unit by the Municipal Housing Office.

These firms are self-financing with their revenues coming from rents which are distributed as expenditures among four accounts. First, depreciation is accrued according to the cost of the unit, which is determined when the property is assigned to the firm. (Each property comes with a certified document from the department, municipality or agency attesting to its value and from this the depreciation allowances are determined. Depreciation allowances continue to be calculated after the property is fully depreciated). Second, major capital repairs are budgeted. Third, current repairs are budgeted. And fourth, the wages of the staff are allocated according to government pay scales.

After deducting expenditures from revenue, maintenance firms are left with gross profit which is subject to taxes. After taxes are paid net profit is returned to the general revenue fund of the municipal maintenance firm and is used for current expenditures. In the rare case where expenditures do not equal revenues, monies drawn from the general fund are used to make-up the difference. No budget subsidy exists for maintenance firms at either the local or national level.

The system of finances for municipal maintenance firms is paradoxical since it works against the firm's primary purpose of maintaining public housing. Funds are not allocated according to repair or maintenance needs, but according to the value of the building which is proportional to its age. Maintenance firms are therefore constrained by a system of accounting which allocates less money to buildings logically in greater need of maintenance. Thus, repair of the housing stock is chronically under-funded, a situation reflected in its current condition.

Home Ownership: Despite the fact that over 90 percent of Bulgaria's dwelling units are in private ownership, the majority of the land underlying such residences remains state-owned. While in the older parts of cities perhaps as much as one-third to one-half of all land is privately held, in the areas developed since 1958, the land is almost wholly state owned. Where land is privately owned, in other words, where people have land rights which did not involve the post World War II state, tenure remains based on the Bulgarian Law of Property, and rights are reasonably clear.

However, where the state acquired the property, both legal rights and records are often unclear. One example is that there is now disagreement between the municipalities and the national government concerning their respective rights of ownership to public land. Also, any action to restore ownership rights to expropriated urban property will be exceedingly complex not only because of unclear records, but because of land use changes and intensification of use.

The Emergence of Housing Markets

Until 1958, private construction accounted for a significant part of the housing supply. After that date, almost all housing was developed by the municipalities who then had the responsibility for allocating and selling the units at fixed prices. Then, in April of 1990, the Parliament modified the Bulgarian Property Law and lifted controls on both the number of housing units a family could own and the free sale of units at market prices.

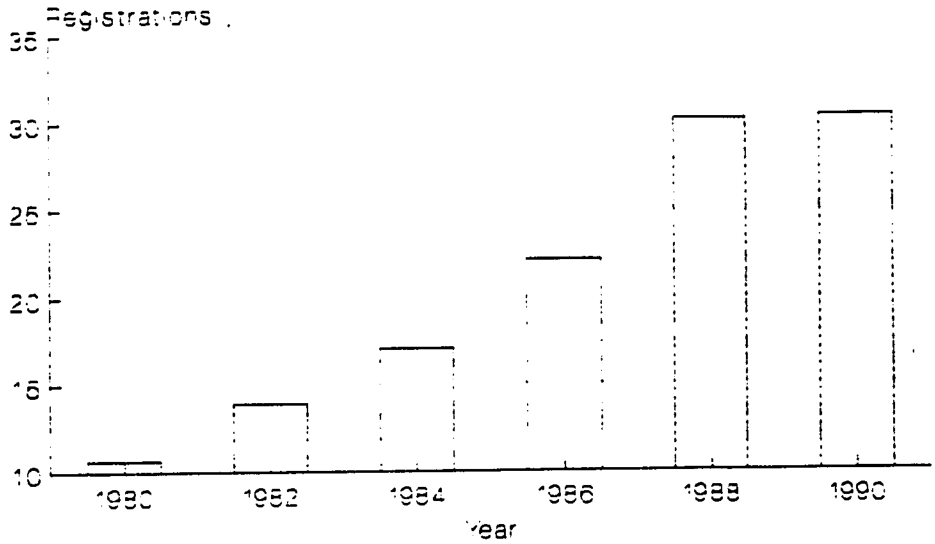
Bulgaria's current lack of functioning real estate brokerage and property appraisal systems severely hinder the formation of a significant private housing market. At present these services are embryonic. However, there is at least one firm which caters to persons who wish to buy, sell, or exchange properties. This company publishes two newspapers which contain listings of properties (as well as other goods and services) and offers to place interested persons in contact with each other for a very small fee. This firm maintains a data base of such persons with about 2,000 properties listed and a second data based -- said to include approximately 8,000 properties -- based on its newspaper listings. As yet, the organization charges no commission for completed transfers or sales, but it does offer to provide legal and other consulting services to interested parties for a fee. Several other firms are active in this fashion, but interviews indicate their efforts to be limited and erratic.

More recently, Bulgaria has seen the re-emergence of the real estate brokerage and appraisal professions. In conjunction with assistance from the United States Agency for International Development two professional training courses were held. Over 130 individuals successfully completed the course and many have begun business activities in the field. In addition, as of the end of 1991 35 registered firms now include real estate brokerage as one of their official activities.

One major factor limiting such services is the lack of a general means for ascertaining information on transaction prices. At present, the notary involved in a real estate transaction records the price, but due to the existence of a tax on property transactions, the parties understate the cost of the unit. Nevertheless, conversations and interviews with local officials and individuals indicate that sales are occurring and, as additional controls are lifted, more transactions will take place. While further analysis is needed, this also points to two additional constraints on the property market. First, notarial procedures appear to be out-dated and interviews indicate that such procedures are excessively time consuming. Second, local permitting and planning procedures are now starting to hold up applications for new development. The system was not designed to accommodate private initiative.

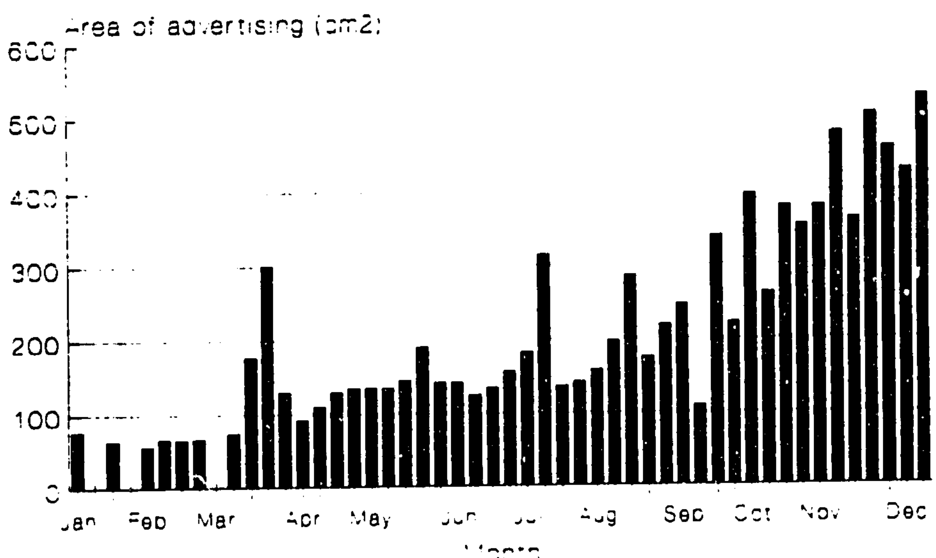
Quantitative Market Indicators: As noted, there are no sources of systematic price data regarding property transactions. As a proxy, however, we have examined two other related sources of data which address the quantity of transactions if not their value. The first of these (figure 2) presents the number of real property transactions of all types which have been recorded since 1980. As can be seen, the pattern shows a slowing of the annual number of transactions in the late 1980's, a reflection of the steep decline in Bulgaria's annual housing production as documented in chapter 3.

Figure 2
Annual Land Registrations
Per 1000 Persons



Source: Notary Records

Figure 3
Real Estate Advertising, 1991
Courier 5 (by issue in cm2)



More immediate, although less scientific, is the data on the amount of real estate advertising placed in the newspaper "Courier 5." Over the last year, this paper has become the focus of such advertising and its increase (see figure 2) is a partial indicator of activity in the market.

Housing Demand

Both conventional wisdom and municipal waiting lists imply that there is a high level of unsatisfied demand for housing. In Sofia alone the waiting list contains over 92,000 names--a number equal to over one-fifth of the city's households. However, the distortions and constraints caused by the state allocation system and the limits on private construction and exchange have themselves created some of this demand. For example, there are people who have serviceable shelter but who nevertheless had the right to acquire a subsidized state unit and thus, are included in the list. Further, very low rates of natural increase and recent migration both to the villages--after the privatization of agricultural land--and out of the country, may serve to lower the actual shortage of units.

In gross quantitative terms Bulgaria in 1984 had 351 units per 1,000 persons which was similar to the situation in Czechoslovakia (360) and Hungary (355), and ahead of Poland (284) and Yugoslavia (287), (World Bank, 1990). Other rough measures also imply a difficult but not desperate situation. For the country as a whole, per capita floor space[1] in 1985 stood at 18.9 square meters, 17.8 square meters in urban areas, levels which are generally accepted as adequate. Similarly, there are 3.26 persons per dwelling unit for the country, and 3.32 in urban areas (Bulgaria, 1986).

1 Floor space is defined here as floor area of habitable rooms and does not include bathrooms, toilets, corridors, kitchenettes or outdoor areas.

If we look to indicators of the amount of the population which lives in what might be termed inadequate circumstances we find 11.4 percent of the urban population in housing with more than 3 persons per room (table 4), and more significantly 17 percent of all urban dwelling units had more than one household, 19.3 percent in Sofia (Bulgaria, 1990). Bearing in mind that the average size (useful floorspace) for an urban dwelling unit in 1985 was 62 square meters, 7.7 percent of the urban population were in units with less than 30 square meters, almost 20 percent in units of less 45 square meters. Nevertheless, in looking at such indicators over the last 25 years (table 4) the most remarkable aspect is the degree of improvement that has occurred. For example, average floor space per person increased by more than 50 percent during the period, while the population in dwellings units under 30 square meters, or with more than three persons per room each dropped by more than two-thirds.

Table 4
Indicators of Urban Housing Shortage

INDICATOR	1965	1975	1985
Average floor space per person (m^2)	11.1	13.9	17.8
Average persons per dwelling unit	4.2	3.8	3.3
Population in dwelling units less than 30 m^2 (%)	18.3	10.1	5.8
Population in dwelling units with more than 3 persons per room	33.2	19.4	11.4

Source: Census of Population & Housing, 1965, 1975, & 1985.

While the above data indicate that there is most likely a significant percentage of the urban population whose housing situation is affected by a physical shortage of suitable units, the overall picture is further complicated by the existence of a large stock of vacant units (table 5). While the rural component of this is not surprising, the existence of that many vacant urban units -- the actual number is 178,000 -- is.

Whether these are vacant because of their physical condition, or because their owners are deliberately keeping them vacant is unknown. It is also uncertain whether the number has changed since the 1985 census.

Table 5
Vacant Dwellings as Percent of Stock

LOCATION	1965	1975	1985
Urban Units	1.57	3.80	9.42
Rural Units	3.69	9.23	20.50
All Units	2.79	6.32	13.82

Source: Census of Housing, 1965, 1975, 1985.

The above discussion has been concerned with the question of whether there is a physical shortage of suitable units as a proxy for unsatisfied demand. As the country moves toward a market economy it is useful to attempt to look at effective demand, although in the present unsettled situation this is difficult. As one indicator, however, we can note information about household expenditure for housing.

Based on a 1989 sample survey of household expenditures undertaken by the Central Statistical Office (Bulgaria, 1989), we estimate that the average household spends 6.75 percent of its income on shelter. This includes the cost of purchasing or renting, utilities, and repair; the utilities cost equalling approximately 44 percent of the total. Thus, if the cost of housing has risen ten or more times since 1989 and incomes have risen approximately 28 percent, according to unpublished data from the Central Statistical Office, effective demand remains extremely limited.

III. Housing Production and Supply

Housing Development

Until 1958 the Bulgarian residential construction industry was characterized by numerous small and medium sized firms. Beginning that year, the government nationalized the construction industry and fostered the creation of large state owned enterprises which specialized in industrial construction processes resulting in the large blocks of apartments which dominate the housing stock today. The investors or developers in this process became the municipalities, or the municipalities in concert with large state owned enterprises which were urged to provide housing for their employees. It was their task to acquire the land, contract for and finance construction, and eventually allocate, and sell or rent the units.

The 1958 policy shift was an effort to quickly increase the supply of housing for the then rapidly growing urban population. Overall, it appears that the change was initially successful. From 1965 to 1985 housing production grew at an average annual rate more than twice that of household formation (table 6), and as noted above (table 4) overcrowding decreased significantly.

Despite this early progress, the picture began to change after 1977 (figure 2). From that year until 1989 annual production declined, albeit gradually, perhaps in recognition of slower population growth and the fact that the preceding decade had at least mitigated the housing shortage. Then, in 1989 and 1990 production dropped sharply, and it appears that it dropped even further in 1991.

Table 6
Comparative Growth of Households and Dwelling Units

	Annual Average Growth Rates	
Period	Households	Dwelling Units
1965-1975	0.81%	1.86%
1975-1985	0.96%	2.28%

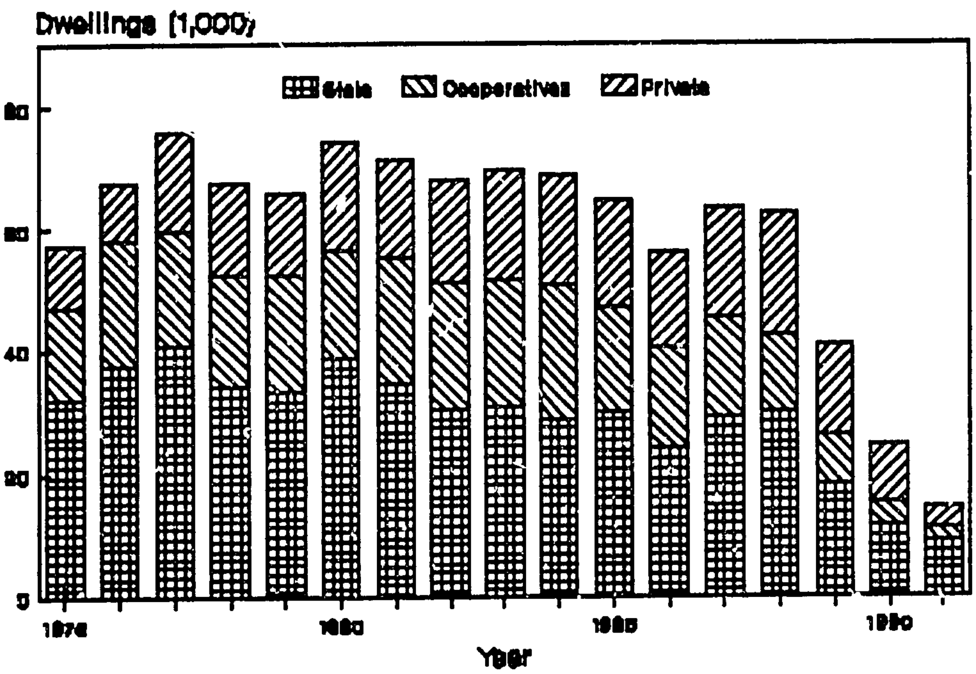
Source: Census of Population & Housing

Despite the fact that construction was concentrated in the hands of large state enterprises, a significant share of the annual supply has always been produced by both cooperatives and private individuals (figure 2). Further, while much of the privately produced supply is located in rural areas, its absolute annual volume has been close to twice that of rural production through the mid-1970's, and an even greater amount since then. Even if all rural production was private, a significant amount of private production has continued in urban areas.

We can also see that beginning in 1981 the share of private and cooperative production became roughly equal to that of the state sector, and by 1985, private production was greater than cooperative (figure 2). Both of these trends have continued until the present, and the overall conclusion has to be that private production was beginning to reassert itself and play a increasingly significant role in Bulgaria several years prior to the recent economic and political changes.

The structure of the state construction industry, at least until very recently, was that there were 41 state owned enterprises with several hundred to over 5,000 employees. These were located throughout the country, but mainly in the provincial or regional capitals. There were also approximately 90 municipal owned construction firms, ranging in size from one to five hundred employees. The larger firms, mostly state owned, had multiple divisions with capacity for project design, engineering, panel construction, and so on, in addition to carrying out the construction process it self. These firms also built nearly all of the schools, hospitals, and government or public buildings. Many of these firms are now in the process of restructuring in anticipation

Figure 4.
Annual Housing Production by Investor



Source: Statistical Yearbooks

of privatization. Often they have created separate internal divisions, each now responsible for its own profit and loss, and the more innovative of these firms are seeking new opportunities for their existing technology and capacities or are looking for ways to retrofit and upgrade their products.

These public enterprises employ 43,000 people. It is estimated by the government that at present 10,000 persons in the construction sector are unemployed, and that this will rise to 25,000 as construction workers presently employed on projects in the Soviet Union are sent home.

Good data on the private sector are lacking, but there are over one thousand officially registered private construction firms in the housing sector. These companies are generally very small and at present most of their work is in the repair and finishing business. In addition, officials claim that a significant share of the firms are solely paper entities, and the government estimates that in total these firms possess only 2 percent of total construction industry assets.

At present, the thinking of many of the new private firms is dominated by the idea of large scale industrialized construction. In interviews with both the owners of individual companies, and the leaders of trade associations, the overriding concern on their part was to obtain either the existing equipment of the state owned enterprises, or capital to buy similar equipment. The notion of starting small, building a few houses or even a couple of four or eight flat buildings was totally absent. The move to different forms of ownership in the construction sector has not been matched by a change in thinking about the scale and nature of the product.

Despite the emergence of these firms, the bulk of realized private construction is still is dominated by individual households who develop their own shelter most often with the assistance of a few skilled workers hired for specific tasks.

As previously noted, construction prices are said to have risen ten times from approximately 250 to 300 leva per square meter in 1990 to 2,000 to 2,500 leva per square meter in April, 1991. Over this same period, general inflation was approximately 500%. These construction prices are for Sofia and large cities, in smaller cities and towns, prices tend to be significantly lower; we attribute this to lower labor costs, cheaper land charges (although this is a small part of the total cost); and lower building standards and levels of infrastructure provision.

Currently, construction costs are driven by the cost of building materials. The production and transportation of these products account for approximately 75 percent of the cost of unit production. Labor accounts for 18 percent of total costs, management 3 percent and overhead 4 percent. Fuel is the most significant component of materials production costs and while later figures are not available, its deregulation in June of 1991 may cause additional price rises.

At the moment, several large state-owned enterprises control the building materials industry. However, these firms are now considering decentralization and privatization and others are entering the field. In 1990, six firms produced basic building materials in Bulgaria. One year later, there were 30 firms in the market and an additional 40 were expected to form in 1991.

As a whole, the industry is very energy inefficient, and Bulgarian companies are said to require approximately 50 percent more fuel than western firms to produce the same volume of output. The condition of the industry is well recognized by local officials and businessmen and there is considerable interest in acquiring more energy efficient technology.

Land Acquisition

Obtaining vacant land for housing construction also remains a problem. At present the urban master planning system remains in place and such plans, which were enacted as laws, designate not just areas for residential use and building types, but also the developer who, with minor exceptions, (small areas were designated for private construction) was either the municipality, a state enterprise, or a government agency.

Land designated for housing construction, if not already owned by the state, is acquired from private individuals with compensation for the land paid according to a tariff set by the Council of Ministers. Buildings are compensated separately and residents on expropriated land acquire the right to purchase or rent a new state unit. The tariff (see Grigorov, 1987:16 for the actual values) is structured by the size of the human settlement containing the land (larger settlements have higher prices) and whether the land is suitable for housing and public services or weekend recreational use, with the latter category given a substantially lower value. The actual allotment of parcels is under the control of the municipal council.

The developer pays the fixed value of the land and in addition a charge for a building right (the underlying land right remains with the state) on a per meter basis. The building right charges are also structured by settlement size and primary home versus second home construction, but in addition there exist a range of charges for different zones within urban areas. Such rates range, for example, from 7 to 21 leva per square meter in towns of 10 to 100 thousand persons, and 9 to 27 leva in Sofia (Grigorov, pp. 16 & 17). In addition, the government has tried to protect arable land and other environmental features through differential charges. Overall, most of the land tariffs have remained unchanged for 15 or more years, and represent a very minor share of direct development cost.

Subsidies in the Housing Sector: Traditionally, the Bulgarian government subsidized the housing sector on many levels including fuel subsidies for material production and transportation, direct funding of materials production companies to cover operating losses, the provision of land and units at prices below the state's cost, and artificially low interest rates on construction and mortgage loans. At the urging of the International Monetary Fund no further direct subsidies for housing are being included in the state budget, and the decline of the state rental sector has decreased another source of subsidies. Nevertheless, the system still contains various off-budget and implicit subsidies which require analysis and reform. Table 8 shows the level of subsidies from 1985 through 1989 in nominal terms. While subsidies remained at a fairly constant level throughout the period, the amount of subsidy per square meter of new construction increased by over one and one half times.

Table 7
State Budget & Housing Subsidies

	1985	1986	1987	1988	1989
Total Budget (millions of leva)	18,666	21,910	22,670	23,212	24,378
Housing Subsidies (millions of leva)	97	131	131	137	138
Subsidies as % of Total Budget	0.52	0.60	0.58	0.59	0.57
Subsidies / m2 (leva)	33.12	50.63	44.62	50.31	85.73

Source: Ministry of Finance

Subsidies in the Sale of State-Owned Rental Units: Subsidies in the sale of state-owned rental units have always been large but have increased significantly over the past two years. Table 8 details their absolute value and growth. In 1989, government units sold at a rate of 136 to 170 leva per square meter. At that time, the private sector price was approximately 400 leva per square meter. The large difference between the government and private sector figures actually overstate somewhat the depth of the subsidy because private sector prices were kept artificially high. Nevertheless, we can roughly assume that the subsidy was 50 to 200 leva per square meter. Average unit size was about 65 square meters, so the subsidy as a percentage of the state-sector unit's cost was 33 to 130 percent. Slightly over 21,000 state-sector units were sold in that year. Thus, the total subsidy in that year was 59 to 240 million leva. This translated into 0.2 to 0.6 percent of GDP in that year.

Table 8
Subsidies in the Sale of State-Owned Rental Units

Year	Average Subsidy as % of Unit Cost	Total Subsidy as % of GDP
1989*	33 to 131	0.2 to 0.6
1990	520	11.6
1991	1,300	6.6

Note: (*) Figures for 1989 are presented as a range with a high and a low estimate.

By 1990, the gap between the state-sector sales price and the free market price had increased dramatically. While the state was still selling units for 136 to 170 leva per square meter, the free market price increased sharply to 950 leva per square meter. The average subsidy as a percent of state housing prices was over 500 percent. The total volume of units sold by the state in that year increased sharply to over 90,000. The total subsidy resulting from this sale was equal to over 11 percent of 1990 GDP.

In 1991, the state sector/private sector housing cost gap was almost 2,000 leva per square meter and the average subsidy as a percent of state-sector housing prices was over 1,300 percent. In the first semester, 1991 the state sold over 20,000 units. Thus, the total subsidy for that semester was slightly more than six percent of 1990 GDP.

IV. Housing Finance

The Evolution of the Bulgarian Banking System

Until 1987, the Bulgarian banking system consisted of only four banks and was extremely simple. Since then, both the number of banks and their role in the economy has expanded significantly. Furthermore, the recent and ongoing changes in Bulgaria's economic system have had a significant impact on the banking system and have created a number of issues for the sector.

Contemporary banking history in Bulgaria began with the nationalization of the industry by the Banking Law of 27 December 1947 which gave the government an exclusive monopoly over the nation's financial system. Until 1981, Bulgaria had a very simple financial system which consisted of only three banks: The Bulgarian National Bank (BNB), The State Savings Bank (SSB) and the Bulgarian Foreign Trade Bank (BFTB). The BNB, under the control of the Council of Ministers, issued money, implemented the state's banking policy, regulated all other banks in the country, coordinated foreign economic relations, and participated with its own assets in banks and firms both in Bulgaria and abroad (Giorov & Koleva, 1990:2). The State Savings Bank had a monopoly on household deposit mobilization and housing lending. The BFTB handled all foreign exchange operations.

From 1981 to 1987, the government undertook a banking reform which created eight new specialized commercial banks (SCBs) each restricted to lending in a particular economic sector (transport, agriculture, electronics, etc.). In 1989, the government created 59 common commercial banks (CCBs) out of the former branches of the BNB; at present this number has increased to 65. At the same time, the state allowed all banks to function as universal banks. In addition, the BNB has recently created interbank domestic and foreign currency markets and a market for Government bonds and treasury bills.

As Table 8 indicates, The BNB is by far the largest bank in terms of capital and also has one-fifth of the system's total assets. The SSB has 39 percent of the system's places of business, 46 percent of system deposits and 14 percent of total assets. The Foreign Trade Bank has nearly one-fifth of system assets. Virtually all, 2,237, of common commercial bank's offices are representative facilities in post offices controlled by the Bulgarian Post Bank.

Table 8
Summary of the Banking Sector by Type of Institution

Banks	No. of Banks	Locations	Percent of Total Banking Industry (Year End 1990) Deposits	BNB Credit	Capital	Assets
Bulgarian National Bank	1	5	15.8%	0.0%	56.5%	20.5%
State Savings Bank (1)	1	1,585	46.2%	0.0%	2.8%	13.9%
Foreign Trade Bank	1	2	10.1%	1.2%	13.1%	24.4%
Specialized Commercial Banks	8	51	11.2%	60.8%	16.1%	15.7%
Common Commercial Banks (CCBs)(1)	65	2,397	16.8%	38.0%	11.4%	25.5%
Total	76	4,040	100.0%	100.0%	100.0%	100.0%
Largest 5 CCBs(2)	na	93.3%	44.4%	31.8%	24.6%	56.3%
Smallest 5 CCBs(2)	na	0.2%	1.0%	0.6%	3.4%	0.7%

(1) Information reflects the creation of the Bulgarian Post Bank from 2,237 representative offices of the SSB. In reality, the Post Bank is still in the process of formation.

(2)Indicates the proportion of the variable which applies to the largest (smallest) 5 common commercial banks. The largest and smallest banks are defined in relation to each variable, e.g. deposits, capital etc.

Source: Thorne, 1991

Most commercial bank stock is owned by the BNB and state enterprises. The BNB in conjunction with the World Bank has designed a merger and sales program whereby all commercial banks will be merged into seven to ten large institutions and their shares sold to private domestic and international investors. It is anticipated that the SSB and the BFTB will be excluded from the merger process.

Recently, two functioning fully-private banks have been established and another will begin operation shortly. In addition to these three predominately domestically-held firms, there are also three international joint ventures. Private sector banks lend almost exclusively to private-sector enterprises.

Banking Sector Issues

The proliferation of banks and recent macroeconomic events have created a number of issues for the banking system. These include interest rate policy, asset quality, capitalization, branch adequacy, BNB reliance, deposit insurance availability, foreign currency exposure, and staffing and equipment issues.

Interest Rates: Interest rates were slightly positive in real terms from 1986 to 1988. By 1989 they were -4 to -9 percent. In 1990, the real rate was -36 to -39 percent (Thorne, 1992:11). Interest rates on deposits followed a similar trend as those on borrowings. Currently banks are paying a rate of approximately 54 percent on deposits - although this varies depending on the length and amount of deposit. Banks typically have a 300 to 500 basis point spread between their deposit and lending rates. Inflation was approximately 500 percent from January to November, 1991. Nevertheless, inflation for the last quarter of 1991 dropped to approximately 60% on an annualized basis, so this problem may be abating. Thus, rates have been highly negative in real terms.

Asset Quality: Banks have two principal sources of losses. The first is non-performing loans to "sick" state enterprises - most of which the BNB initially made and later transferred to commercial banks - and the second is the losses banks incurred through lev devaluation when they borrowed in foreign currencies and made loans in levs. The second type of loss was principally incurred by the BFTB. At the end of 1990, non-performing loans stood at 21.3 billion levs and accounted for slightly over one-half of commercial banks' outstanding loans. This figure was equivalent to 34 percent of GDP (Thorne 1991).

The effect of these loans on banks' balance sheets is limited. The BNB has deposits in banks almost equivalent to the amount of these credits because the BNB established SCBs and CCBs by transferring the same amount of loans and deposits. The primary effect of these loans on the banking system is to severely damage the BNB's net worth and cash-flow.

Capital and Risk Management: The BNB (1991c) puts total bank capital at 4.4 percent of assets in June, 1991 but commercial bank capital was an incredibly low 0.9 percent of assets in the same month (BNB 1991c).

Deposit Insurance System: The Bulgarian government insures deposits in the State Savings Bank but not commercial bank deposits. Commercial banks pay higher rates of return on savings than the SSB (the difference is now as high as 10 percentage points on some deposits) in order to attract resources. Given that the SSB and commercial banks will be increasingly competing for the same savers and borrowers, this system creates an unfair advantage for the SSB.

Bank Branch Network: The as yet nascent Bulgarian Post Bank plans to have 160 branches and an additional 3,000 representative offices in post offices by the end of

1992. Excluding the Postal Bank, there are only 160 offices of commercial banks. The SSB has 529 branches and 1,585 representative offices. This branch network is grossly inadequate to service the private sector which will spring up over the short to medium term and it is insufficient for mobilization of the household savings which will be needed to meet new firms' demand for credit. Finally, such a small branch network inhibits competition.

Reliance on BNB Resources: While the State Savings Bank has historically been a net lender to the banking system, the remaining commercial banks, and particularly the eight specialized banks, have been highly dependent on the BNB for resources.

Foreign Currency Exposure: Since the mid-1980s, banks have borrowed extensively in foreign currencies and made loans in levs. Thus, these firms have assumed all foreign exchange rate risk. By November 1990 banks' foreign exchange risk as defined by Thorne (1991) was 4.8. Thus, a one percent nominal devaluation at that time would have had the effect of increasing average bank liabilities by 4.8 percent more than assets.

Staff, Training and Equipment: A large expansion in the branch network requires a concomitant growth in financial sector personnel. Yet even current bank employees are poorly trained to perform their roles in a liberalized financial system. The banking system also lacks the computer and telecommunications equipment and personnel which the sector's growing size and complexity requires. The BNB, with assistance from international donors, has recently established a Banker's Training Institute.

Additional Banking Issues Which the Bank Merger Process Should Rectify: Bank stock is primarily held by the BNB, the BFTB, other banks and large, non-financial enterprises. BNB ownership of banks can create conflicts of interest for that institution between its duties as a bank regulator and its interests as a stockholder. Bank ownership by non-financial enterprises can also be dangerous in that firms can use their stockholder position to pressure banks into issuing imprudent credits.

Many banks are too small to exploit economies of scale. Furthermore, most Bulgarian enterprises are large and require major loans but many banks are unable to offer very large credits without becoming dangerously exposed to a single client. In addition, the industry is highly concentrated. At the end of 1990, the BNB, SSB and BFTB together accounted for 59 percent of total system assets, 72 percent of deposits and 72 percent of capital. On average, each of the eight original specialized commercial banks accounted for less than 2 percent of total assets, deposits and capital while each of the 59 original common commercial banks accounted for 0.6 percent or less of these resources.

Traditionally, the SSB and the older commercial banks focused on specific market segments. While most banks are now attempting to diversify their assets, they remain dangerously concentrated in their traditional sectors.

Housing Finance and the State Savings Bank

The State Savings Bank (SSB) was created in 1951. Its traditional role was to act as a financial intermediary to accumulate savings from the population and make consumer and housing related loans. In 1989, the SSB, along with all other Bulgarian banks, received permission to behave as a universal bank.

Although all banks are legally able to undertake housing finance, in practice virtually none have done so. The SSB believes that no other banks are engaged in mortgage lending and that it has over 95 percent of the housing construction market.

The SSB has 238 branches, 291 subsidiary offices and 1,056 representative offices.[2] Excluding the Post Bank, the SSB has 88 percent of bank's total offices, if the Post Bank is included, it has approximately 39 percent of the total. See Table 1.1.

Assets, Resources, & Profitability

SSB assets declined by approximately 83 percent in real terms from 1987 to 1991. Lending to the BNB accounted for 72 percent of total assets in 1987. This figure declined to 6 percent by 1990 but lending to other banks increased from 0 to 60 percent of assets over the period. This trend reflects the fact that in the past the BNB borrowed from the SSB and lent these funds to commercial banks whereas now the SSB and commercial banks transact directly. The SSB has no foreign currency denominated assets. Table 9 delineates the SSB's asset portfolio.

Table 9
Assets of the State Savings Bank
For August 1991 and August 1987

	August 1991		August 1987	
	Volume (Billion LV)	% of total	Volume (Billion LV)	% of total
Loans to Households	6.89	23.9	3.11	14.4
Loans to Other Banks	17.31	60.1	0.00	0.0
Loans to BNB	1.84	6.4	15.48	71.5
Loans to Non-financial Firms	0.23	0.8	0.26	1.2
All Other Liabilities	2.53	8.8	2.80	12.9
Total	28.80	100.0	21.65	100.0%

Note: These figures may not be completely accurate due to some ambiguities in aggregating.
Source: The State Savings Bank

2 Subsidiary branches do not keep their own separate accounts and do not have the right to issue housing loans, although they do issue consumer credits. Representative offices are little more than windows at post offices, state enterprises, cooperatives etc. which accept deposits, loan applications etc. but do not perform substantive tasks.

The SSB receives the overwhelming majority of its resources--78 percent--from household deposits. The SSB retains over 94 percent of the banking industry's domestic currency household deposits. Equity has declined reflecting the fact that the firm has experienced financial difficulties due both to the dramatic decline in real lending and its portfolio of outstanding loans at subsidized interest rates. The SSB has no foreign currency liabilities. Table 10 details the SSB's resource portfolio.

Table 10
State Savings Bank Resources
For August 1991 and August 1987

Source	August 1991		August 1987	
	Volume (Billion LV)	% of total	Volume (Billion LV)	% of total
Household Deposits	22.57	78.4	18.07	83.5
All Other Liabilities	4.04	14.0	0.23	1.0
Equity	2.19	7.6	3.35	15.5
Total	28.80	100.0	21.65	100.0

Note: These figures may not be completely accurate due to some ambiguities in aggregating.
Source: The State Savings Bank

From 1987 to 1989, SSB net profit increased by approximately 10 percent per year and stood at 243 million levs in 1989. However, in 1990 profits dropped by approximately 40 percent in real terms. The SSB's "tax rate"[3] is 80 percent of net profits compared to approximately 55 percent for commercial banks.

Housing Finance Loan Products

The bank makes short-term construction loans to municipalities and ministries, mortgage and major repair loans to households and combined construction and mortgage loans to individuals and cooperatives which build their own homes.

3 The share of SSB profits appropriated to the budget

Construction Loans: The bank lends to municipal councils for the construction of sale and rental units and to ministries and state-enterprises for the construction of housing for their employees. SSB management anticipate that over time, municipalities and ministries will cease to be involved in the construction of sale-housing and the currently state-owned construction companies will become private and account for the majority of lending in this sector.

Currently, construction loans are generally for 2.5 years and carry an interest rate of 55 percent or slightly higher. Non-municipality borrowers must place a deposit equal to 30 percent of the cost of the project in a deposit account with the SSB. The SSB plans to extend the 70 percent loan-to-cost and 30 percent deposit rules to municipalities shortly.

Mortgage Loans: The SSB is in the process of decreasing the term on mortgage loans from 30 to 20 years. These loans now carry an interest rate of 49 percent for families with housing-linked savings accounts. The SSB does not have a maximum payment to income ratio. The bank requires households to retain from the combined incomes of all members 65 percent of the minimum wage per person.[4] All income families earn over this amount can be used for mortgage repayments.[5] The SSB no longer provides concessionary terms to larger families. The SSB sometimes requires borrowers to have guarantors[6] and/or mortgage additional property. The SSB's only mortgage product is a standard, equal-monthly-installments instrument.

4 Currently the minimum wage is 620 levs per month and the minimum living standard per person is 65 percent of that--403 levs. This amount is widely considered to be inadequate.

5 For example, the average income in Sofia is currently approximately 935 levs per month. A two-income family with two dependents would earn 1,870 levs per month in income and an additional 600 levs per month from the state for child allowances. The SSB's regulation would require them to save 1,612 levs per month for all non-mortgage expenses. Thus they could devote 858 levs per month to mortgage payments--an amount equal to 35 percent of their total income.

6 Guarantors are financially liable for the debt if the borrower defaults.

Over the last year, SSB's loan sizes have not kept pace with increases in unit costs. The SSB's maximum loan size is only 20,000 levs.[7] In the future, the SSB will issue loans for from 70 to 100 percent of the cost of a unit based on the state-determined price of 1,000 levs per square meter. If borrowers keep a deposit equal to 30 percent of the state-determined home price in the SSB's housing-linked savings account scheme for at least six months they will be eligible for loans at a 49 percent interest rate. If they do not make a housing-linked deposit of at least this amount they will pay an interest rate of 54 percent on loans for up to 70 percent of the state-determined cost of the unit and a rate of 57 percent on the portion of the loan which is from 70 to 100 percent of the state-determined cost. Beginning in January 1992, borrowers will be required to keep deposits in housing-linked accounts for at least one year to be eligible for the lower interest rate.

It is unlikely that this new system will have a significant impact on housing affordability because, faced with very high unit costs and interest rates, few families will be able to afford loans large enough to cover a significant portion of housing costs.[8]

Long-term Construction Loans: For individual families or cooperatives who wish to build their own units, the SSB makes combined construction/mortgage loans called long-term construction loans. During the construction period, interest is capitalized. When construction is completed (a maximum of four years after the first tranche of the loan is disbursed) the loan becomes a standard 20 year mortgage with mortgage interest rates and terms.

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7 Equivalent to approximately 20 percent of the cost of a non-subsidized 50 square meter unit priced at 2,000 levs per square meter or 42 percent of the cost of the same unit sold by the state priced at 1,000 levs per square meter.

8 For example, assuming an average family is able to devote 858 levs per month to housing payments (see footnote 5) they would be able to take a 20 year loan at a 49 percent interest rate of still only 21,00 levs which, as indicated above, is inadequate to purchase even a state-subsidized unit.

Other Housing Finance Products: The SSB also lends, with a maximum of 10,000 levs and a term of 20 years for repairs and upgrading. The firm plans to increase this maximum loan size to 70 percent of the cost of the project.

Volume of Lending by Type of Loan Product

Lending was quite stable until 1990. From 1985 to 1989, the total number of housing-related loans issued varied from 53,000 to 60,000. In 1987, the SSB issued 57,515 housing loans of which 54,278 were for home purchase. The number of home purchase loans was equal to approximately 85 percent of the number of units produced in that year. Housing loans accounted for approximately 62 percent of SSB's retail lending in that year. Total home purchase loans accounted for 36 percent of SSB retail credit volume and short-term construction loans accounted for approximately one-fourth of volume.

Lending in terms of number of loans issued and volume was extremely high in 1990 reflecting the government's massive sale of state-owned housing at pre-1990 prices and deregulation of the inter-household real estate market. These loans accounted for 68 percent of total SSB retail lending. For 1990, home purchase lending accounted for 61 percent of total retail loan volume. In 1991, mortgage lending continued to exceed 1987 figures (if 1991 figures are annualized) due to the continued sale of homes at pre-1990 prices. Nevertheless, these sales were well below the peak reached in 1990. Short- and long-term construction lending plummeted. A very rough estimate of the real decline in total lending volume from 1987 to 1991 is that in real terms first semester 1991 housing loan volume was approximately 26 percent of volume in the first semester of 1987.[9] Table 11 provides information on SSB household loans sanctioned since 1987 by type of loan. Trends for each type of lending are discussed in more detail below.

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9 Inflation was approximately 64 percent in 1990 and approximately 317 percent in the first half of 1991. We assume that inflation was almost negligible from 1987 to 1989.

Table 11
SSB Household Issued by Type of Loan
1987 to 1991

	1987 Number	1987 % tot vol	1990 Number	1990 % tot vol	1991 Number January to June 30	1991 % tot vol
Mortgages	34,438	24.0%	127,811	45.9%	25,567	36.9%
(Rental as % of total)	55.9%	55.3%	73.9%	69.4%	83.9%	74.9%
Long-term Construction	19,840	12.2%	34,585	15.3%	1,644	5.2%
Total Home Purchase	54,278	36.2%	162,396	61.2%	27,211	42.1%
Repair and Upgrade	2,749	0.4%	3,576	0.3%	63	0.0%
Short-term Construction	488	25.2%	519	6.6%	122	32.4%
Total Housing	57,515	61.9%	166,491	68.1%	27,396	74.5%
Consumer	418,423	38.1%	337,147	31.9%	39,045	25.5%
Total	475,938	100.0%	503,639	100.0%	66,441	100.0%

Source: SSB Records

Mortgage Loans: Table 12 examines mortgage lending from 1987 to 1991. Mortgage lending was relatively stable from 1985 to 1989. Loans for the purchase of rental units accounted for slightly over one-half of total mortgage loans. The remaining 46 percent of loans was accounted for almost entirely by the sale of state-constructed new units.

In 1990 the number of mortgage loans sanctioned increased by over 270 percent, reflecting the massive state sale of its rental stock at highly subsidized prices[10] and the fact that many people took advantage of the deregulation of the inter-household housing market to sell their second units.

Over the course of 1991, housing prices continued to rise and mortgage interest rate increased from 2 percent in December, 1990 to 49-54 percent by August, 1991. Not surprisingly, lending volume declined sharply in 1991 and 84 percent of loans were for rental units--which the state continued to sell at pre-1990 prices. Total first semester 1991 volume of mortgage loans was only about one-third of its volume in first-semester 1987 in real terms. Average loan size dropped sharply from 1990 to 1991 reflecting the reduced affordability of mortgages as the interest rate rose. It is anticipated that mortgage sales for second semester 1991 will be significantly below those of the last six months. The state rental stock available for sale is exhausted everywhere but Sofia and even in the capital it is almost entirely depleted. While the government plans to renew its sale of newly constructed units, escalating costs and prohibitive interest rates will make these and all other units very difficult to afford. See footnotes above.

Long-term Construction Loans: Over the last year, the demand for long-term construction loans has plummeted. Given the extreme volatility in housing construction prices, families have been very reluctant to undertake construction projects since they have no way of ascertaining at the beginning of the project the total cost of the undertaking. Furthermore, most families can no longer afford the cost of building a unit and compounding this difficulty is that interest rates increased from

10 The state sold its rental housing stock at from 137 to 170 levs per square meter although the free market price for housing was approximately 400 levs per square meter in January 1990 and increased to from 1,800 to 3,000 levs per square meter by September, 1991.

Table 12
Mortgage Lending
From 1987 to 1991

	1987	1990	1991 January to June 30	Real % Change 1987 to 1990	Real % Change 1987 to 1991*
Total # Mortgages	34,438	127,811	25,567	271	48
# Former Rental Units	19,235	94,436	21,445	391	123
# All Other Units	15,203	33,375	4,122	120	-46
Total Volume (MM Levs)	347	1,376	191	210	-67
Volume Former Rental Units	192	955	143	288	-56
Volume All Other Units	155	421	48	112	-82
Average Loan Size ('000 LV)	10.1	10.8	7.5	-17	

* To facilitate comparison, 1991 figures are compared to first semester 1987 figures.

Source: SSB Records

2 to 49-54 percent from January to June, 1991. The number of these types of loans sanctioned in the first six months of 1991 was about 17 percent of its level in first-semester 1987. See Table 13.

Short-term Construction Loans: Table 14 details the SSB's short-term construction lending for 1987 to 1991. If first semester 1987 figures are compared with 1991 results it appears that for 1991, the total number of loans issued will drop by about one-half while, in real terms, construction lending volume will probably be about 28 percent of its 1987 level.

Table 13
Long-term Construction
1987 to 1991

	1987	1990	1991 January to June 30	Real % Change 1987 to 1990	Real % Change 1987 to 1991*
Number	19,840	34,585	1,644	74	-83
Volume (MM LV)	176	459	27	104	-91
Average Size ('000 LV)	9	13	16	17	-45

* For ease of comparison, 1991 figures are compared with first-semester 1987 figures.
Source: SSB Records

Table 14
Short-term Construction Lending
From 1987 to 1991

	1987	1990	1991 January to June 30	Real % change 1987 to 1990	Real % Change 1987 to 1991*
Number	488	519	122	6%	-50%
Volume (MM LV)	364	199	168	-57%	-72%
Average Size ('000 LV)	746	383	1,377	-60%	-45%

* For ease of comparison, 1991 figures are compared with first semester 1987 figures.
Source: SSB Records

Repair and Upgrading Loans: Loans for repair and upgrading have always been a very small share of SSB's total loans. These loans numbered only 2,749 in 1987 and represented only 0.4 percent of SSB lending volume for that year. Lending for repair and upgrading has virtually ceased this year.

Table 15
Repair and Upgrading
1987 to 1991

	1987	1990	1991 January to June 30	Real % Change 1987 to 1990	Real % Change 1987 to 1991*
Number	2,749	3,576	63	30	-95
Volume (MM Levs)	6	8	0.1	-1	-99
Average Size ('000 LV)	2.2	2.2	1.6	-24	-79

* For ease of comparison, 1991 figures are compared with first semester 1987 figures.
Source: SSB Records

Competition in the Housing Finance Market

Currently the SSB is doing almost 100 percent of Bulgaria's mortgage lending and probably over 95 percent of housing construction lending. Yet the SSB expects that as the commercial bank merger issue is resolved and prices and interest rates stabilize, commercial banks will move into housing finance.

The SSB has several advantages that should enable it to retain its hegemony in the market. Being the country's only housing lender from the 1950s to 1989, it has tremendous name recognition. Second, the SSB has more branches and places of business than all other banks combined, with the exception of the nascent Bulgarian Post Bank. Third, the SSB is the only Bulgarian bank whose deposits are insured by the government. This allows it to pay lower rates on its deposits and pass these savings to borrowers. Finally, other lenders may be reluctant to enter the market until an adequate foreclosure law is developed.

The Bulgarian Post Bank: The SSB's only significant housing and consumer lending competitor for the short- to medium-term will be the newly-created Bulgarian Post

Bank (BPB). Over the next 18 months it plans to establish over 160 branches, and representative offices in over 3,000 post offices. It intends to be a universal bank and will offer housing and consumer loans.

Issues in Housing Finance

Issues in housing fin~~e include high interest rates, rapidly escalating housing costs, a large volume of outstanding SSB loans at extremely low interest rates and lending procedures and training systems which are probably inadequate to cope with the evolving mortgage environment.

Interest Rates: The interest rate on time deposits varies from 46 percent for one month deposits to 62 percent for one year deposits.[11] Housing-linked deposits earn an interest rate of 44 percent. Other deposits earn 38 percent interest. Housing lending rates on new loans stood at 49 percent for borrowers who had housing-linked deposit accounts and 54 percent for all other mortgage borrowers. Rates for short term construction loans were 55 percent. These rates were extremely negative in real terms for most of 1991. Inflation was about 400 percent for only January to September. Nevertheless, the annualized inflation rate for the last quarter of 1991 was only about 60 percent. Thus, this problem has been mitigated.

Despite the fact that lending rates have been very negative in real terms, they are nevertheless too high for most households to afford and have contributed to a very rapid decline in mortgage borrowing over the last eight months.

Inflation: Even more damaging to housing affordability than the increase in interest rates is the fact that housing prices rose 10 to 17 times from spring, 1990 to fall, 1991. While general inflation and wages have risen over the period, they have not

11 The SSB has the right to change its interest rates on any of its deposits at any time.

kept up with housing cost increases. General prices have increased by about 700 percent from January 1990 to September 1991 (Mladenov, 1991).

Outstanding SSB Loans at Subsidized Rates: As of August 1991 the firm had approximately 2.8 billion levs in mortgage loans made before January 28, 1991 which currently carry a 10 percent interest rate and 1 billion in consumer loans which carry a 17 percent rate. These low-interest rate loans represented 71 percent of total outstanding loans to non-financial entities and 13 percent of total assets. The difference in monthly revenues between the interest the SSB earns on these loans and the interest it would earn if the loans carried current market rates is 123 million levs. If this figure is deflated to December 1990 prices and annualized, it represents approximately 160 percent of the SSB's 1990 net profit.

The SSB is able to cover the losses it incurs on these loans via the spread it makes on its current lending. Thus, the SSB is paying a subsidy to some of its borrowers which, when figured on an annual basis, is greater than its entire 1990 profits. This huge transfer is being financed via cross-subsidization by other borrowers and is not recorded as an on-budget subsidy, thereby masking its true size.

A recent parliamentary Act gave the SSB the right to raise the interest rate on its low rate loans up to two-thirds of the current base interest rate.[12] The SSB has yet to do so because it faces heavy social pressure to keep these rates low and it fears massive defaults.

Lending Procedures: The SSB has no separate underwriting or collection departments. Underwriting is performed by "financial inspectors". At this point, the process consists exclusively of prospective borrowers submitting information on

12 The base rate is set by the BNB. It is 54 percent.

household income[13] for mortgages, income information and construction plans for long-term mortgages and construction plans for short-term construction loans. If income and plans are deemed acceptable, the borrower is issued a loan. If income is not acceptable, the SSB asks for two guarantors. Virtually no applicants are denied credit.

Most borrowers pay monthly installments through salary deductions. The SSB's accountants handle payment processing. In the event of a borrower missing "five or six" payments, the accountants notify a financial inspector who follows up on the case. Each January the accountants make sure that each borrower has made 12 payments. If any payments are missing they inform financial inspectors who follow up. Financial inspectors have no formal collection guidelines.

Training and Systems: Most new SSB employees have University degrees. The SSB has a formal training program for new employees. They have not modified this program since the changes in Bulgaria's economic system and have no concrete plans for doing so.

The SSB's computer operations are handled by BNB-sponsored computer centers located throughout the country. These centers serve most banks in their respective regions. The SSB has entered into a contract with the British firms ICL and Kendal to develop the bank's in-house computer capacity. SSB computerization has begun and should be completed in three years.

Conclusions

The Bulgarian banking system evolved slowly from the 1950s to 1990. Currently the system consists of several large, specialized banks and a number of very small firms. Virtually all firms are state-owned and most are dangerously undercapitalized.

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13 The SSB does not verify this information.

Currently about 60 percent of Bulgaria's outstanding bank credits are to state enterprises, one-third to the government and 5.8 percent to consumers and nascent private sector enterprises. Outstanding bank credits stood at 115 billion levs in June 1991. This represented a decline of about 60 percent in real terms since December 1990. Foreign liabilities and domestic liabilities in foreign currency amount to over three-fourths of total bank resources. Total bank resources declined by about 21 percent in real terms from December 1990 to July 1991.

Government plans call for substantial banking sector modifications over the next year or so. The new system which will result should consist of seven to ten large, diversified, privately-owned firms and a number of small banks which did not participate in the merger process. The merger program is expected to correct a number of the financial systems current ills. Nevertheless, the merger program does not address the banking sector's negative real interest rates, large volume of non-performing loans, foreign exchange rate exposure, limited bank branch network, inadequately trained personnel and a number of other issues.

For the first six months of this year, housing lending totaled 386 million levs. The real volume of housing lending has declined precipitously over the last four years. The real volume of lending in the first half of 1991 was only about 22 percent of its level in the first semester of 1987. Furthermore, 37 percent of 1991 housing volume was for the purchase of rental units at artificially low prices. As this source of housing dries up, the demand for housing loans will likely decline even more. For the last six months, 42 percent of SSB's retail lending volume was for housing purchase loans and an additional 32 percent for short-term construction.

The housing finance system consists almost exclusively of the State Savings Bank which issues all mortgage loans and over 95 percent of housing construction credits. While all banks are free to undertake these loans, in practice it is likely that few will do so in the near future. Nevertheless, the SSB is likely to face some competition from the Bulgarian Post Bank.

The major issues facing the housing finance system are unaffordable housing costs, high and wildly fluctuating inflation rates contributing to very high interest rates, tremendous subsidies to borrowers paying below-market interest rates--which translate into massive losses for the SSB, a dearth of trained banking underwriters and collection agents and grossly inadequate underwriting and collections procedures and guidelines.

V. Characteristics of the Housing Stock

Sixty percent of the country's housing stock is located in detached, single family homes, duplexes and large, old homes subdivided into apartments.[14] The remaining homes, 40 percent, are in blocks of flats (Table 16). However, these country-wide figures mask large differences between urban and rural areas. In Sofia, 92 percent of all units are located in blocks of flats, while in small towns and villages only 13 percent of the stock is located in such complexes.

Table 16
Type of Dwelling by Location
(in percent of households)

	City Group*			
	Sofia	Reg'l	Small	TOTAL
Block of Flats	91.9	69.5	12.5	40.4
Other	8.1	30.5	87.5	59.6
TOTAL	100.0	100.0	100.0	100.0

Source: National Housing Survey, Bulgaria, 1990.
Note: * Reg'l = Regional Capitals; Small= Small Towns & Villages

The age of the stock also varies significantly between Sofia and other areas. In Sofia 27 percent of the housing was built since 1980, 59 percent since 1970; for the whole country the respective figures are 16 percent and 42 percent (Table 17).

14 In the tables that follow we label these types of dwellings as "other" a residual category which is intended to include everything other than large apartment blocks

Table 17
Distribution of Dwellings by Age and Location

	City Group*			
	Sofia	Reg'l	Small	TOTAL
< 1945	5.5	7.0	14.0	10.7
1946-56	7.5	4.5	17.1	11.8
1957-60	5.3	7.0	12.8	10.0
1961-65	9.4	10.8	14.0	12.4
1966-70	13.7	16.5	11.0	12.8
1971-75	18.1	15.5	9.9	12.7
1976-80	13.8	19.5	9.9	13.5
1981-85	17.3	13.4	7.8	10.7
1986-90	9.3	6.8	3.4	5.2
TOTAL	100.0	100.0	100.0	100.0

Source: National Housing Survey, Bulgaria, 1990.
Note: * Reg'l = Regional Capitals; Small = Small Towns & Villages

Average unit sizes increased by 25 percent (from 49 meters square to 62 meters square) in Bulgaria during the 1965 to 1985 period according to census figures. Urban units have tended to average 5 percent smaller and rural units 10 percent larger than the national figure.

If we look at the distribution of unit sizes (Table 18) we find that Sofia with over 32 percent of all units below the national average fares better than regional cities where this figure is 42 percent. If we look to units which are approximately half again as large as the national average (91 or more meters square) we find that they are more prominent in small towns with 1 of every five units falling in this category.

Table 18
Distribution of Dwellings by Size (m^2)

	City Group*			
	Sofia	Reg'l	Small	TOTAL
Unknown	.2	.7	.3	.4
≤ 30	4.2	9.4	5.4	6.6
31-60	28.0	32.2	29.7	30.4
61-90	53.3	45.6	44.6	45.9
91-120	13.4	11.0	16.4	14.2
> 121	.9	1.2	3.6	2.4
ALL	100.0	100.0	100.0	100.0

Source: National Housing Survey, Bulgaria, 1990.
Note: * Reg'l = Regional Capitals; Small = Small Towns & Villages.

Shifting to the facilities or amenities available in units it is easy to note very substantial improvements since 1965 (Table 19A[15]). For example, census figures indicate that the presence of flush toilets in urban areas has increased from 26 percent in 1965 to 71 percent in 1985. Rural areas have also shown dramatic increases although overall levels remain low. Looking at the current situation in urban areas (Table 19B), basic amenities are almost universally present in Sofia and in regional cities. Only in small towns are there significant inadequacies, particularly in the area of waste disposal.

15 The data in tables 19A and 19B are from different sources and are not precisely comparable because of differences in definitions of urban places.

Table 19A
Unit Characteristics by Year & Location
(in percent)

Facility		Dwellings With Facility in Unit 1965	1975	1985
Piped Water	Urban	55.0	84.5	94.4
	Rural	7.7	43.6	66.8
Bath	Urban	8.7	49.5	78.0
	Rural	1.3	15.1	39.5
Flush Toilet	Urban	26.1	48.9	71.7
	Rural	0.9	1.5	5.1

Source: Census of Population & Housing, 1965, 1975, 1985.

Table 19B
Unit Characteristics in 1990 by City Group*
(in percent)

Facility	Dwellings With Facility Present in Unit: Sofia	Reg'l	Small	All
Piped Water	98.7	94.6	74.6	84.1
Hot Water	95.6	89.3	64.8	76.5
Bath	97.8	89.0	67.5	78.1
Flush Toilet	94.8	82.6	27.3	53.5
Public Sewerage System	96.5	92.3	41.6	64.9

Source: National Housing Survey, Bulgaria, 1990.
Note: * Reg'l = Regional Capitals; Small = Small Towns & Villages.

If we shift our focus to the types of units in Sofia which are experiencing the greatest lack, it is apparent that it is the other category -- not the blocks of flats -- which lack facilities (Table 20). Of more interest is that if we divide these facilities into those which are provided by the municipality (public sewerage and water distribution) and those which need to be provided by the owner or occupant (baths, hot water, and flush toilets) the greatest lacks are in the latter category.

Table 20
Unit Characteristics by Dwelling Type
Sofia, 1990 (in percent)

	Dwellings With Facility Present in Unit	
Facility	Blocks of Flats	Other
Piped Water	98.8	85.9
Hot Water	96.6	73.0
Bath	98.1	69.3
Flush Toilet	98.0	52.3
Public Sewerage System	98.8	80.1

Source: National Housing Survey, Bulgaria, 1990.

As to other facilities not represented in the tables, we would note that electricity is present in virtually all urban areas, while heating presents a more complex picture. Most cities are partially served by municipal heating plants developed in conjunction with the surge in apartment construction. The municipal systems suffer from deferred maintenance both at the plants themselves and in the equipment located in the serviced buildings. In Sofia, the plants close down for maintenance and repair for three months every summer leaving the residents without hot water. In 1985 approximately 21 percent of all urban units were served by this system (Bulgaria, 1985), officials of the municipal heating enterprise in Sofia state that 85 percent of all buildings in the city are connected to the central municipal heating system. The balance are heated by a variety of systems which are generally in the individual dwelling unit as opposed to having one heating system for the entire building. While a variety of fuels (including coal and wood) are used for unit heating, a large share is electric heat, a major contributor to winter blackouts.

The above statistics illustrate the basic condition of the housing stock in Bulgaria, but in general such indicators address the presence or absence of particular items, or gross measures of size and quantity. Indications of the quality of shelter and the condition of its components is harder to determine. In Eastern Europe this is particularly troubling as the design of apartment blocks and their subsequent neglect by the owners, be it the state or a private party, has left a housing stock which is in most instances in worse condition than a reading of housing statistics would indicate. A recent study of the maintenance and rehabilitation situation in Bulgaria (Nutt-Powell and Lowry, 1991) concluded that:

> "Almost without exception buildings are in need of significant repair and/or maintenance on every building system . . . [This] is the result of (1) accrued needs building up from deferred maintenance; (2) lower quality building materials yielding shorter expected useful life and more rapid replacement, and (3) no system of property maintenance to ensure proper system monitoring, repair, and replacement in a timely and cost effective manner (p.2)."

Thus, one can conclude that not only is the housing stock in poor condition, but that its condition will continue to deteriorate rapidly unless there is a decisive change. The creation of housing markets and the development of new units will serve part of demand for a higher quality of shelter, but addressing the needs of a large share of the population, particularly those with moderate and low incomes, will depend on the country's ability to rehabilitate its existing stock.

V. Reforms & Future Directions

General Developments & Property Rights

The popular perception of Bulgaria has been that it has lagged behind other ex-socialist nations in its transition to democracy and a market economy. Yet, in some respects -- and especially in the housing sector -- the opposite is true. Overall, Bulgaria has now conducted three democratic national elections, has avoided civic unrest and ethnic strife, and has begun to reincorporate the Turkish minority into the mainstream of political life. Equally important, Bulgaria adopted a new constitution in July of 1991 which guarantees private property rights and removed the former distinction between "state" property and that owned by private citizens (see articles 17 and 18).

In the area of housing, in addition to the high share of private ownership of dwellings, Bulgaria has removed all restrictions on private sales of property as well as controls on rent levels for private rental contracts. Further, private rental contracts are enforceable and tenants can be evicted without being provided an alternative unit. Even in municipal housing, evictions for non-payment of rent and other breaches of contract are permitted. Similarly, mortgages and other security interests in real property are enforceable, and these factors place Bulgaria ahead of many other ex-socialist countries in the protection of private property, and give it greater immediate potential for real estate investment.

Legislation was also passed in 1991 returning agricultural land to its former owners and implementation of that law is underway. For urban areas, the reform and restitution of property rights is currently high on the parliament's agenda, the restitution of retail shops has already begun. Parliament has also acted to begin the privatization of smaller state assets.

Remaining Reforms & Technical Assistance

In other aspects of housing, Bulgaria has also made progress, but much more remains to be done. Specifically, we would note four areas where attention is necessary:

- the removal of remaining constraints on the housing market;
- the development of a workable housing finance system;
- the improvement of the use of the existing housing stock; and,
- the creation of workable and financially realistic policies and programs for low-income groups.

A first priority involves the further removal of constraints on the functioning of housing markets. There are aspects of notarial practice including the registration of land rights and security interests which currently slow land transactions and raise prices. The further development of both the real estate brokerage and appraisal professions is critical. And, the reform of planning and land use regulations and permitting procedures requires attention.

Also, attention should be devoted to the construction industry itself. Small private building firms have emerged, but few if any are producing significant amounts of housing. It is necessary to more closely determine the constraints such small builders are facing.

Second, Housing finance has virtually stopped in Bulgaria due to high interest rates, inappropriate mortgage instruments, and a single, out-dated housing finance institution -- The State Savings Bank. The State Savings Bank is saddled with disastrous past financial arrangements, and to date has been given neither the resources or the government direction to change its practices.

We would suggest that a very high priority is the renovation of the country's mortgage lender and the development of a competitive mortgage lending system. Current banking reforms are a move in the right direction but the efforts must pay more attention to housing finance. There is also a role for technical assistance. The central bank has expressed serious interest in adopting an alternative mortgage instrument which would make home loans affordable to a greater segment of the population. Further, that bank recognizes that in addition to adopting such an instrument the banking community needs training in underwriting and collection procedures.

Third, attention must also be given to improvements in the use of the existing housing stock. This involves better management, maintenance, and rehabilitation in both the private and public sectors. Public maintenance firms should be privatized and municipalities need to develop the capacity to negotiate and contract with such firms.

Finally, Bulgaria will need to consider the needs of those who cannot afford shelter on a market basis while being aware of the potentially disastrous costs of such an objective. In most countries, rental housing plays an important role in serving this part of the population, but here, the rental stock has been depleted through the sale of state units. Thus, there is a need to increase the share of rental housing.

While production of additional rental units is a possible solution, practicality and the shortage of resources mandate an alternative approach. As a first step, existing tenure patterns and the very recent rental market need to be analyzed to determine how much additional rental space could be created as a result of the recent removal of controls on private renting. Also, initial analyses indicate that Bulgarian cities contain large numbers of vacant units and second homes, and some of these will be brought into the rental market in the near future.

One complement to these activities could be the development of a housing allowance scheme as part of the country's social safety net. Allowances paid directly to a household, as opposed to subsidy programs which existed in the past, are an administrative and financial efficient method of providing assistance but they also have a two additional advantages. First, they allow the family the freedom to choose their own housing avoiding both the regimentation of individuals and the concentration of poorer families in public projects. Second, allowances work to increase rental markets -- and hence the number of rental units -- by providing greater demand. Nevertheless, the costs of such proposals would need to be carefully calculated.

As a whole, a comprehensive approach to the three areas discussed above forms the basis of a suggested housing policy and strategy for the development of the sector. These suggestions attempt to address immediate needs as well as long term objectives and provide the basis for stimulating the housing market.

The Institutional Framework of Reform

Finally, there is the question of the institutional framework or approach to housing reform. The experience in some countries undergoing the transition to a market economy has been that of seeing the market as an instrument to implement centralized policies and programs. While it is true that there is an element of this in all countries, the essence of a market economy is that there is a multiplicity of decisions being made by a multiplicity of actors. Thus, many of the decisions that are made are outside government control. Governments facilitate markets, the provide incentives, they regulate markets and provide disincentives. But ultimately, their control remains incomplete. This is a continual frustration for policy makers, a rallying point for those who would return to centralized systems, and often the source of policy failure. Nevertheless, it is not only inevitable, but it is proper. The alternative is a return to the command economy.

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