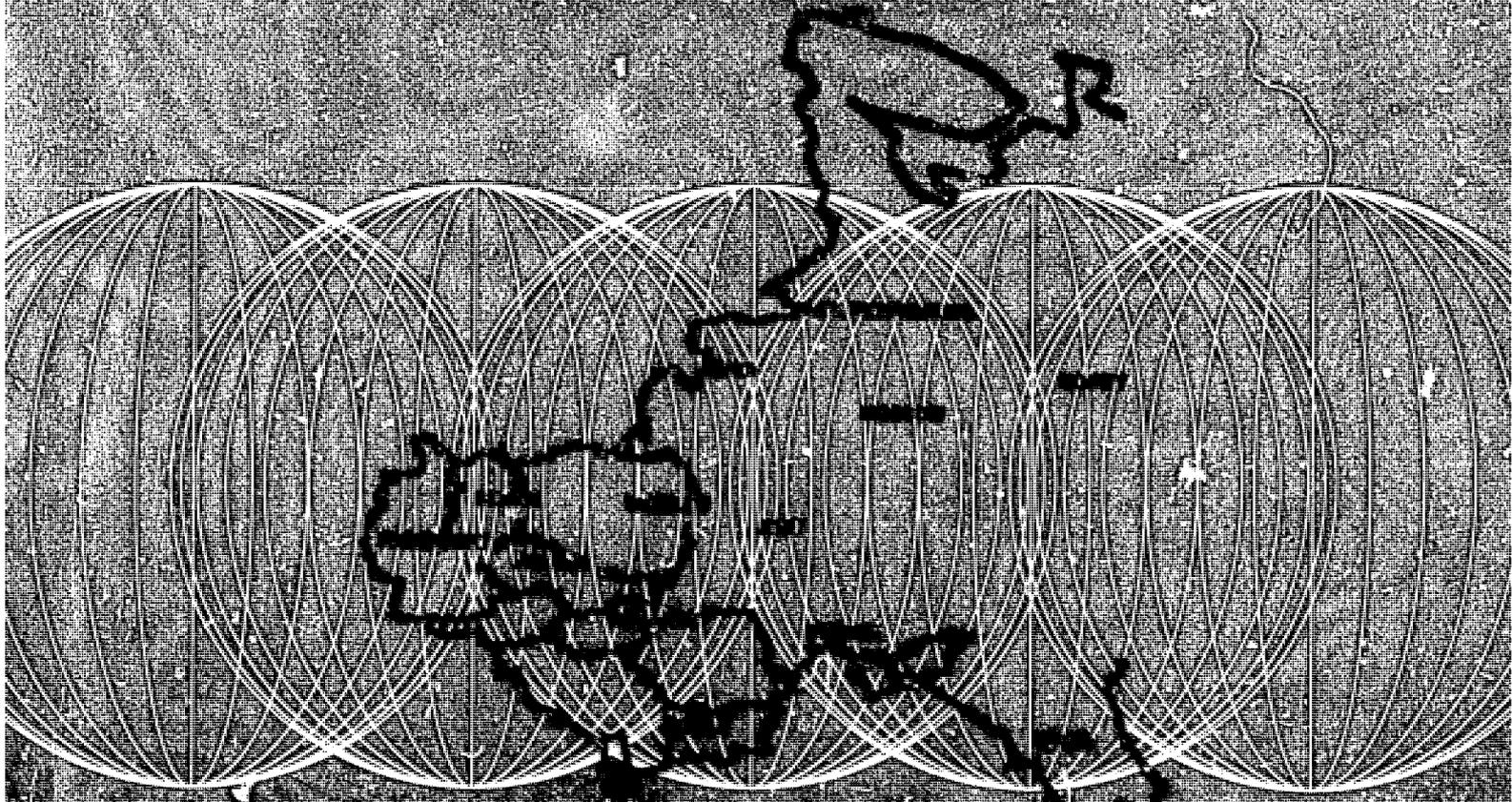
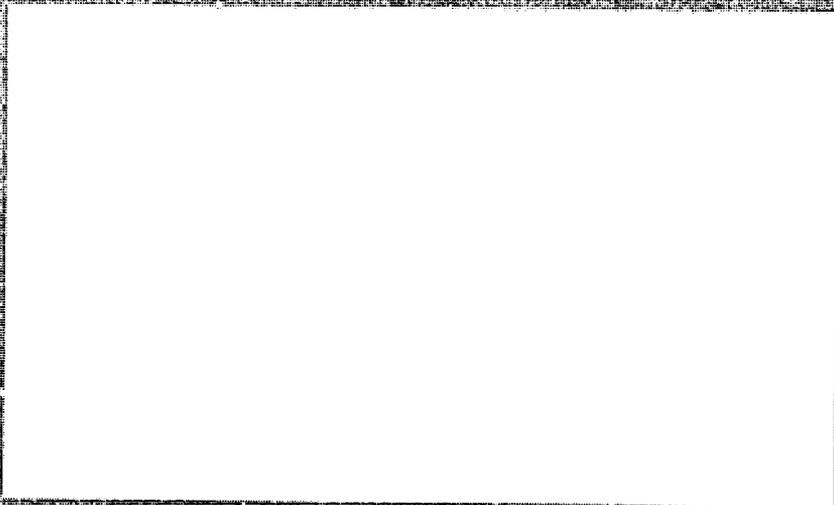


PM 46.1-198

**AN INTERNATIONAL ACTIVITIES PROJECT**

**FROM PLANNING TO MARKETS**

**HOUSING IN EASTERN EUROPE**



**THE URBAN INSTITUTE**

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

**HOUSING PRIVATIZATION IN PRAGUE**

***Two Case Studies***

Peter A. Tatian

January 1993

Report Prepared for the  
Office of Housing and Urban Programs  
U.S. Agency for International Development

Contract No. EUR-0034-C-00-2034-00  
U.I. Project No. 6283-03

**THE URBAN INSTITUTE**  
Washington, D.C.

## **PREFACE**

Housing privatization and housing management are key areas of concern for municipal government officials in the CSFR. Local governments throughout the country are endeavoring to ways to deal with these two issues. In July 1992, the U.S. Agency for International Development (USAID) requested that case studies be prepared of two districts in Prague that have attempted to address these problems.

The author would like to thank Č Sedláčková, Romana Provazníková, and Hanna Zelenková for their invaluable assistance in preparing this report.

## TABLE OF CONTENTS

|   |    |
|---|----|
| PREFACE .....   | i  |
| EXECUTIVE SUMMARY .....                                       | 1  |
| INTRODUCTION .....  | 12 |
| HOUSING MANAGEMENT PRIVATIZATION .....                        | 14 |
| SALES OF PUBLIC HOUSING .....                                 | 27 |
| REFERENCES .....  | 42 |
| ANNEX A -- PRIVATE HOUSING MANAGEMENT FIRMS .....             | 43 |
| ANNEX B -- MODEL MEMORANDUM OF AGREEMENT FOR COOPERATIVES ... | 44 |

## TABLES

|  |    |
|--|----|
| Table 1 -- Descriptive Statistics on Housing Management Firms .....        | 17 |
| Table 2 -- Housing Management Firm Activities .....                        | 18 |
| Table 3 -- Characteristics of Buildings Offered for Sale in Prague 3 ..... | 33 |

## **EXECUTIVE SUMMARY**

### **INTRODUCTION**

According to the 1988 *Mikrocensus*, there are approximately 1.8 million households living in rental housing units in Czechoslovakia, accounting for approximately 34 percent of all the occupied housing units in the country. In 1991, as part of privatization legislation, the ownership of most of the public housing stock was transferred from the federal to the municipal governments. Since that time, the municipalities have been faced with the many problems involved in owning, managing, and privatizing this large stock of public housing.

A large portion of this housing has been privatized through restitution claims. Now that the restitution process is virtually completed, however, the municipalities are beginning to consider new approaches for privatizing the remaining public housing. They are also faced with the continuing problems of managing this housing until it is privatized. In conversations with local government officials, these two topics -- housing management and privatization -- have emerged as critical areas of concern.

This report presents two case studies describing different approaches being taken to the problems of housing management and privatization. The first is in second district of Prague, where the magistrate has hired private management companies to operate its public housing stock, rather than continuing to rely on the state management company. The second case study examines the situation in Prague district 3, where officials are implementing a plan to sell public housing to tenants through the formation of coops. These two schemes are among the most advanced of the housing privatization strategies in the CSFR, and there are undoubtedly many lessons that can be learned from the experiences of these two districts.

### **HOUSING MANAGEMENT PRIVATIZATION**

Under the former regime, the management of public housing in Czechoslovakia was the responsibility of the district housing management companies, or *Obvodní podnik bytového hospodářství* (OPBH). The OPBHs continue to operate, in various forms, in

many parts of Czechoslovakia. Some municipalities, however, have begun to experiment with eliminating the OPBHs and replacing them with private housing management companies.

One such municipality is the second district of Prague, which has abolished its OPBH and turned responsibility for the management public housing over to some 20 private management firms. In June 1991, Prague 2 issued a request for private companies interested in managing municipal housing. A total of 25 companies responded to the original request, and 19 companies were selected by the municipality and given contracts to manage part of the municipal housing stock. In February 1992, the contracts for 3 of the firms were terminated because of unsatisfactory performance and 5 new companies were hired, bringing the total number of management companies engaged by the district to 22.

### **Overview of companies**

In order to learn more about the private management companies hired by Prague 2, a questionnaire was sent to all 22 management companies. This questionnaire asked basic questions about the history of the firms, their activities other than housing management, the number of buildings managed by the firms, rent collection methods, and automation of management tasks. The questionnaires were returned by 12 of the firms currently managing housing for Prague 2. In addition, in-depth interviews were conducted with 6 of the housing management companies, which gave more of an opportunity to delve into the problems facing housing managers in Prague.

The following summarizes the conclusions drawn from the data collected on the sample of 12 management companies:

- All of the companies are rather young, with the average age of a firm being just over 2 years and the oldest firm being only 3½ years old. Most of the companies had been established prior to Prague 2's request for private housing managers, but only 2 had previous experience managing housing before being hired by the district.
- The firms employ few full-time staff for housing management, but they employ many part-time personnel for housing management.
- All but one of the companies have personal computers. The firms reported that they use a variety of software to assist them with record keeping tasks associated with property management and other business activities.
- Most of the firms are involved in other activities aside from managing housing. Although 4 out of the 12 companies started out exclusively as housing management firms, all but one firm reported that it currently has other areas of interest.

In-depth interviews with 6 of the companies revealed the types of problems faced by housing managers in Prague 2:

- **Deferred maintenance and lack of repair funds:** This is clearly the most significant problem facing housing managers. Most of the buildings are in poor condition due to the substantial amount of deferred maintenance. Since rent levels remain very low and direct government housing subsidies have been eliminated, there has actually been a decrease in the amount of money spent to maintain the housing. This shortage of repair funds means that most of the money gets spent on emergency repairs, and that preventive or regular maintenance tasks are often neglected.
- **Rent collection:** Under the contract with Prague 2, the management firms are responsible for collecting the rents. Surprisingly, most firms said that uncollected rents are not a major problem. Of greater concern is the ability to obtain reliable, timely information from the rental collection center on non-payments. Most residential tenants continue to pay their rents through the rental collection center, a remnant of the old housing system. Unfortunately, firms using the rental center do not find out until three months later that a tenant has not paid his rent.
- **Illegal occupants:** Another significant problem cited by the management companies has to do with people moving into vacant apartments without authorization. These illegal occupants result in a loss of valuable revenue for management companies already strapped for resources. Unfortunately, it is difficult (or impossible) under the current legal system to evict such people.
- **Subcontractors:** Several of the firms stated that it was difficult to find good subcontractors for doing repair work or providing other building services. Almost all of the firms contract with plumbers, masons, carpenters, and other craftsmen for carrying out repairs. Other managers said that they had no difficulty finding quality subcontractors, however.
- **Profitability of private housing management:** All managers agreed that, given the current situation in the CSFR, it is very difficult to make a profit managing housing. Almost all of the firms in Prague 2 are involved in other business activities apart from housing management.

### **Lessons Learned from the Prague 2 Experience**

Despite the problems, overall the privatization of housing management in Prague 2 seems to have been successful. According to district officials, tenants are, on the whole, satisfied with the new management companies and in most cases the quality of the building management is much improved over that provided by the OPBH, in spite of the fact that less is being spent on the operation and maintenance of the buildings.

Nevertheless, there were some difficulties to overcome during the privatization process. Several lessons learned from the Prague 2 experience would be helpful to other municipalities considering a transfer to private housing management:

- *It may be better to include the OPBH in the privatization process and allow it to compete in the new environment.* During the transfer to private housing management, the OPBH was not cooperative and even obstructed the plan. This is understandable, since the jobs of the people at OPBH were being eliminated. By allowing them to compete, in some form, along with the private firms, it will give the people at the OPBH a chance to prove that they can adapt to the new situation and will make the transition smoother.
- *The municipality should immediately obtain all property registration and technical documents on its buildings.* Many important records that were in the custody of the OPBH are now missing in Prague 2 because the municipality did not take possession of them right away.
- *Honest, trustworthy people should be selected for the liquidation process, which should be monitored closely by the municipality.* Prague 2 had some difficulties with the liquidators chosen to sell the assets of the OPBH. Some buildings were sold under suspect circumstances and the funds generated from the liquidation have not all been accounted for.
- *The liquidation of the OPBH should be separated from the housing management privatization process.* If one person were responsible for both processes, there could be a problem with conflicts of interest.
- *The municipality should be prepared to subsidize the OPBH liquidation during the initial stages.* Prior to the transfer to private management, Prague 2 had to lend money to the OPBH so that it could continue to pay its bills. For example, the OPBH did not have enough money to pay the water bill, and, had it not been paid, the water company could have cut off the water for all the municipal buildings in the district.
- *The number of firms selected should be limited so that each firm has an adequate number of buildings.* If a company has only a few buildings, it will not have enough revenue to cover repairs and operating costs. Limiting the number of firms will also make the management more efficient, since the firms chosen will be able to make full use of their staff.
- *The municipality must learn to do business in the new environment and make proper decisions as the owner of the buildings.* Some of the management companies complained that it is often difficult to work with municipalities because they do not understand their role as property owners. The municipality must establish a proper business relationship with the

management company. The contract with the management firm must clearly spell out the responsibilities for both parties.

### **Conclusions**

The privatization of housing management would appear to be an effective partial solution to the problems municipalities face in operating their housing stock. By employing the competitive environment of the free market, the municipality can at the same time improve the quality of building management and reduce operating costs. The following conclusions should be kept in mind when attempting to apply this strategy to other municipalities:

- There was no special effort required by Prague 2 to develop private management firms. Firms already operating in the district were quite willing to take on the responsibility of managing the municipal housing. Although most of the firms did not have prior experience with housing management, they were able to quickly develop the necessary expertise.
- When soliciting offers from firms, the municipality should require information on the firm's history and financial status, as well as a list of references (such as private owners or other municipalities).
- The management agreement should clearly define the length and terms of the contract, as well as the responsibilities of both the management company and the municipality. Reporting requirements for the management firm should also be stated explicitly.
- Since the purpose of the strategy is to improve the quality of housing management, providing for tenant input in the evaluation of management companies is crucial. The municipality might also consider carrying out a tenant satisfaction survey.
- The use of private management companies can only be a partial solution to the housing management problems. For instance, private management can not address the problem of low rents that provide insufficient revenues for operating costs, maintenance, and repairs. Until such issues are addressed, the municipality may have to provide subsidies for operating or repairing buildings.

### **SALES OF PUBLIC HOUSING**

In addition to solving the problem of managing the public housing stock, the municipalities are also concerned with the issue of housing privatization. The third district of Prague is implementing a strategy to begin selling off its municipal buildings

to private owners. Interestingly, the genesis of the Prague 3 strategy was actually with the tenants themselves.

At the start of the restitution process, Prague 3 had over 2,000 buildings that had been transferred to its ownership from the federal government. Since this is one of the oldest districts in Prague, there were many restitution claims and only 650 buildings remained in municipal hands as of July 1992. These 650 buildings require about 70 million Kcs per year to operate and maintain, money that the municipality could not afford from its budget. Therefore, municipal officials began to formulate a strategy for alleviating the district of this financial burden.

Initially, Prague 3 had planned to sell off buildings with high operating costs by holding an auction. When the plan was announced, however, some of the tenants in these buildings became concerned that a private landlord might eventually try to evict them or raise their rents. One tenant, Dr. Štefan Faturik, came up with an alternative approach that would allow the tenants to purchase the buildings themselves.

The tenants presented their plan to members of the district council. Under their proposal, if at least 50 percent of the tenants wished to purchase the building they would be allowed to do so by forming a cooperative association. If the residential tenants did not want to buy the building, the commercial tenants (if any) would be given an opportunity to do so. If neither the residential nor the commercial tenants desired the building, it would be sold at a public auction. In all cases, the land would be sold along with the buildings. This plan eventually received the support of the Mayor and a majority of the council, and was put into effect in the summer of 1992.

The prices of the buildings and the accompanying plots of land are based on the official appraisal system specified in Decree No. 393/1991 coll. of the Ministry of Finance of the Czech Republic. This document provides, by administrative fiat, a uniform means of valuing property for the purposes of "public auctioning." The value of land is set at a flat rate of 1,700 Kcs per square meter within the city of Prague. Neither the value of property nor the value of land varies by geographic location within the city.

If at least 50 percent of the residential tenants in a building decide to form a cooperative, the municipality will discount the official appraised price of the building by 40 percent. (The price of the land is not discounted.) The tenants must make a 25 percent down payment, and then pay the balance of the sales price in equal monthly payments over a ten year period. No interest will be charged by the municipality on this installment loan. All cooperative members obtain shares in the entire property, that is, in both residential and commercial spaces.

If the residential tenants do not wish to purchase the building, it is then offered to the tenants of commercial spaces at the full appraised price without discount. If neither the residential nor commercial tenants are interested in buying the property, it will be put up for public auction, with the appraised value used as the minimum asking

price. In this case, the building and land may be purchased by private investors.

Once the sale of the building is finalized, all responsibilities for the operation and maintenance of the property are transferred from the municipality to the buyer.

### **Incentives for Tenants**

The municipality wishes to encourage tenant ownership because it feels that cooperatives would have more incentive to maintain the building in good condition than private owners. They expect that tenant ownership will result in further investment in the buildings, thus improving the overall quality of the housing stock in the district. Prague 3 is offering several incentives that it hopes will allow even citizens with modest incomes to participate in the scheme:

- A discount on the price of the building of 40 percent,
- A zero-interest installment loan,
- The cooperative may draw money for making building repairs from a special fund created from the proceeds of the building sales.

The money withdrawn from the fund is a grant, not a loan. Through this fund the cooperative may recover between 10 and 80 percent of the amount it has paid for its building. The exact percentage that may be withdrawn is based on a complex formula that takes into consideration the condition of the building, its location, and the size, quality and potential utilization of the building's commercial spaces. Money obtained from the fund may be used only for making repairs to the building's roof or facade or for upgrading the building's heating system to one that is "more ecologically sound."

### **Buildings Selected for Privatization**

The privatization strategy document states that a total of 450 buildings out of the 655 owned by the municipality will eventually be sold. The 200 buildings continuing as *municipal* property were chosen from among those buildings that had low operating costs, a heating system that was in good condition, and in general were in sound physical condition.

Twenty-nine (29) buildings were chosen for the first round of sales. These buildings are generally moderately sized, with an average of 19 apartments per building and the largest building having 38 apartments. The newest building is 31 years old and half of the buildings were built more than 60 years ago.

The average discounted sales price is 2.6 million Kcs, with the least expensive property being 0.6 million and the most expensive 5.2 million. Assuming that only 50 percent of the tenants decide to participate in the purchase of the building, the average

share of the price to be paid by each cooperative member would vary from 126 to 510 thousand Kcs. The corresponding average down payment per tenant (25 percent of the purchase price) would range between 32 and 127 thousand Kcs. and each cooperative member would make monthly payments between 788 and 3,185 Kcs.

If, on the other hand, the participation rate is 100 percent, the average price paid by each tenant is roughly halved. In this case, the average price per tenant would vary from 68 to 255 thousand, the down payment from 17 to 64 thousand Kcs, and the monthly payment from 424 to 1,593 Kcs.

As of October 1992, 2 buildings had been sold to the residential tenants, 23 buildings were in the process of being sold to the residential tenants, 2 buildings had not been purchased by the residential tenants but were being sold to the commercial tenants, and in the remaining 2 buildings there was no interest either among the residential or commercial tenants.

### **The Lucemburská Cooperative**

The Lucemburská Cooperative is an example of a typical building among those being sold in the first round. It has seven stories with 26 apartments and no commercial spaces. The sales price (with discount) of the building and plot is 2,645,770 Kcs. According to Mrs. Kalivodová, a representative of the coop, 18 of the 26 tenants are participating in the purchase of the building.

The building has two basic types of units -- studios and two-room apartments. Thirteen of the cooperative members live in large apartments and five live in studios. (The non-members all live in studios.) The price of a large share is approximately 170,700 Kcs while that of a small share is 85,400 Kcs. The down payment and monthly payment for a large share is 42,700 and 1,100 Kcs, respectively. For a small share, the down payment is 21,300 Kcs and the monthly payment is 530 Kcs.

As its first capital improvement for the building, the cooperative would like to replace the old coal heating system with a modern gas furnace. The cost for installing gas heating is approximately 500,000 Kcs and the cooperative plans to use the municipality's repair fund to finance the conversion.

While the cooperative has not yet paid its down payment, Kalivodová said that the members have said that they have the money. She did not know where people got the funds from, but suspects that they had savings or borrowed money from family members. She also was unaware if any members had borrowed money from a bank, although she knew of one woman who had obtained a loan from her employer.

The members of the cooperative feel that their building is affordable under the conditions provided by Prague 3. The current monthly gross rent (i.e. rent plus utilities and services) for a large apartment is about 2,300 Kcs. As cooperative members, the

residents of large apartments will be paying approximately 3,100 Kcs per month, an increase of 35 percent. Kalivodová pointed out, however, that once the new heating system is installed there will be a substantial decrease in the heating costs, since coal is much more expensive than gas.

The cooperative has not yet discussed how it will deal with members who default on their obligations, but Kalivodová said that they hope to be able to help people through any temporary difficulties. She noted that there has been a great improvement in morale among the tenants, and that a real spirit of cooperation has taken hold in the building. "There are fewer disputes and everyone is working together now," she said.

Why did the tenants decide to buy their building? The most important reason seems to be security. People were afraid that a private landlord might buy the building and eventually raise the rents or evict the tenants. But, the cooperative members also see the value of the property as investment. They feel that the value of their shares in the property will appreciate over time.

### **Evaluation of the strategy**

Since this privatization scheme has only recently gotten underway, it is impossible to state whether or not it will be successful. Indeed, Prague 3 considers this first round of sales to be an "experiment." Some key issues remain that will affect the eventual success or failure of this strategy:

- **Defaults on loan payments:** The municipality has attempted to reduce this problem by doing background checks on the cooperative members to find out if they have a history of non-payment of rent. In the event that the cooperative is not able to repay its loan, there is a provision in the contract that allows the municipality to foreclose on the property.
- **Low participation rates:** It has been estimated that only 60 percent of the tenants will join coops for buildings being sold in the first round. Low participation rates will result in a higher cost per share for the members, adversely affecting the affordability of the purchase for the tenants. Also, problems may emerge in buildings where there are both cooperative members and renters.
- **Viability of cooperatives:** Another question about the Prague 3 strategy is whether or not the new cooperatives will be able to maintain and operate their buildings without help from the city. One of the reasons given by the municipality for favoring tenant ownership of housing is that tenants would be more likely to maintain the building in good condition than an outside landlord. While this may be true, problems in the decision making process within the cooperative could stymie efforts to invest in the building. For example, people living on the ground floor may not be interested in spending

money fixing the elevator, while people on the top floors may not care about drainage problems in the basement.

In spite of the difficulties, Faturik believes that the tenants will be able to maintain the buildings and make the necessary investments to improve them. He points out that even before privatization the tenants themselves often invested in repairing and maintaining their buildings because the OPBH would not make necessary repairs. Asserts Faturik, "We already have a lot of experience managing our building because we were doing it anyway."

- **Opposition to the plan:** It should be pointed out that not everyone was enthusiastic about this privatization strategy. The commercial tenants opposed giving a discount to the residents of the building because they wanted to obtain the buildings themselves. The Association of Home Owners and the Association of Real Estate Agents also were against the plan because it did not benefit their members. Faturik has formed an Association for City Initiatives made up of tenants in the new coop buildings. This Association works actively to respond to criticism of the strategy by other groups and to maintain support for continued sales.

### **Conclusions**

The Prague 3 privatization strategy has many features that would be of interest to other municipalities that are developing strategies for selling off public housing. A municipality pursuing this type of privatization strategy will need to establish a system for recording payments received by the cooperatives and for reporting on overdue payments. The municipality may also want to develop a system for monitoring building conditions and commercial development in privatized and municipal buildings. This will allow municipal officials to evaluate whether or not the privatization strategy is producing the desired results.

Although the cooperatives that have purchased the first few buildings in Prague 3 appear to be well run and enthusiastic, this may not be the case for all buildings. The municipality should be prepared to deal with problems within the cooperatives. There should be some flexibility to allow a cooperative the chance to succeed, but in the end the municipality must be ready to deal with cooperative failures by retaking control of the property.

Some improvements could be instituted to improve the process as it has been implemented in Prague 3. First, the cooperatives receive detailed information on the buildings only *after* the sale has been approved. In order for the tenants to be able to evaluate the financial risks and costs in purchasing and managing their building, they should be given a detailed prospectus on the property, with as much information as possible on the operating costs, rent revenues, and past maintenance records. This will allow them to make a more realistic appraisal of their ability to purchase and operate the

building.

Another possible area of improvement is that of providing training for the new cooperatives. Participating in a cooperative and managing a building is an unfamiliar experience for most of these tenants and they may be ill prepared for their new responsibilities. By providing them with some type of training and guidance, the municipality can help ensure the that strategy will be successful and that the privatization program will not fail because of poorly run cooperatives.

## INTRODUCTION

According to the 1988 *Mikrocensus*, there are approximately 1.8 million households living in rental housing units in Czechoslovakia, accounting for approximately 34 percent of all the occupied housing units in the country. Prior to the 1989 Velvet Revolution, virtually all of these rental units were owned and operated by the central government. As part of its initial effort towards privatization, the government of the CSFR passed the 1990 "Act on Relieving the Consequences of Some Property Injustices,"<sup>1</sup> also referred to as the "Small Restitution Act." The act provided for the return of all assets acquired by the state since February 1948 through forced or unfair practices.

In order to further the privatization process, the Czech National Council transferred ownership of most state-owned residential property to the municipal governments in April 1991.<sup>2</sup> As a result of this act and amendments to the Prague City Charter, the ownership of over 200 thousand units was transferred to the Prague district governments. Since that time, the municipalities have been faced with the many problems involved in owning, managing, and privatizing this large stock of public housing.

Over the last two years the process of restituting buildings to former owners has proceeded rapidly. For example, a survey of district magistrates in Prague revealed that through January 1992 approximately 7,000 out of 18,000 municipally owned buildings have been restituted.<sup>3</sup> In Brno, restitution of municipally owned buildings has resulted in 20,000 out of 70,000 housing units being turned over to private owners.<sup>4</sup>

Although these numbers indicate that a large proportion of the public housing

---

<sup>1</sup>Act no. 403/1990.

<sup>2</sup>"Act of the Czech National Council on the transfer of some of the parts of the Czech Republic property into the ownership of the municipalities," no. 172/1991 Sb., 24 April 1991.

<sup>3</sup>Results of survey conducted by Urban Research, Prague (unpublished). Not all districts were reported.

<sup>4</sup>Municipal Property Office, City of Brno.

stock has been privatized, there nevertheless remains a significant share of rental housing that is owned and operated by municipal governments. The fact that the public sector still retains much of the rental housing is undoubtedly an impediment to the establishment of a healthy private housing market. Putting more of the housing stock into the hands of private owners would allow the market forces to better allocate the supply of rental units. In addition, the management of this housing is a task that could be taken on largely by the private sector, which would relieve the public sector of this responsibility and create a competitive market for property management firms that would improve the efficiency and quality of management services.

Now that the restitution process is virtually completed, the municipalities are beginning to consider new approaches for privatizing the remaining public housing. They are also faced with the continuing problems of managing this housing until it is privatized. In conversations with local government officials, these two topics have emerged as critical areas of concern.

This report presents two case studies describing different approaches being taken to the problems of housing management and privatization. The first is in second district of Prague, where the magistrate has hired private management companies to operate its public housing stock, rather than continuing to rely on the state management company. The second case study examines the situation in Prague district 3, where officials are implementing a plan to sell public housing to tenants through the formation of cooperatives. These two schemes are among the most advanced of the housing privatization strategies in the CSFR, and there are undoubtedly many lessons that can be learned from the experiences of these two districts.

## Chapter 1

### HOUSING MANAGEMENT PRIVATIZATION

#### Background

Under the former regime, the management of public housing in Czechoslovakia was the responsibility of the district housing management companies, or *Obvodní podnik bytového hospodářství* (OPBH).<sup>5</sup> The OPBHs continue to operate, in various forms, in many parts of Czechoslovakia. Some municipalities, however, have begun to experiment with eliminating the OPBHs and replacing them with private housing management companies.

One such municipality is the second district of Prague, which has abolished its OPBH and turned responsibility for the management public housing over to some 20 private management firms. The reasons for undertaking this strategy are laid out in a document by Mr. Jiří Paluska, who at the time was Deputy Mayor of Prague 2. In this document, Paluska referred to the poor financial situation of the OPBH in Prague 2, which he attributed to inadequate labor productivity, improper activities of the company's managers, and unsatisfactory organizational structure and procedures. Paluska concluded that the OPBH was deeply rooted in the socialist way of thinking and would have no chance to survive in a competitive environment.<sup>6</sup>

Based on this analysis, it was decided to liquidate the Prague 2 OPBH, privatizing some of its activities (property management, investment, construction, and transportation) while retaining some public functions in the form of "communal companies" (cleaning and maintaining streets and public grounds, supplying heat and hot water, and legal services related to the Restitution Act). The property management activities of the OPBH were to be transferred to an undetermined number of private management companies. The resulting competitive environment among the different

---

<sup>5</sup>It should be noted that the OPBHs were not part of the municipal governments but rather were subsidized and directed by the central government. Therefore, municipal officials had little information about or control over the operation of their local branch of the OPBH. This lack of local government experience in the area of housing management has contributed to the difficulties in reforming the housing sector.

<sup>6</sup>Paluska, 1991, pp. 2-3.

management companies, it was hoped, would then lead to an overall improvement in efficiency, performance, and level of service.<sup>7</sup>

In June 1991, Prague 2 issued a request for companies interested in managing municipal housing. Although Prague 2 officials did not have a specific number of firms in mind, they did want to hire several firms so as to foster a competitive environment. A total of 25 companies responded to the original request. Each applicant was required to supply references and a statement regarding its financial condition. The companies also had to demonstrate that they had adequate financial resources to fund the management of the housing during the initial transition period, when there would be lag between the start of management responsibilities and the receipt of rent revenues. Prague 2 also checked on the backgrounds of the people in the companies to see if any of them had criminal records.

Of the 25 management companies that originally applied, 19 were selected by the municipality and were given contracts to manage part of the municipal housing stock. The contracts stipulated that each management company would receive 10 percent of the rent collected from the buildings they managed as a management fee. Sixty percent of the rent would be used for repairs and maintenance of the buildings, while the remaining 30 percent would be retained by the municipality and put into a reserve fund for capital improvements.

At the beginning of the process, a total of 200 buildings were assigned to the 19 management firms. Prague 2 had estimated that a company needed to have at least 10 buildings in order to have enough revenues to operate at a profit. Also, according to Paluska, the municipality attempted to distribute buildings with commercial spaces evenly among the 19 companies. This is important because commercial spaces can be an important source of revenue for a building, since in most cases commercial spaces are free from rent controls.

In February 1992, six months after the first management contracts were awarded, the Prague 2 Property Committee evaluated the performance of the management companies. The Property Committee is an elected body that is part of the municipal government. The municipal housing office prepared background papers on the firms, which included a log of complaints made against them by the tenants. Hearings were held by the committee and both representatives of the management companies and tenants were invited to attend. The tenants had no direct role in the decision to retain or dismiss a management company, however.

As a result of the evaluation, the contracts for three firms were terminated because of unsatisfactory performance. At the same time as the February evaluation, the municipality issued a second notice requesting applications from additional private

---

<sup>7</sup>Paluska, 1991, pp. 3-9.

management companies. A total of fifty companies responded to this second request. Five of these were given contracts, bringing the total number of management companies engaged by the district to 22. In addition, during the past year all remaining municipal buildings were assigned to the private firms, bringing the total number of buildings under private management to over 400. (Annex A contains a partial list of management companies that have managed municipal housing for Prague 2.)

It can be seen, then, that the municipality did not have any trouble finding firms to manage its housing. Indeed, there were many more applicants than were needed to manage the municipality's 400 buildings. In addition, it appears that the performance of these firms has been for the most part satisfactory, given that only three of the original nineteen companies had their contracts terminated.

### **Overview of companies**

In order to learn more about the private-management companies hired by Prague 2, two data collection methods were employed. First, a questionnaire was sent to all 22 management companies. This questionnaire asked basic questions about the history of the firms, their activities other than housing management, the number of buildings managed by the firms, rent collection methods, and automation of management tasks. These questionnaires were returned by 12 of the firms currently managing housing for Prague 2.<sup>6</sup> The second method consisted of in-depth interviews with 6 of the housing management companies, which gave more of an opportunity to delve into the problems facing housing managers in Prague.

Tables 1 and 2 summarize the results obtained from the questionnaire data provided by the 12 firms. All together, these firms manage a total of 10,855 units in 896 buildings. Three hundred thirty four (334) of these buildings are owned by Prague 2, accounting for over 80 percent of the district's municipally owned housing stock. An additional 311 buildings are owned by other Prague districts, and the remaining 251 buildings are privately owned.

One can see from Table 1 that all of the companies are rather young, with the average age of a firm being just over 2 years and the oldest firm being only 3½ years old. Most of the companies had been established prior to Prague 2's request for private housing managers, but only 2 had previous experience managing housing before being hired by the district. All 12 firms participated in the district's first request for property managers in June 1991, and 6 applied for additional buildings during the subsequent request in February 1992.

The firms employ few full-time staff for housing management. Generally, most of

---

<sup>6</sup>Repeated attempts were made to obtain responses from other firms, without success. In some cases, the company refused to provide the information. In other cases, the manager of the firm could not be reached.

**Table 1**  
**Descriptive Statistics on Housing Management Firms**

| Description                          | Mean | Std. Dev. | Minimum | Maximum |
|--------------------------------------|------|-----------|---------|---------|
| Age of firm (yrs)                    | 2.2  | 0.6       | 1.4     | 3.5     |
| Years managing housing               | 1.5  | 0.3       | 1.3     | 1.9     |
| No. units managed                    | 905  | 1,269     | 180     | 4,890   |
| No. bldgs managed                    | 75   | 132       | 6       | 489     |
| No. bldgs for Prague 2               | 28   | 17        | 5       | 59      |
| No. bldgs for other municipalities   | 26   | 89        | 0       | 310     |
| No. privately owned bldgs            | 21   | 34        | 0       | 120     |
| Percent res. tenants paying by:      |      |           |         |         |
| Rental collection center             | 78   | 21        | 25      | 100     |
| Postal checks                        | 16   | 20        | 0       | 75      |
| Bank transfers                       | 6    | 5         | 0       | 15      |
| Other                                | 0    | 0         | 0       | 0       |
| Percent comm. tenants paying by:     |      |           |         |         |
| Rental collection center             | 6    | 7         | 0       | 25      |
| Postal checks                        | 17   | 20        | 0       | 75      |
| Cash payments                        | 0    | 0         | 0       | 0       |
| Bank transfers                       | 72   | 32        | 0       | 100     |
| Other                                | 5    | 17        | 0       | 63      |
| Full-time employees (all activities) | 17   | 28        | 2       | 100     |
| For housing management only          | 6    | 7         | 2       | 29      |
| Part-time employees (all activities) | 30   | 47        | 0       | 170     |
| For housing management only          | 24   | 43        | 0       | 150     |
| No. computers used by firm           | 2.4  | 2.4       | 0       | 7       |

the full-time people work on other activities engaged in by the companies. The firms do employ many part-time personnel for housing management, however, mostly maintenance and cleaning staff.

All but one of the companies have personal computers. Half of the firms have only one computer, while 2 of them use as many as 7 computers. The firms reported that they use a variety of housing management, spreadsheet, data base, and accounting

software to assist them with record keeping tasks associated with property management and other business activities.

Most of the firms are involved in other activities aside from managing housing. Although 4 out of the 12 companies started out exclusively as housing management firms, only one firm reported that it continues to be involved just in this area. Furthermore, only five of the firms indicated that housing management is their most financially important activity. Other activities pursued by the firms are indicated in Table 1, and include construction, construction management, assistance to restituted owners, real estate, decorating, and software sales and consulting services.

**Table 2**  
**Housing Management Firm Activities**

|   |    |
|---|----|
| Total number of firms interviewed   | 12 |
| Number of firms that originated as housing management companies                                 | 4  |
| Number of firms that first started managing housing for Prague 2                                | 10 |
| Number of firms currently involved only in housing management                                   | 1  |
| Number of firms currently involved in:  |    |
| Construction  | 5  |
| Construction management   | 4  |
| Restitution assistance  | 4  |
| Real estate   | 1  |
| Insulation  | 1  |
| Decorating  | 1  |
| Heating/air conditioning  | 1  |
| Maintenance services  | 1  |
| Software  | 1  |
| Wholesaler  | 1  |
| Number of firms who stated that housing management is their most financially important activity | 5  |

### **Interviews with selected companies**

Representatives from 6 management companies were interviewed in order to obtain more firsthand information on the problems involved in introducing a system of private

housing management for public housing in Czechoslovakia.<sup>9</sup> The following companies were interviewed:

**Hašek** - A private company founded in 1990, Hašek started off by providing insulation and decorating services. The company entered into a contract in August 1991 to manage buildings for Prague 2. They currently manage only 21 buildings for Prague 2, and continue to provide insulation, decorating, and construction services. Hašek manages no buildings for other municipalities and no private buildings. The firm employs 5 full-time persons in housing management.

**D. a K.** - One of the larger companies interviewed, D. a K. manages 500-600 buildings (approximately 10,000 units). The firm began in 1990 repairing air conditioners and inspecting fire protection equipment, later expanding into the areas of construction management and real estate. D. a K. began managing 380 buildings for Prague 2, 340 of which were later restituted. They now manage 40 buildings for the municipality, along with 270 buildings owned by other municipalities and 150 privately owned buildings. The company employs 12-15 persons in housing management -- 5 of whom are solely responsible for Prague 2's buildings.

**Fungor** - This firm is one of the few that actually began as a housing management company. It was founded to provide management services for owners of restituted buildings. Later, it took over the management of 30-35 municipal buildings in Prague 2. Fungor also manages 60 private buildings in Prague 2 and other districts. The firm employs 5 technicians who are responsible for both management and operation of the buildings.

**Prudom** - Prudom originated as a "natural" (i.e. not legal) entity in 1991 and it has been a limited company since March 1992. Its founder, Mr. Ludek Kulhan, worked in property management in the state enterprise PORS. Unlike most of the other firms, Prudom is strictly a housing management company; it has no other activities. Prudom currently manages 350 buildings, of which 27 are municipally owned buildings in Prague 2, 25 are private buildings in Prague 2, and the rest are municipal and private buildings in other parts of Prague. The firm employs 13 full-time staff.

**Rebel** - The firm started as a real estate agency in 1991, but, since real estate was not very lucrative (the market was chaotic and prices were not well set), it went into housing management. Rebel first got into the property management business through the restitution process. In addition to assisting people who wanted to file claims to recover lost property, Rebel also provided services to the owners of

---

<sup>9</sup>The 6 firms selected for the interviews were *not* chosen by random sampling.

restituted buildings either by selling the buildings or by managing the property for the new owners. Rebel currently manages approximately 400 buildings, 80 of which are privately owned. (They recently stopped managing buildings for Prague 2.) They employ a full-time staff of 15.

**Zvonář** - This firm was created in 1989 as a construction and construction management company. They manage a total of 50 buildings -- 20 for Prague 2, 10 private buildings, and 20 buildings in the process of being restituted. The firm employs 3 full-time persons in housing management.

### **Deferred maintenance and lack of repair funds**

Although these companies all have had different experiences in housing management, there were many problems that they had in common. The most often cited problem was the deferred maintenance on the buildings and the lack of funds to deal adequately with their deteriorating condition. Since the amount spent on repairs is limited to only 60 percent of the rent collected, and since direct government housing subsidies have been eliminated, there has actually been a decrease in the amount of money spent to maintain the housing.<sup>10</sup>

This shortage of repair funds means that most of the money gets spent on emergency repairs, and that regular and preventive maintenance tasks are often neglected. It was difficult to obtain a figure as to what was actually needed to maintain the housing adequately because most firms either could not or would not provide this information. (One housing manager, however, offered an estimate of "twenty times" what is currently being spent.) Most managers agreed that it is difficult to talk about ordinary operating and maintenance costs because the buildings are in such a state of disrepair. According to one manager, his main goal is to "keep the buildings from collapsing."

Mr. Dvořák of D. a K. said that it takes at least one year to bring a building up to condition where it can begin to be managed properly. This means making necessary repairs, updating passport information on the buildings, maximizing the use of commercial spaces, and dealing with tenants who are delinquent in their rent payments. After this initial year, the firm can begin to earn a profit from the building. D. a K. is operating on a four year plan for improving buildings. For the first year, only emergency repairs are carried out. During the second and third years, major and minor repairs are made to improve the condition of the building. By the fourth year the building should require only routine maintenance.

The limited funds available for repairs forces the management companies to be

---

<sup>10</sup>In 1990, the federal government provided 4.8 billion kcs in subsidies for the operation and maintenance of all housing in Czechoslovakia (Telgarsky, *et al.*, p. 4).

judicious when deciding which tenant complaints to respond to. Most management companies said that they try to help people who really need assistance (senior citizens, for example), as opposed to those who complain excessively and are "abusing the system." Nevertheless, tenants who are knowledgeable of their rights under the law and are assertive of those rights are more likely to receive attention. In addition, the companies feel that they receive a lot of frivolous complaints. For example, an older gentleman went to one firm and complained that he should not have to pay for the external lighting around his building because he did not go out at night.

One particular regulation that is subject to abuse (from the point of view of the management companies) is Directive 45. This directive gives tenants the right to demand that certain types of repairs be made. If a tenant is having problems with his stove, for example, he can pay a technician a fee of 100 kcs to have him inspect the stove and certify that it is in need of repair or replacement. With this certificate, the tenant can insist that the owner take appropriate action, or, if the owner will not comply, the tenant can have the repair or replacement made himself and bill the owner.

One manager told us that some technicians could be bribed an extra 100 kcs to provide the certificate without inspecting the appliance. So, if twenty tenants in a building want new stoves, they can all obtain certificates easily. The owner can respond by sending his own technician, but this process can become costly and time-consuming.

### **Rent collection**

Another significant problem for the housing management companies is rent collection. Under the contract with Prague 2, the management firms are responsible for collecting the rents. Since the collected rents are their only revenue from the buildings, they have a strong incentive to recover uncollected rents. Surprisingly, most firms said that uncollected rents are not a major problem. One firm estimated that only 5 to 7 percent of rent is uncollected. And, in spite of the length of the process, the firms do feel that they have legal means to force delinquent tenants to pay.

Of greater concern than uncollected rents is the ability to obtain reliable, timely information from the rental collection center on non-payments. The rental collection center is a remnant of the old housing system that is still used to collect a substantial portion of the rent from Prague 2 municipal housing. As can be seen in Table 1, approximately 78 percent of tenants pay through the rental collection center. Although not required to use the center for collection of rents, many private firms continue to do so because tenants are accustomed to paying this way. The rental center also has a computerized rent roll and accounting system, something some firms do not have.

Nevertheless, many of the management companies complained about the rental center's poor performance. For example, firms using the rental center do not find out until three months later that a tenant has not paid his rent. Two firms also reported that

rent payments that should have been sent to them were being erroneously sent to the former OPBH. (One of these firms, Rebel, is suing the OPBH for 1.2 million kcs.) As a result of these difficulties, many management companies are switching to payment through cash or postal checks.

### **Illegal occupants**

Another significant problem cited by the management companies has to do with people moving into vacant apartments without authorization. These illegal occupants, or squatters, result in a loss of valuable revenue for management companies already strapped for resources. Unfortunately, it is difficult (or impossible) under the current legal system to evict such people.

### **Subcontractors**

Several of the firms stated that it was difficult to find good subcontractors for doing repair work or providing other services. Almost all of the firms contract with plumbers, masons, carpenters, and other craftsmen for carrying out repairs. Mr. Kulhan of Prudom said that he contracted with small enterprises only, because the larger firms are often former state enterprises that still have "bad habits" from the old system. For instance, they charge high overhead rates for their services, making them too expensive.

Mrs. Malková of Rebel said that she had no difficulty finding quality subcontractors. In fact, she pointed out that it may be easier for management companies to find good people than it would be for the owner of a single building since the management companies are in a position to offer them a lot more work. For example, a typical plumbing job might cost 1,200 kcs for a private owner, but only 300 kcs for Rebel. Furthermore, according to Mrs. Malková, the plumber will be more likely to do a good job for Rebel since he knows that if he does not, he will not be hired again.

In the case of some suppliers (water, electricity, sewer, trash collection) there were some complaints about excessive bureaucracy and monopolistic behavior. For example, the electric company may threaten to cut off electricity for all buildings managed by a firm for an overdue balance of as little as 500 kcs. Because there are no competing suppliers in many cases, the management companies feel frustrated by their inability to do anything about the situation.

### **Profitability of private housing management**

Even though there seem to be many firms currently involved in housing management, everyone agrees that, given the current situation in the CSFR, it is very difficult to make a profit managing housing. Almost all of the firms in Prague 2 are involved in other activities apart from housing management. Mr. Kulhan of Prudom, one of the few companies that does only housing management, said that a company must have a large number of buildings if it does not have revenues from other sources. Other

managers agreed and some felt that 22 management companies may be too many for a district with only 400 municipal buildings.

Ironically, firms managing panel construction buildings may be better off than those managing older buildings, even though the panel buildings are reputed to be poorly constructed. According to Mr. Nedbal of Fungor, an older building with ten Category IV units (Prague 2 has many apartments of this level) and no commercial spaces might generate 500 kcs per month in revenues. Almost all of this rent would have to be spent on maintenance. On the other hand, a panel building with 100 Category I units might generate 30,000 kcs per month. So, a firm managing a panel building would have much more money for repairs and maintenance.

Most of the firms manage housing for other owners besides Prague 2. They manage private buildings as well as buildings for other municipalities. Two firms mentioned that they are looking to expand their activities beyond Prague. Prudom has sent letters offering its management services to other cities in Czechoslovakia and has already received some replies. D. a K. has taken out an advertisement in a Canadian newspaper, in the hopes of doing business with expatriate Czechs who have recently become owners of restituted buildings.

### **Lessons Learned from the Prague 2 Experience**

Despite the problems, overall the privatization of housing management in Prague 2 seems to have been successful. According to Paluska, tenants are, on the whole, satisfied with the new management companies and in most cases the quality of the building management is much improved over that provided by the OPBH. Mr. Libor Krátký, deputy mayor of Prague 2, feels that the problem of privatizing housing management has been solved.

Although tenants appear on the whole to be satisfied with the level of service provided by the management companies, people may actually be more likely to complain under a private management system for two reasons. First, because it is "private" housing management tenants may have inflated expectations as to the level of service they will receive. The tenants may not understand that, given the low level of rents in the CSFR, the amount of service must necessarily be limited. Second, unlike the situation under the old, anonymous management system, the tenants actually *have* someone to whom they can complain. Furthermore, it is likely that their complaints will produce some action on the part of the management company.

As a result of the new competitive environment, the cost efficiency of housing management seems to have been improved in Prague 2. In spite of spending less on the operation and maintenance of buildings, the quality of the management is at least as good as it was under the OPBH. In fact, Paluska points out that, instead of continuing to pay large subsidies for housing, the municipality is actually making money from its

buildings.

Nevertheless, there were some difficulties to overcome during the privatization process. Paluska said that there were several lessons learned from the Prague 2 experience that would be helpful to other municipalities considering a transfer to private housing management:

- *It may be better to include the OPBH in the privatization process and allow it to compete in the new environment.* During the transfer to private housing management, the OPBH was not cooperative and even obstructed the plan. This is understandable, since the jobs of the people at OPBH were being eliminated. By allowing them to compete, in some form, along with the private firms, it will give the people at the OPBH a chance to prove that they can adapt to the new situation and will make the transition smoother.
- *The municipality should immediately obtain all property registration and technical documents on its buildings.* Many important records that were in the custody of the OPBH are now missing in Prague 2 because the municipality did not take possession of them right away. At the start of the privatization process, the municipality should set a deadline for the transfer of all building documents.
- *Honest, trustworthy people should be selected for the liquidation process, which should be monitored closely by the municipality.* Prague 2 had some difficulties with the liquidators chosen to sell the assets of the OPBH. Some buildings were sold under suspect circumstances and the funds generated from the liquidation have not all been accounted for. At the very beginning of the process, the municipality should obtain a list of all assets of the OPBH to ensure that only those assets are sold. It should ensure that careful records are maintained on funds generated from sales of public assets. The liquidation process should be completely open to public scrutiny.
- *The liquidation of the OPBH should be separated from the housing management privatization process.* If one person were responsible for both processes, there could be a problem with conflicts of interest.
- *The municipality should be prepared to subsidize the OPBH liquidation during the initial stages.* Prior to the transfer to private management, Prague 2 had to lend money to the OPBH so that it could continue to pay its bills. For example, the OPBH did not have enough money to pay the water bill, and, had it not been paid, the water company could have cut off the water for all the municipal buildings in the district. As a means of generating funds, the municipality could identify some state-owned buildings to sell at the start of the liquidation.

- *The number of firms selected should be limited so that each firm has an adequate number of buildings.* If a company has only a few buildings, it will not have enough revenue to cover repairs and operating costs. Limiting the number of firms will also make the management more efficient, since the firms chosen will be able to make full use of their staff.

In addition to the points made by Paluska, a further consideration is that the municipality must learn to do business in the new environment and make decisions as the owner of the buildings. Some of the management companies complained that it is often difficult to work with municipalities because they do not understand their role as property owners. For example, the municipality may be too prone to give in to complainers. If there is a problem with a building, a private owner will either have the money to take care of the problem, or he won't. A municipality, however, may tell the management company to fix the problem without considering the cost or where the money would come from.

The municipality must have a proper business relationship with the management company. The contract with the management firm must clearly spell out the responsibilities for both parties. Although some of the management companies complained that the municipalities did not know how to act as owners, this situation will undoubtedly change as the municipalities gain more experience with their new position.

### **Conclusions**

The privatization of housing management would appear to be an effective partial solution to the problems municipalities face in operating their housing stock. By employing the competitive environment of the free market, the municipality can at the same time improve the quality of building management and reduce operating costs. The following conclusions should be kept in mind when attempting to apply this strategy to other municipalities:

- There was no special effort required by Prague 2 to develop private management firms. Firms already operating in the district were quite willing to take on the responsibility of managing the municipal housing. Although most of the firms did not have prior experience with housing management, they were able to quickly develop the necessary expertise. In cities where there has been a large amount of restitution, there may already be some private management companies operating.
- When soliciting offers from firms, the municipality should require information on the firm's history and financial status, as well as a list of references (such as private owners or other municipalities). The municipality should choose firms that are well established and that are financially sound. This is very important since housing management in the CSFR is a precarious business. The firms chosen will need to have proven their stability and ability to operate

efficiently.

- The management agreement should clearly define the length and terms of the contract, as well as the responsibilities of both the management company and the municipality. Reporting requirements for the management firm should also be stated. The municipality should provide the management company with the necessary information on the buildings so that the firm can make a proper financial evaluation of the management agreement. The municipality may wish to specify a six month trial period in the contract, so that firms can be dismissed quickly if they perform poorly.
  - Tenants should be included in the evaluation of the management companies. Since the purpose of the strategy is to improve the quality of housing management, providing for tenant input in the evaluation process is crucial. Ideally, tenants should also be represented on the body that decides which companies to dismiss and to retain. The municipality might consider carrying out a tenant satisfaction survey.
- 5) The use of private management companies can only be a partial solution to the housing management problems. For instance, private management can not address the problem of low rents that provide insufficient revenues for operating costs, maintenance, and repairs. Until such issues are addressed, the municipality may have to provide subsidies for operating or repairing buildings. This might be done by setting up a capital repair fund, as Prague 2 has done. If subsidies are provided, they should be operated under clear and explicit guidelines and be closely monitored. Management firms should not undertake any major renovations of buildings without prior approval of the municipality.

## *Chapter 2*

### **SALES OF PUBLIC HOUSING**

#### **Prague 3 Privatization Strategy**

In addition to solving the problem of managing the public housing stock, the municipalities are also concerned with the issue of housing privatization. The third district of Prague is implementing a strategy to begin selling off its municipal buildings to private owners. Interestingly, the genesis of the Prague 3 strategy was actually with the tenants themselves.

At the start of the restitution process, Prague 3 had over 2,000 buildings that had been transferred to its ownership from the federal government. Since this is one of the older districts in Prague, there were many restitution claims and only 650 buildings remained in municipal hands as of July 1992. These 650 buildings require about 70 million Kcs per year to operate and maintain, money that the municipality could not afford from its budget. Therefore, municipal officials began to formulate a strategy for alleviating the district of this financial burden.

Initially, Prague 3 had planned to sell off buildings with high operating costs by holding an auction. The Prague 3 OPBH had good records on the buildings and was able to draw up a list of 450 buildings that were expensive to operate or that were in poor condition. When the plan was announced, however, some of the tenants in these buildings became concerned that a private landlord might try to evict them or raise their rents. One tenant, Dr. Štefan Faturik, came up with an alternative approach that would allow the tenants to purchase the buildings themselves.

Faturik and other tenants in his building went and discussed the situation with people in 100 of the other buildings that were scheduled to be sold. An informal survey was conducted to determine whether there would be sufficient interest among the tenants in purchasing the buildings. They concluded that most tenants would like to buy their building, but if the building were to be sold at the full official price only 10 to 15 percent of the tenants would be interested. Faturik calculated the maximum amount that a typical, two-wage earner Czech family could afford to spend on housing. Taking an average family income of 12,000 Kcs per month and subtracting costs for food and other expenses, Faturik estimated that 2,500 Kcs per month (20 percent of income) would be

available to spend on housing.

The tenants presented their plan to members of the district council. Under their proposal, if at least 50 percent of the tenants wished to purchase the building they would be allowed to do so by forming a cooperative association. If the residential tenants did not want to buy the building, the commercial tenants (if any) would be given an opportunity to do so. If neither the residential nor the commercial tenants desired the building, it would be sold at a public auction. This plan eventually received the support of the Mayor and a majority of the council, and was put into effect in the summer of 1992.

In addition to obtaining the approval of the district government, the plan also had to be accepted by the Prague Magistrate (the central city government). The Magistrate gave its approval to the plan, including a provision to sell the plots along with the buildings. It took some effort to get this part of the strategy approved because the City Council decree that transferred control of the housing from the Magistrate to the districts states that, while the buildings may be sold, the plots are only to be leased for 99 years. The Mayor of Prague 3 felt very strongly, however, that the land should be sold with the buildings, and after much discussion, Prague 3 was able to persuade the Magistrate to permit sales of land as well as buildings.

Although the privatization strategy document indicates that 450 buildings will be sold, only 29 buildings have been selected for the first round of sales. Most of the units in these buildings are Category I (that is, they have central heating). During the first round, the tenants in the building have the right of first refusal. The tenants were given sixty days to declare their intention to purchase the building.<sup>11</sup>

The prices of the buildings and the accompanying plots of land are based on the official appraisal system specified in Decree No. 393/1991 coll. of the Ministry of Finance of the Czech Republic. This document provides, by administrative fiat, a uniform means of valuing property for the purposes of "public auctioning." The value of buildings is based primarily on its age and floor space, but the value may be depreciated up to 80 percent for physical wear and tear. The value of land is set at a flat rate of 1,700 Kcs per square meter within the city of Prague. Neither the value of property nor the value of land varies by geographic location within the city. The buildings in Prague 3 were appraised by a licensed Court Appraiser.<sup>12</sup>

If at least 50 percent of the residential tenants in a building decide to form a cooperative, the municipality will discount the official appraised price of the building by

---

<sup>11</sup>The deadline for the first round of sales was 10 September 1992.

<sup>12</sup>Since there does not yet exist a transaction-based appraisal system in Prague, it is not possible to compare these official values to the market values of the buildings.

40 percent. (The price of the land is not discounted.) The tenants must pay a 25 percent down payment, and then pay the balance of the sales price in equal monthly payments over a ten year period. No interest will be charged by the municipality on this installment loan. In addition to the down payment, the commercial code requires that the cooperative provide at least 50,000 Kcs in "registered basic capital."

All cooperative members obtain shares in the entire property, that is, in both residential and commercial spaces. The privatization strategy provides three alternative formulas for dividing the property into shares. The first method divides the property into equal shares among all the cooperative members, regardless of the size of their apartments. The cost of each member's share would therefore be identical. The second method is to divide the property into shares that are proportional to the floor space of the members' apartments. Under this formula, tenants in larger apartments would have larger shares (and consequently pay a higher cost) than those in smaller apartments. The third method is more flexible. It sets a limit on the size of the smallest share based on the ratio of the floor space of the smallest apartment to the total floor space in the building. The size of the other shares would be set by agreement of the cooperative members.

The cooperative must prepare a "Memorandum of Agreement" conforming to the requirements of commercial code on cooperatives. One coop, who had a lawyer as a member, put together an agreement that Prague 3 is now distributing as a model for other cooperatives (Annex B). The agreement must be registered with a notary at a fee of 3,100 Kcs. In principle, the municipality must also approve the cooperative agreement, but there does not seem to be a rigorous approval process.

Once the memorandum of agreement has been registered and the sale of the building has been approved, the cooperative association assumes all responsibility for the operation and maintenance of the building. At this time, the OPBH provides the cooperative with all the available technical and financial information on the building. In the event that not all tenants are participating in the purchase, the non-members, both residential and commercial, will begin paying rent directly to the cooperative. The association may engage in commercial activities, but it can not sell the building until the loan is completely repaid.

Although cooperatives existed for decades under the communist system, the cooperatives being formed as part of the housing privatization strategy differ from the older version in a number of respects. Most importantly, the new cooperatives are not subsidized or administered by the government but are independent and self-reliant. Cooperative members have full rights to dispose of their shares, and all operating rules are created by the members themselves. Faturik stressed that the Prague 3 scheme does not represent a "return to socialism," but rather the opportunity for "real private ownership" of housing.

If the residential tenants do not wish to purchase the building, it is then offered

to the tenants of commercial spaces at the official appraised price. The commercial tenants are not eligible for the 40 percent discount on the price of the building, however. If several commercial tenants would like to buy the building, they must form an association and each tenant will obtain a share in the property. The size of an individual share is based upon the floor space of the commercial unit occupied by each buyer. As was the case with residential cooperatives, the association becomes responsible for the operation and maintenance of the building once the sale is finalized.

If neither the residential nor commercial tenants are interested in buying the property, it will be put up for public auction, with the official appraised value used as the minimum asking price. In this case, the building and land may be purchased by private investors. According to the privatization laws, any Czech citizen or "agent" may purchase a building at such an auction. The term "agent" includes foreign firms that are registered with the Czech Republic (foreign individuals as such are not agents).

The municipality must pay a transfer tax on the sales of its buildings. The tax is based on the official appraised value of the property, not on the actual price for which the building is sold. The municipality keeps all the net proceeds from the sale of the land and the buildings. Apart from the transfer tax, none of the money goes to the Prague Magistrate or the Republic government.

### **Incentives for Tenants**

According to the privatization plan, the sale of municipal housing is necessary to solve the "hopeless situation" resulting from an estimated 1 billion Kcs deferred building maintenance.<sup>13</sup> The municipality wishes to encourage tenant ownership because it feels that cooperatives would have more incentive to maintain the building in good condition than private owners. They expect that tenant ownership will result in further investment in the buildings, thus improving the overall quality of the housing stock in the district. Prague 3 is offering several incentives that it hopes will allow even citizens with modest incomes to participate in the scheme:

- A discount on the price of the building of 40 percent,
- A zero-interest installment loan,
- The cooperative may draw money for making building repairs from a special repair fund created from the proceeds of the building sales.

The money withdrawn from the repair fund is a grant, not a loan. Through this fund the cooperative may recover between 10 and 80 percent of the amount it has paid

---

<sup>13</sup>Prague 3, 1992, p. 1.

for its building.<sup>14</sup> The exact percentage that may be withdrawn is based on a complex formula that takes into consideration the condition of the building, its location, and the size, quality and potential utilization of the building's commercial spaces. All cooperatives may withdraw at least 10 percent of the building's purchase price. Larger amounts may be drawn based on the quality of the building: Category I buildings may take an additional 5 percent of the sales price, Category II buildings an additional 10 percent, Category III buildings an additional 15, and Category IV buildings (the lowest standard housing) an additional 20 percent.

The percentage of the sales price that may be refunded to the tenants also depends upon the amount and quality of commercial spaces in the building. The amount is based on the ratio of the floor area of commercial spaces to the area of residential spaces. The calculation is further weighted based on the "quality" of the commercial spaces, that is, whether they face the front, sides, or back of the building. The more and better quality the commercial spaces in a building, the less the cooperative may withdraw from the fund.

Money obtained from the fund may be used only for making repairs to the building's roof or facade or for upgrading the building's heating system to one that is "more ecologically sound."<sup>15</sup> The money may not be used for making repairs to the interior of the building or the apartments. The reason for these restrictions is that the use of the fund is limited to those items that are in the interest of the city. Improving the appearance of the building or changing to a more efficient, less polluting heating system are deemed to be beneficial to the surrounding community, not just to the building occupants. The proposed repairs must be approved by the technical office of the Division of Construction. This office is currently a state-owned company, but it will become a newly privatized joint-stock company by the end of the year.

### **Buildings Selected for Privatization**

The privatization strategy document states that a total of 450 buildings out of the 655 owned by the municipality will eventually be sold. The remaining 200 or so buildings that will be retained by the municipal government are distributed among three areas: Ohrada-Jarov, Old Žižkov, and Vinohrady. The buildings continuing as *municipal* property were chosen based on the following criteria:

- The buildings should have low operating costs.
- The heating system should be in good condition.

---

<sup>14</sup>The coop may obtain up to 50 percent of the total allowable amount as a write-off of the outstanding loan balance.

<sup>15</sup>Prague 3, 1992, p. 1, 6-7.

- The building should be in good physical condition.
- The heating system should be independent from any buildings owned by another owner.
- Consideration should be given to groups of buildings that could be reconfigured as a complex.
- Non-barrier buildings and vacated houses will be retained by the municipality.

As was mentioned above, one of the original purposes of the housing sales program was to free the municipality from the responsibility of owning buildings with high operating costs. These concerns are reflected in the above criteria.

Officials in Prague 3 supplied us with data on the 29 buildings that are being offered for sale in the first round. This information is summarized in Table 3.

No panel buildings were included in the first round of sales. (There were originally two panel buildings on the list, but they were removed because the tenants expressed no interest in purchasing them.) The buildings are generally moderately sized, with an average of 19 apartments per building and the largest building having 38 apartments. As is typical of Prague 3, the buildings in the list are also fairly old. The newest building is 31 years old and half of the buildings were built more than 60 years ago.

Most of the residential units in these buildings are Category I. The buildings in general have few commercial units. One building has 6 commercial spaces, but 7 buildings have only one commercial unit and 8 buildings do not have any commercial spaces. (Unfortunately, no information was available on the floor area of commercial space in each building.) Since commercial spaces are a significant source of revenue for building owners, the number of such units in a building could have a significant impact on the ability of a cooperative to finance the purchase and maintenance of its building.

The average discounted sales price is 2.6 million Kcs, with the least expensive property being 0.6 million and the most expensive 5.2 million. Assuming that only 50 percent of the tenants decide to participate in the purchase of the building, the average share of the price to be paid by each cooperative member would vary from 126 to 510 thousand Kcs.<sup>16</sup> The corresponding average down payment per tenant (25 percent of the purchase price) would range between 32 and 127 thousand Kcs, and each cooperative member would make monthly payments between 788 and 3,185 Kcs.

If, on the other hand, the participation rate is 100 percent, the average price paid by each tenant is roughly halved. In this case, the average price per tenant would vary

---

<sup>16</sup>The average participation rate for the first round is expected to be 60 percent.

**Table 3**  
**Characteristics of Buildings Offered for Sale in Prague 3**

|   | Mean      | Standard deviation | Minimum | Maximum   | Median    |
|---|-----------|--------------------|---------|-----------|-----------|
| Number of residential units                         | 19.1      | 9.3                | 4       | 38        | 17        |
| Number of commercial units                          | 1.6       | 1.5                | 0       | 6         | 1         |
| Age of building (yrs)                               | 71.1      | 27.9               | 31      | 124       | 60        |
| Size of plot (m <sup>2</sup> )                      | 448.9     | 158.3              | 228     | 900       | 412       |
| Value of plot (Kcs)                                 | 789,956   | 302,726            | 359,040 | 1,683,000 | 719,950   |
| Value of building                                   | 3,049,448 | 2,155,080          | 310,753 | 6,935,189 | 2,743,171 |
| Sales price of property (plot + 60% building value) | 2,620,209 | 1,458,119          | 636,373 | 5,208,313 | 2,186,632 |
| If 50% of tenants form coop:                        |           |                    |         |           |           |
| Avg. share of price                                 | 268,897   | 96,915             | 126,053 | 509,622   | 263,398   |
| Avg. down payment                                   | 67,224    | 24,229             | 31,513  | 127,406   | 65,850    |
| Avg. monthly payment                                | 1,681     | 606                | 788     | 3,185     | 1,646     |
| If all tenants form coop:                           |           |                    |         |           |           |
| Avg. share of price                                 | 139,762   | 48,755             | 67,875  | 254,811   | 131,699   |
| Avg. down payment                                   | 34,940    | 12,189             | 16,969  | 63,703    | 32,925    |
| Avg. monthly payment                                | 874       | 305                | 424     | 1,593     | 823       |

Number of buildings = 29

from 68 to 255 thousand, the down payment from 17 to 64 thousand Kcs, and the monthly payment from 424 to 1,593 Kcs.

Assuming that only 50 percent of the tenants in a building decide to form a coop, the average down payment of 67,224 Kcs would be roughly 87 percent of the median annual income for urban households living in rental housing. The highest down payment, 127,406 Kcs, would be approximately 1.6 times this income level.<sup>17</sup>

In view of the fact that there is currently no mortgage financing in the CSFR, there is a question as to whether most tenants would be able to afford a down payment equal

<sup>17</sup>The 1991 median annual income for urban households in rental housing is approximately 77 thousand Kcs. This figure was derived from the *Mikrocensus*.

to 87 percent of their income. The money for a down payment would have to come from savings, sales of assets, or borrowing from friends or family members. Of course, the affordability situation improves as more tenants decide to join the coop. At the 100 percent participation level, the average down payment drops to only 45 percent of the median annual income.

Aside from the down payment, there is also the question of the monthly payments that each cooperative member will have to pay. At a 50 percent participation level, the average monthly payment of 1,700 Kcs is about 26 percent of the median household income. This would seem to be affordable (by the standards of western housing markets), though it is considerably more than the 260 Kcs per month average rent currently paid by households living in communal housing.<sup>18</sup> Even at a 100 percent participation level, the average monthly payments would be more than three times the current average rent. Furthermore, the cooperative members would also have to pay for repairs and maintenance on the building, expenses that are now being paid by the municipality. The repair fund set up by the municipality, however, would reduce this burden.

Because the sales are being financed through a zero-interest loan, the real value of the monthly payments will decrease over time. This makes the purchases even more affordable from the tenants point of view, but erodes the value of the sale for the municipality. Given that inflation is currently about 5 percent per year and that banks are paying interest rates of 15 percent on savings accounts, a reasonable approximation for the annual discount rate would be 20 percent. Applying this rate to the sale of a building at the average sales price of 2.6 million Kcs, the present value of this loan would be about 1.5 million Kcs.<sup>19</sup>

### **Progress thus far**

As of October 1992, the status of the 29 buildings being put up for sale by the municipality was as follows:

- 2 buildings have been sold to the residential tenants,
- 23 buildings are in the process of being sold to the residential tenants,

---

<sup>18</sup>Telgarsky, Kingsley, and Tatlan, 1992, p. 7. The monthly rent of 131 Kcs cited in this report was multiplied by 2 to account for the 100 percent rent increases that took effect in July 1992.

<sup>19</sup>Present value is calculated as:

$$PV = DP + MP \frac{1-(1+i)^{-n}}{i}$$

Where *DP* is the down payment, *MP* is the monthly payment, *i* is the monthly discount rate, and *n* is the number of months.

- 2 buildings were not purchased by the residential tenants but will be sold to the commercial tenants,
- In the remaining 2 buildings, there was no interest either among the residential or commercial tenants.

Cooperatives have already been formed in two of the buildings. Approximately 80 percent of the tenants in these buildings have decided to join the coop. The tenants have had their cooperative agreements registered, paid the registration fee, and deposited their "basic capital" (equity) as required by the commercial code. They have not yet made their 25 percent down payment, but have two months in which to do so. The sale of the first building was shown on television.

The 23 buildings expected to be sold are in the process of having their cooperative agreements registered, but the sales contracts for these buildings have already been prepared. Mrs. Janatková of the Prague 3 housing office estimated that an average of 60% of the tenants will join the cooperatives in these buildings. Two other buildings will be sold to the commercial tenants, as there was insufficient interest among the residential tenants.

Janatková said that the two buildings that were not sold may be re-offered to the tenants at a lower price. If there is still no interest among the tenants, the building will be sold at an auction, which will be held at a later date once there are more unsold buildings. Janatková explained that the two buildings were not bought because the tenants are mostly pensioners who could not afford to purchase them. Also, she said, these tenants lacked the energy and enthusiasm to organize a cooperative association.

These 29 buildings were the first part of the first round of sales. Offers were recently sent to the tenants of the remaining 31 buildings in the first round and they had until the end of November to respond. A second round of 54 buildings is in the process of being approved by the Prague Magistrate.

### **The Lucemburská Cooperative**

The Lucemburská Cooperative is an example of a typical building among those being sold in the first round. It has seven stories with 26 apartments and no commercial spaces. The sales price (with discount) of the building and plot is 2,645,770 Kcs. According to Mrs. Kalivodová, a representative of the coop, 18 of the 26 tenants are participating in the purchase of the building. The sale has not yet been finalized, but they are in the process of having the cooperative agreement registered.

The building has two basic types of units -- studios and two-room apartments. Thirteen of the cooperative members live in large apartments and five live in studios. (The non-members all live in studios.) The prices of the cooperative shares were set in a 2:1 ratio for large and small apartments. So, the price of a large share is approximately

170,700 Kcs while that of a small share is 85,400 Kcs. The down payment and monthly payment for a large share is 42,700 and 1,100 Kcs, respectively. For a small share, the down payment is 21,300 Kcs and the monthly payment is 530 Kcs.

The cooperative is organized as specified in the commercial code. There is a three member "directorate" and a three person "inspecting commission." The cooperative will have general assembly meetings if necessary to resolve disagreements. There are currently no cooperative fees, but both tenants and cooperative members must pay for utilities -- about 1,000 Kcs per month for studios and 2,000 Kcs per month for two-room apartments.

At present, the building is still being managed by the state management company, the OPBH. There is a stoker and two cleaning staff who are employed by the OPBH; the cooperative would now like to hire them directly. The stoker's salary is 2,500 Kcs per month and is paid for out of the charges for heating. The rent from the eight non-members' apartments (a total of 1,600 to 2,400 Kcs per month) is enough to cover the remaining basic operating and maintenance costs of the building.

As its first capital improvement for the building, the cooperative would like to replace the old coal heating system with a modern gas furnace. The cost for installing gas heating is approximately 500,000 Kcs and the cooperative plans to use the municipality's repair fund to finance the conversion. Since the building is 54 years old, there are also many other problems that need attention -- ranging from painting window frames to repairing the plumbing -- but the association does not have the resources to address all of these right away.

Kalivodová reported that there have been almost no problems with the tenants who did not join the coop. She said that the non-members were mostly older people living off pensions who were not interested in purchasing the building. Their only concern is that their apartments are in good condition and that their rents are not increased.

While the cooperative has not yet paid its down payment, Kalivodová said that the members have assured her that they have the money. She did not know where people got the funds from, but suspects that they had savings or borrowed money from family members. She also was unaware if any member had borrowed money from a bank, although she knew of one woman who had obtained a loan from her employer.

The members of the cooperative feel that their building is affordable under the conditions provided by Prague 3. The current monthly gross rent (i.e. rent plus utilities and services) for a large apartment is about 2,300 Kcs. Most of this cost is for utilities, as the clear rent is only 300 to 400 Kcs. As cooperative members, the residents of large apartments will be paying approximately 3,100 Kcs per month, an increase of 35 percent. Kalivodová pointed out, however, that once the new heating system is installed there will be a substantial decrease in the heating costs, since coal is much more expensive than gas. In fact, the savings from the conversion should reduce the total monthly costs to

the point that the cooperative members will be paying no more than they were as renters.

The cooperative has not yet discussed how it will deal with members who default on their obligations, but Kalivodová said that they hope to be able to help people through any temporary difficulties. She noted that there has been a great improvement in morale among the tenants, and that a real spirit of cooperation has taken hold in the building. "There are fewer disputes and everyone is working together now," she said.

Why did the tenants decide to buy their building? The most important reason seems to be security. People were afraid that a private landlord might buy the building and eventually raise the rents or evict the tenants. But, the cooperative members also see the value of the property as investment. They feel that the value of their shares in the property will appreciate over time.

### **Evaluation of the strategy**

How should a strategy like this one be evaluated? Prague 3's own criteria provide a good guide. The privatization strategy document describes this scheme as a compromise between two extremes -- selling all of the buildings through an auction and handing them over to the current tenants for free. The main objective "is not to fill the municipal treasury " but to provide a "rational solution" to the public housing problem. The end result, hopes the municipality, will be an overall improvement in the housing stock through greater investment, better utilization of commercial spaces and promotion of community development, and an improvement in the ecology of the district by encouraging conversion to more efficient, cleaner heating systems.

Since this privatization scheme has only recently gotten underway, it is impossible to state definitively whether or not it will be successful. Indeed, Prague 3 considers this first round of sales to be an "experiment." Nevertheless, some key insights can be gained from what has been accomplished so far and what the concerns are for the future.

One potential problem is that of defaults on loan payments. The municipality has attempted to reduce this problem by doing background checks on the cooperative members to find out if they have a history of non-payment of rent. In addition, the requirement of 50,000 Kcs registered capital provides a demonstration of the financial soundness of the cooperative association. In the event that the cooperative is not able to repay its loan, there is a provision in the contract that allows the municipality to foreclose on the property. Proceedings against defaulters could take up to a year, however, and the municipality would prefer not to have to take this type of action.

Prague 3 officials did not feel that there would be a problem with non-payment because the cooperatives would replace any members who were delinquent. It is not clear, however, why other tenants who had already rejected the idea of joining the cooperative would later change their mind. Furthermore, given the laws protecting tenants from evictions, it might be difficult to remove the delinquent cooperative member

from the apartment and replace him or her with another tenant.

An additional factor that will put further financial strain on the cooperatives was the manner in which the municipality handled the tenants renting commercial space in the buildings. Prior to the start of the sales program, the municipality signed long term leases with the commercial tenants, fixing their rents at low levels. It did this because it wanted to support commercial activity in the district. When a cooperative buys a building, it can not break the leases with the commercial tenants without paying a large penalty, nor can it raise their rents until the lease expires. Most of the leases are for four years with a rent level of 1,000 Kcs per square meter per year. Market rents for commercial spaces in the district are reported to vary between 1,500 to 2,400 Kcs per square meter.

The residential tenants were very unhappy about this situation because they had expected to be able to earn substantial revenue from the commercial spaces. As a way of compensation, the municipality is allowing the cooperatives to withdraw additional money from the repair fund based on the length of the lease signed with the commercial tenants in the building.

Another potential problem is that low participation rates in the new cooperatives. It has been estimated that only 60 percent of the tenants will join cooperatives for buildings being sold in the first round. Two problems may emerge if the participation rates are low. First, low participation rates will result in a higher cost per share for the members, adversely affecting the affordability of the purchase for the tenants. Second, problems may emerge in buildings where there are both cooperative members and renters. The renters may resent the new "owners" of the building, who were once renters like themselves, or the cooperative members may find it too burdensome to deal with the new responsibilities of being landlords. (Nevertheless, according to Janatková there have only been minor problems with non-members so far.)

To alleviate the undersubscription problem, Faturik says that some cooperatives are searching outside of the building for prospective members. This is especially true in buildings where there are older pensioners who do not wish to join the coop. The outsider can agree to pay for the pensioner's share and take possession of the unit at a later date. The current tenant benefits because he or she no longer has to pay rent on the apartment. Faturik says that such arrangements can be formalized and are perfectly legal.

Another question about the Prague 3 strategy that can only be answered after more experience has been gained is whether or not the new cooperatives will be able to maintain and operate their buildings without help from the city. One of the reasons given by the municipality for favoring tenant ownership of housing is that tenants would be more likely to maintain the building in good condition than an outside landlord. While this may be true, problems in the decision making process within the cooperative could stymie efforts to invest in the building. For example, people living on the ground floor

may not be interested in spending money fixing the elevator, while people on the top floors may not care about drainage problems in the basement.

How well the new tenant-owners maintain the building may depend on their motivation for purchasing it. Mrs. Malková, former head of the Prague 3 privatization committee, says that most people are buying the buildings for security, that is, they are afraid of a private landlord purchasing the building and raising all the rents. In this case the tenants main interest may be simply to minimize costs. They might therefore choose to spend the minimum necessary to maintain the building in an adequate condition. If, on the other hand, the tenants are buying the building as an investment, they would then have an interest in keeping it in good condition to keep the value of their investment from declining.

The problem of maintaining the buildings may be further complicated by the fact that the municipality intends to retain the buildings with the lowest operating and maintenance costs. While this may make sense from the perspective of municipal cash flow, it means that the buildings to be sold are those that will be the least affordable for the cooperatives to maintain. An alternative approach would be to privatize the buildings that are in *better* condition, which would put less of a burden on the cooperatives. (Tenants in these buildings have, in fact, begun to express interest in purchasing them, and the municipality may eventually be forced to acquiesce to these requests.)

In spite of the difficulties, Faturik believes that the tenants will be able maintain the buildings and make the necessary investments to improve them. He points out that, despite the fact that the old OPBHs actually spent little on building maintenance over the past few decades, most of the buildings are nonetheless in decent condition. This is because in many cases the tenants themselves invested in repairing and maintaining the buildings (in spite of the fact that it was illegal to do so). Faturik claims to have spent over 150,000 Kcs on his own apartment, and the tenants in his building paid to have insulation put on the roof and to repair the heating pipes. Asserts Faturik, "We already have a lot of experience managing our building because we were doing it anyway."

Faturik thinks that there is a tradition of responsibility towards housing that has survived despite 40 years of communist rule. A private owner, he feels, would not care as much about the building as the people who live there. He also echoed statements by Kalivodová that the cooperative members in his building are all willing to working together to make the cooperative successful.

It should be pointed out, however, that not everyone was enthusiastic about this privatization strategy. The commercial tenants opposed giving a discount to the residents of the building because they wanted to obtain the buildings themselves. The Association of Home Owners and the Association of Real Estate Agents also were against the plan because it did not benefit their members. Faturik has formed an Association for City Initiatives made up of tenants in the new coop buildings. This Association works actively to respond to criticism of the strategy by other groups and to maintain support for

continued sales.

### **Conclusions**

The Prague 3 privatization strategy has many features that would be of interest to other municipalities that are planning schemes for selling off public housing. It is clear, however, that more experience needs to be gained with the practical aspects of pursuing such a strategy. By observing closely the effort in Prague 3, valuable lessons could be learned that would facilitate replicating this method in other municipalities.

Although the first round sales involved less than 5 percent of the municipal buildings in the district, the Prague 3 strategy is worth noting for several of its interesting features. In particular:

- Developing a scheme that allows the current tenants to purchase the buildings through the formation of cooperatives.
- Selling land along with the buildings.
- Setting up a repair fund from the proceeds of the building sales.
- Allowing third parties to purchase buildings not sold to the current tenants through a public auction.

A municipality pursuing this type of privatization strategy will need to establish a system for recording payments received by the cooperatives and for reporting on overdue payments. The municipality may also want to develop a system for monitoring building conditions and commercial development in privatized and municipal buildings. This will allow municipal officials to evaluate whether or not the privatization strategy is producing the desired results.

Although the cooperatives that have purchased the first few buildings in Prague 3 appear to be well run and enthusiastic, this may not be the case for all buildings. The municipality should be prepared to deal with problems within the cooperatives. There should be some flexibility to allow a cooperative the chance to succeed, but in the end the municipality must be ready to deal with cooperative failures by retaking control of the property.

Some improvements could be instituted to improve the process as it has been implemented in Prague 3. First, the cooperatives receive detailed information on the buildings only *after* the sale has been approved. In order for the tenants to be able to evaluate the financial risks and costs in purchasing and managing their building, they should be given a detailed prospectus on the property, with as much information as possible on the operating costs, rent revenues, and past maintenance records. This will allow them to make a more realistic appraisal of their ability to purchase and operate the

building.

A cooperative should be able to freely set the rents for the commercial spaces in its building. As the owner of the property, this is its right. Further, these rents are an important source of revenue that can help finance the upkeep of the property. Since the cooperative will have adequate incentive to ensure that all of the commercial spaces are occupied, it will most likely be unnecessary for the municipality to provide additional encouragement for businesses to operate in the district.

Another possible area of improvement is that of providing training for the new cooperatives. Participating in a cooperative and managing a building is an unfamiliar experience for most of these tenants and they may be ill prepared for their new responsibilities. By providing them with some type of training and guidance, the municipality can help ensure that that strategy will be successful and that the privatization program will not fail because of poorly run cooperatives.

Finally, other municipalities pursuing such a strategy may want to encourage the new cooperatives to form an association (like the Association of City Initiatives). This type of organization could provide a useful base of support for the strategy, to counter opposition to the plan from other groups. It would also be a means of allowing the cooperatives in different buildings to share ideas and experiences with this new form of home ownership.

---

**REFERENCES**

*The Act of the Czech National Council from April 24, 1991 on the transfer of some of the parts of the Czech Republic property into the ownership of the municipalities.* Number 172/1991Sb. Prague, CSFR.

Paluska, Jiří (1991). *Draft of the OPBH 2 Transformation.* Report prepared for Prague 2. Prague, CSFR.

Prague 3 (1992). *Introduction to the Privatization of Housing Stock, and Proposed Guidelines for Privatization of the Housing Stock Owned by District Prague 3.* Prague, CSFR.

Struyk, Raymond J., Katharine Mark, and Jeffrey P. Telgarsky (1991). "Private Management for Eastern Europe's State Rental Housing." *Journal of Housing Economics*, 1, 1(March): 90-109.

Telgarsky, Jeffrey P., G. Thomas Kingsley, and Peter Tatian (1992). *Housing Allowances and Czechoslovakia's Social Safety Net.* Washington, D.C.: The Urban Institute. Report prepared for the U.S. Agency for International Development, Office of Housing and Urban Programs.

**ANNEX A**  
**PRIVATE HOUSING MANAGEMENT FIRMS**

**CHALOUPKA a NOVOTNY**  
Na Vytoni 10, 120 00 Praha 2  
Tel: 29-22-31, Fax: 29-22-31  
Contact: L. Verner

**D. a K.**  
Kladská 3, 120 00 Praha 2  
Tel: 25-60-22, Fax: 25-60-22  
Contact: M. Dvořák

**FUNGOR**  
Karlovo náměstí 7, 120 00 Praha 2  
Tel: 212-34-50, 212-34-01  
Contact: D. Nedbal

**HAŠEK**  
Americká 14, 120 00 Praha 2  
Tel: 25-38-94  
Contact: M. Hašek

**NEMOSERVIS**  
Belehradská 79, 120 00 Praha 2  
Tel: 20-47-31, Fax: 20-47-31  
Contact: L. Hynar

**PROFES**  
Varšavská 12, 120 00 Praha 2  
Tel: 25-37-66, Fax: 25-08-01  
Contact: Rezek

**PRUDOM**  
Záhřebská 48, 120 00 Praha 2  
Tel: 25-69-58  
Contact: L. Kulhan

**REAL KONSTRUKTA**  
Lublaňská 55, 120 00 Praha 2  
Tel: 29-28-74  
Contacts: Štepaniková, J. Kořenek

**REAL SERVICE**  
Londýnská 67, 120 00 Praha 2  
Tel: 20-71-57  
Contact: J. Cvanciger

**REBEL**  
Radhostská 12, 120 00 Praha 2  
Tel: 29-39-35  
Contacts: L. Malková, Lames

**REKONT**  
Jenštejská 3, 120 00 Praha 2  
Tel: 29-76-22  
Contact: M. Linder

**SERVANT**  
Na Morani 17, 120 00 Praha 2  
Tel: 29-55-39, Fax: 29-96-04  
Contact: Horaková

**SOLID**  
Václavská 14, 120 00 Praha 2  
Tel: 29-09-94, Fax: 29-05-25  
Contact: Jindra

**ZVONĀŘ**  
Jana Masaryka 2, Praha 2  
Tel: 691-00-26  
Contact: Feltlová, Zvonař

**ANNEX B**  
**MODEL MEMORANDUM OF AGREEMENT FOR COOPERATIVES**

## MEMORANDUM OF ASSOCIATION

of the Cooperative of Tenants of House \_\_\_\_\_, Prague 3

### SECTION I

#### Basic Provisions

##### Article 1: Title and Seat of Cooperative

The cooperative accepted the title "Cooperative of Tenants of House \_\_\_\_\_ Prague 3" seated in Prague 3.

##### Article 2: Legal Status

The Cooperative of Tenants of House \_\_\_\_\_ Prague 3 (hereinafter "Cooperative") is a legal entity, it acts in legal relations in its own name and bears responsibility for those relations ensuing.

### SECTION II

#### Activity of the Cooperative

##### Article 3: Subject of Activity

1. The subject of activity of Cooperative is above all the operation of housing and commercial spaces in the house, care for common interior and outdoor spaces, care for the operation of common technological facilities and the assurance of services associated with residence.

2. Cooperative assures above all:

a) maintenance, repairs and modernization of the building with the exception of interior fixtures and fittings of apartments, unless the member meeting decides otherwise

b) the dispersement of electricity, gas, water and the removal of sewage water with the exception of interior dispersion systems in apartments (i.e., from fuse boxes, or as the case may be the main of pressure and sewage water), unless the member meeting decides otherwise.

3. In the case of the breakdown of a main in an apartment, Cooperative will defray the costs. If incompetent handling of the tenant created the breakdown, the elimination of the breakdown will be charged at his expense.

4. Cooperative will assure further activities and services approved by the member meeting, to the extent that it directly concerns the activity of Cooperative.

5. Cooperative will coordinate joint care for the house and common spaces (e.g., the color matching of windows, banisters, common interiors, etc.). Agreed procedures are binding for members of Cooperative.

6. Cooperative decides on the occupation and lease of housing and commercial spaces in the house.

### SECTION III

#### Membership in Cooperative

##### Article 4:

1. The following can become a member of Cooperative:

a) a standing tenant of an apartment during the founding of Cooperative on the day of Cooperative's establishment

b) in the framework of the inheritance code, he to whom a member's share is transferred

c) a physical entity who acquires an apartment by exchange, if the member meeting approves the exchange of the apartment and accepts this person as a

member of Cooperative, if this person undertakes to take on all obligations following from membership

d) a person who showed interest in a free apartment, if this person undertakes to take on all obligations following from membership and the member meeting approves his acceptance.

2. Cooperative can deny a citizen acceptance as a member of Cooperative should he not provide the guarantee of the orderly management of Cooperative property or the upholding of good morals in the house.

3. A minor citizen can become a member of Cooperative only in the case of inheritance from some member of Cooperative.

4. A person cannot become a member of Cooperative who at the time of the transfer of property to Cooperative does not live in the house, with the exception of the provisions of points 1 and 3 of this article.

#### Article 5: Establishment of Membership

1. A requirement of the establishment of membership is the payment of the inscription fee in the sum of 1,000.- Kcs (reads "one thousand crowns") and the entering deposit (part of the basic member deposit) in the sum of 4,500.- Kcs (reads "four thousand five hundred crowns") within 15 days following the holding of the constituting member meeting to a certain member of the directorate of Cooperative in a manner stipulated by the member meeting.

2. Members of Cooperative are obliged to pay the basic member deposit exceeding the entering deposit in a period approved by the member meeting. Its sum will be fixed following the execution of an estimate and the stipulation of the price of the house. Each of the founding members of Cooperative is obliged to pay a proportional part equalling the stipulated price divided by the number of sounding members of Cooperative, because the real estate will be divided up into ideal joint-ownership parts regardless of the size of individual apartments.

3. The member deposit represents the property share of the member in Cooperative.

4. The registered basic capital of Cooperative is 50,000.- Kcs (reads "fifty thousand crowns").

5. Cooperative will establish an indivisible fund in the sum of 10% of the basic capital of Cooperative and this fund is supplemented by 10% of the year's net gain if made, and this until a time when the sum of the indivisible fund shall reach an amount equalling half of the registered basic capital of Cooperative. This fund may not be used during the existence of Cooperative for division among the members.

6. Cooperative will decide on applications for membership within 30 days following its delivery and will notify the applicant of its decision in writing against certification of delivery.

7. Cooperative will return the registration fee and entering deposit to applicants who were not accepted as members of Cooperative within 30 days from the date of the entering into force of the negative decision.

#### Article 6: Joint Membership of Married Couples

1. Should one member of a married couple become a member of Cooperative for the duration of the marriage, the joint membership of the married couple will also be established for the spouse.
2. The married couple act jointly and indivisibly in Cooperative with the right to one vote.
3. The provisions of paragraphs 1 and 2 are not valid if the married couple does not permanently live together.
4. With divorce or in the case of the death of one of the spouses, the joint membership of the married couple in Cooperative is cancelled. Membership remains in the case of divorce to the spouse who will remain living in the apartment in accordance with a concluded agreement on the settlement of unshared ownership of the spouses or to the person who was assigned by legal court ruling.

#### Article 7: Member Shares

1. Member share is the conglomerate of rights and obligations of members of Cooperative and the basic membership deposit which members pay according to provisions of article 5, points 1 and 2.
2. The participation of members in the assets and debts of Cooperative is reckoned in the ratio of size of their share to the total of shares of all members of Cooperative.
3. Members can appeal a decision on the result of the calculation according to point 2 to the member meeting. Appeals, however, do not have a dilatory effect.
4. Should a member of Cooperative no longer be capable of performing an obligation following from membership, he can:
  - a) transfer his member share in the sense of the provisions of art. 14;
  - b) withdraw from Cooperative on the basis of written notification submitted to the directorate. By withdrawal, membership is cancelled following the elapsing of six months from the date of submittal of written notification of withdrawal, which must be confirmed by a member of the directorate. In this manner membership is cancelled, on the condition that the other members of Cooperative will take on all financial obligations of the departing member.
5. For the reason of incapacity to perform obligations following from membership, a member of Cooperative can realize the exchange of the apartment under the terms stipulated in art. 15.
6. A person taking on the obligation of the payment of the membership deposit for a tenant who does not accept the terms of membership shall gain the claim to a member share.

#### Article 8: Membership Rights

Members of Cooperative especially have the following rights:

- a) to participate personally or by the agency of a legal representative in the

- discussions and decision-making of the member meeting;
- b) to be elected into bodies of Cooperative should he have full qualification for legal functions;
- c) to participate in all cooperative activities and enjoy the advantages provided by Cooperative to its members, unless he surrenders these rights;
- d) to submit proposals for the embetterment of Cooperative's activity, to turn to its bodies with suggestions, instigations and complaints, should they concern Cooperative's activity, and to be informed of their passing on
- e) to participate in the yearly statement of activity.

#### Article 9: Member Obligations

Members of Cooperative are especially obliged to:

- a) uphold generally-binding legal regulations, the house order, the memorandum of association of Cooperative and guide themselves by decisions of the member meeting and decisions of other bodies of Cooperative;
- b) to pay the basic membership deposit in the sense of art. 5, points 1 and 2;
- c) to protect cooperative property, to uphold the operational code of the house and generally-binding legal regulations concerning the public order;
- d) to notify bodies of Cooperative of arisen defects on property managed, as well as behavior and activities damaging cooperative property, and according to their means and capabilities to work against their spreading;
- e) to indicate changes in a timely manner to bodies of Cooperative concerning the member and members of his household which are important for record-keeping of members and Cooperative's property;
- f) to maintain and care for property in their private ownership which is directly or indirectly connected with the property of Cooperative, with the aim of forestalling the damaging of Cooperative's property and of forestalling an unpleasant environment in the house at variance with the operational code and normal local customs;
- g) to allow commissioned agents of Cooperative the determination of the technical state of their apartment
- h) to pay defrayments for services associated with housing

#### Article 10: Member Records

1. Cooperative will keep records of members and maintain them in compliance with reality. It is formed by a book of members and member records.

2. Written into the book of members are all of its members with the statement of name, residence and state identification number, the sum of their membership deposit, and all changes to the recorded facts will be written into the list without undue delay.

3. Member records are formed by records and correspondence with members following from the membership relation and accounting records.

#### PART IV.

#### Termination of membership, Property Settlements

#### Article 11: Termination of Membership

1. Membership is terminated:

- a) by written agreement.
- b) by the withdrawal of the member from Cooperative.
- c) by the decease of the member, unless membership is transferred to the inheritor.
- d) by the expulsion of the member from Cooperative.

e) by the winding-up of Cooperative without legal succession

2. Membership can be terminated at any time by written agreement between the member and Cooperative.

3. A member of Cooperative can withdraw in a manner and under the conditions of provisions of article 7, point 4 of the memorandum of association.

4. Should a member of Cooperative die and the joint membership of a married couple not be concerned, the member share is transferred to the inheritor.

5. A member can be excluded from Cooperative by ruling of the directorate for the following reasons:

a) repeatedly and after warning breaches generally-binding legal regulations concerning the public order, the memorandum of association or a decision of bodies of Cooperative;

b) uses Cooperative's property so that significant damages arise or allows the property to be used in such a manner;

c) alone or with co-residents breaches the house order, moral rules and the cohabitation of citizens;

d) does not pay defrayment for services associated with residence for a period longer than 2 months;

e) was sentenced for an intentional crime committed against Cooperative, its members, its property or against co-residents in the house.

Exclusions must be announced in writing to the member.

6. The directorate can decide on exclusion according to point 5, letters a) to d) following a prior written warning delivered into his own hands, insofar as even following it the reasons persist.

7. Rulings of the directorate on exclusion must be delivered into his own hands and must contain a justification. The member can appeal to the member meeting against the ruling, the appeal has a dilatory effect.

#### Article 12: Property Settlement

1. With the termination of membership arises the right of the former member, of his inheritors or of legal successors to the payment of the remaining value of the member share, and this at the earliest one month following the approval of the year's book closings for the year in which the membership was terminated.

2. To the extent that the termination of membership is associated with a notice of a lease agreement, the payment will be realized within one month following the clearance and transfer of the apartment to Cooperative.

3. Besides claims according to point 1, the former member nor his inheriting or legal successors do not have a claim to any other part of the property of

Cooperative for reasons of the termination of membership.

4. Cooperative will credit its payable claims towards the former member up to the time of approval of the year's book closings for the year in which membership was terminated.

Article 13: Termination of the joint membership of a married couple

1. Joint membership of a married couple is terminated:

- a) by the termination of membership according to the provisions of art. 11;
- b) by the death of one of the married couple;
- c) by agreement of a divorced couple;
- d) by a court ruling having taken effect;
- e) by the termination of the indivisible joint-ownership of the married couple for the duration of the marriage.

2. Should joint membership of a married couple be terminated by the death of one of them, the widowed spouse remains a member.

3. Following divorce, he of the divorced couple who was fixed by an agreement of the couple or by authorizational court ruling will remain a member.

4. Should the termination of indivisible joint-ownership of the married couple occur or should one of the married couple quit the apartment permanently, he of the married couple who continues to live in the apartment will remain a member.

#### SECTION V.

Disposal of Member Share

Article 14: Transfer of Membership Deposit or Member Share

1. The transfer of membership deposits or member shares by a member of Cooperative is subject to the consent of the directorate of Cooperative. Transfers are carried out by written agreement. Member shares are transferred to the acquirer in relation to Cooperative on the day of certification of the agreement on the transfer of membership by the directorate of Cooperative or on a later day stated in such agreement. Members can appeal to the member meeting against a negative ruling.

2. A member of Cooperative or his inheritor can conclude an agreement on the transfer of membership to another citizen.

3. The consent of the directorate is not necessary for the transfer of membership deposits or member shares between relatives in the first line, between siblings, between spouses and former spouses. Transfers are implemented by the registration of the written agreement by the directorate of Cooperative.

Article 15: Exchange of Apartment

1. A member of Cooperative can conclude an agreement on the exchange of an

apartment with a physical entity who fulfills the requirements of membership with the consent of the directorate. The agreement must be in writing and must contain an agreement on mutual property settlement which does not contradict individual provisions of this memorandum of association.

2. The exchange of an apartment between a member Of Cooperative and a non-member and the exchange of the apartment of a member with a member of another cooperative are subject to the consent of the directorate of Cooperative. With the exchange, the transfer of member share occurs by written agreement, whose integral part is also an agreement on mutual property settlement.

3 . Finally , the exchange of an apartment of a non-member of Cooperative with a non-member is also subject to the consent of Cooperative.

4. A non-member of Cooperative residing in the house as a tenant does not have the right of disposal to the apartment.

#### Article 16: Lease of Apartments

1. A member of Cooperative can temporarily lease his apartment or its part with the consent of Cooperative.

2. A tenant who is not a member of Cooperative cannot lease his apartment.

#### Article 17: Use of Apartments

Cooperative sees to it that apartments are orderly and purposefully used for residence. Should Cooperative ascertain that a member of Cooperative and a tenant of an apartment who is not a member use the apartment for other purposes than residential, it will call upon the member or non-member in order that he use the apartment in an orderly manner or that he carry out such a disposal of the apartment which the memorandum of association allows. Should this not become so, Cooperative will request a court to rule in the matter.

#### SECTION VI.

#### Disposal of Residential and Commercial Fund

#### Article 18: Occupation of Freed Apartments

1. A freed apartment shall be occupied by Cooperative according to the urgency of the needs of its members. For purposes, or as the case may be merging of apartments, the directorate will compile a housing list of members who express interest in the merging of the apartments. The housing list is approved by the member meeting and Cooperative will favor families in it with a large number of children, young married couples and single persons with children.

2. Should Cooperative not need an apartment for its members, it shall lease it. The member meeting will decide on the occupation of the apartment at the recommendation of the directorate. The needs of other tenants of the house will be favored in the decision-making.

3. The member meeting decides on the use and disposal of commercial spaces in accordance with generally-binding legal regulations.

#### SECTION VII.

#### Bodies of Cooperative

#### Article 19:

1. The bodies of Cooperative are the following:

- a) the member meeting;
- b) the directorate;
- c) the inspecting commission.

2. The directorate and the inspecting commission are elected by the member meeting.

3. The period of function of elected bodies is two years. A member of an elected body can step down during the course of an electoral period.

4. At least 75% of members must be present for elections or the recalling of members, or recalls must be voted for by a simple majority of those present. The member meeting must be convened seven days prior to its holding in writing with the statement of the date and program of discussion. Members who are poorly mobile must be invited in person.

5. Bodies of Cooperative can negotiate only to an extent in which they are commissioned by the member meeting or by the memorandum of association and on matters which belong to their jurisdiction.

6. Collective bodies of Cooperative are qualified to decide only under the participation of a simple majority of members. Should the member meeting not have a quorum, the directorate will convene a replacement member meeting so that it is held within three weeks following the date of the originally-convened member meeting. It must have the same discussion agenda and a simple majority participation of members is not required for a quorum.

7. From discussions of collective bodies, minutes are provided containing the matters discussed, passed rulings and the voting results on them. Records are signed by a member of the body which directed the discussion.

8. Members of elected bodies may not be entrepreneurs nor members of statutory and supervisory bodies of legal entities with a professional subject of activity.

#### Article 20: Member Meeting

1. The supreme body of Cooperative is the member meeting.

2. Belonging to the exclusive body of the member meeting are the following:

- a) to accept and change the memorandum of association;
- b) to elect and recall members of the directorate and the inspecting commission;

- c) to discuss reports of the directorate and the inspecting commission;
- d) to approve the conception of development and economic intention, the creation and use of funds, to approve the yearly book closings;
- e) to decide on recalls and complaints against rulings of the directorate;
- f) to decide on the increase or reduction of the registered basic capital;
- g) to decide on the cancellation, coalescing, merging and transformation of Cooperative;
- h) to decide on disposal of residential and commercial spaces;
- i) to approve the housing list;
- j) to decide on the division and use of gains and the manner of defrayment of losses;
- k) to decide on further activities which it sets aside for itself.

3. The member meeting must be convened at least twice per year, of which once within one month following the compilation of the yearly book closings, and always when one-third of the members or of the inspecting commission request this. The meeting is convened by the directorate, it is directed by the chairman or his deputy.

4. The manner of voting is decided at the member meeting. Members of Cooperative can authorize another member of Cooperative to represent him at member meetings. Precisely stated in the authorization is the extent of representation and how the representative is to vote.

5. From discussions of the meeting, minutes are provided which must contain the following:

- a) the date and place of the holding of the meeting;
- b) passed rulings;
- c) voting results;
- d) unaccepted objections of members who requested for their placing on the agenda

The appendix of the minutes is formed by the list of participants of the meeting, the invitation to it and the brief which was submitted for points of discussion.

#### Article 21: Directorate of Cooperative

1. The directorate directs the activity of Cooperative and decides on all matters of Cooperative which are not reserved according to the Commercial Code or according to this memorandum of association to another body.

2. The directorate is the statutory body of Cooperative and has three members. The members of the directorate are elected by the member meeting. The directorate is composed of the chairman and two other members who see to the economic sphere and the operational sphere. One of them concurrently represents the chairman in the time of his absence.

3. The directorate performs the rulings of the member meeting and is

responsible to it for its activity. The chairman or his deputy outwardly negotiate for the directorate. However, should written form be necessary for a legal function, the signature of at least two members of the directorate is required.

4. The directorate especially:

- a) convenes member meetings and prepares briefs for their discussions;
- b) executes the rulings of the member meeting and is responsible to it for its activity;
- c) compiles the yearly accounting book closings and submits it to the member meeting for approval, it is responsible for the administration and the keeping of member records.

5. The chairman organizes and directs discussions of the member meeting and of the directorate and negotiates on matters for which he is authorized by the member meeting.

6. The directorate convenes at least four times per year. It must meet within 10 days following the delivery of an instigation of the inspecting commission, if the remedy of insufficiencies does not occur at its beckoning.

7. Recompensation can be provided to members of bodies of Cooperative. It is subject to the approval of the member meeting.

#### Article 22: Inspecting Commission

1. The inspecting commission is the control body of Cooperative, which inspects every activity of Cooperative and discusses the complaints of its members.

2. The inspecting commission is formed by three members.

3. A member of the inspecting commission may not concurrently be a member of the directorate.

4. The inspecting commission especially inspects the following:

- a) the upholding of the memorandum of association and legal regulations;
- b) the fulfillment of rulings of the member meeting;
- c) expresses itself on the management of Cooperative, the yearly book closings and the proposal for dividends or the defrayment of losses.

5. The commission is authorized to require of members all documents and information which it considers necessary. It has the same right towards the directorate. The directorate of Cooperative as well as individual members are obliged to provide these documents and information.

6. The inspecting commission meets at least once per three months.

94

7. Reports on the result of inspections are submitted by the commission to the directorate and itself is authorized to propose remedial measures. Should the directorate not eliminate determined insufficiencies, the inspecting commission is authorized to convene the member meeting.

#### SECTION VIII.

##### Management of Cooperative

##### Article 23:

1. Cooperative manages in the subject of its activity independently and at its own expense.

2. It pays expenses from the funds created from gained income from housing management and from other economic activity.

3. Cooperative shall create especially the following funds:

a) an indivisible fund according to point 4, art. 5 of this memorandum of association;

b) other funds according to decisions of the member meeting.

4. The creation of funds is governed by generally-binding legal regulations and principles approved by the member meeting.

5. Defrayments for housing and for services associated with housing are decided by the directorate individually with each tenant. A new leasing agreement for the use of the apartment as well as of commercial spaces will be drawn up by members as well as non-members of Cooperative. These defrayments will be paid for each month always at the latest by the fifth day of the ensuing month to the account of Cooperative. Should it not happen so, the obligation arises to the tenant to pay Cooperative a fee for arrears.

6. If an agreement on the sum of defrayment should not be reached, the directorate shall set it according to planned costs by its ruling.

7. Cooperative will see to the assurance of a long-term financial equilibrium in the guaranteeing of effective management of joint use of the house.

8. Cooperative is obliged to compile for every year its book closings, together with the year's book closings the directorate will also propose the manner of use and distribution of dividends, or as the case may be the manner of defrayment of losses. Both are approved by the member meeting. Gains are divided in the ratio of size of share of the member to the total of shares of all members of Cooperative. Regarding members who were members only part of the year, the gains are proportionately cut. In the distribution of gains, necessary repairs to the house shall be favored besides items stated in the Commercial Code.

#### SECTION IX.

##### Cancellation and Liquidation of Cooperative

##### Article 24:

1. Cooperative is wound up by its deletion from the commercial register.

2. Cooperative is cancelled:

- a) by ruling of the member meeting;
- b) by announcement of bankruptcy or denial of a proposal for the announcement of bankruptcy for lack of property;
- c) by court ruling;
- d) by other manners laid out by law.

3. The ruling of the member meeting on winding up is verified by notarial record.

#### SECTION X.

#### Interim, Joint and Final Provisions

#### Article 25:

1. Rulings of an authority of Cooperative concerning individual members are announced only to them, unless the member meeting decides otherwise.

2. The deadline for submitting appeals is normally 15 days and commences on the day following the delivery of the ruling. Advices on appeals are given by this memorandum of association.

This memorandum of association was passed by the founding member meeting on June 3, 1992.