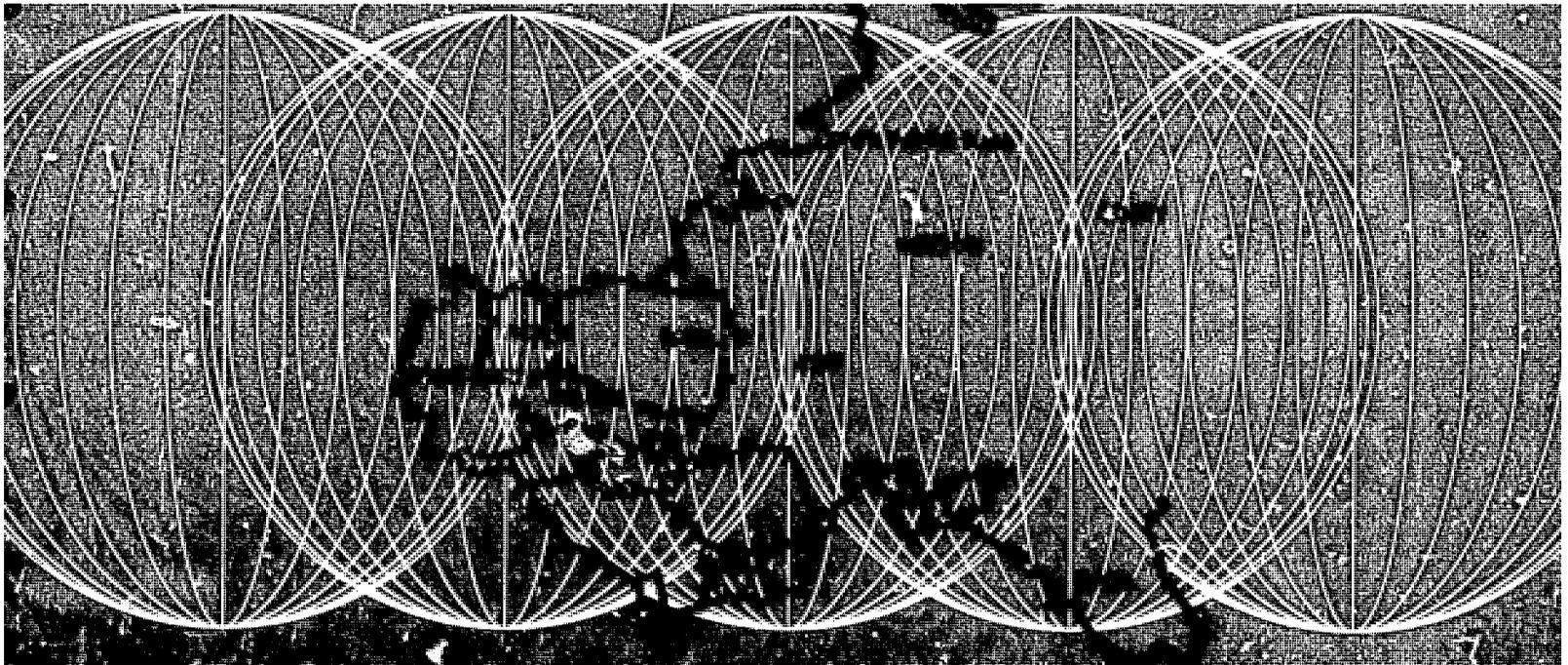


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FROM PLANNING TO MARKETS
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THE URBAN INSTITUTE
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**RENOVATION LOAN PROGRAM
FOR PRIVATIZED BUILDINGS**

DISTRICT VII, BUDAPEST

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I. OVERVIEW

The purpose of this program is to ensure that loans are available on affordable terms for the completion of deferred maintenance and partial renovation of residential buildings privatized by District VII after 1991.

There are four aspects to this effort.

- 1) The District will ensure that a renovation fund is established for each building with OTP at the required time during the privatization process. This is necessary so that the owners in the privatized buildings are eligible to participate in the program of government subsidized loans for the renovation of common areas.
- 2) For buildings that participate in the government-subsidized loan program, the District will make the payments on loans to qualifying pensioners and low-income owners. These repayments will be due to be reimbursed to the District at the time of sale of the unit or the death of the owner.
- 3) The District will guarantee repayment to OTP of loans made to a condominium association to cover the share of renovation costs of those owners who choose not to participate in the regular OTP program.
- 4) The District will set up an Office of Condominium Affairs that will be responsible for assisting condominium associations with respect to operating their buildings and for managing the District's property in mixed-use buildings.

These steps by the District will permit the new owners in privatized buildings to remedy most major maintenance problems and to deal with owners who are unable or unwilling to participate. The program is designed to complement the existing subsidized program, but it can be modified to replace that program if the subsidies are eliminated.

II. DESCRIPTION OF THE PROGRAM

Eligible Activities

The program will be available in those buildings privatized under the 1992 privatization regulations, to assist with the renovation of the common areas and systems in their buildings. These areas have suffered from deferred maintenance for many years due to the extreme shortage of funds. The program is limited to these newly-privatized buildings because the sale of the buildings is the source of revenue to finance the program.

If desired and agreed upon by the owners and the District, more extensive renovations, including improvements such as the addition of elevators and various modernization steps, could also be

financed. (The District may wish to be more specific about eligible activities if there are certain ones which are to be excluded as being too "luxurious" or not pressing enough if the capacity of the District to assist is being exceeded.)

A Combination of Loan Programs

This special loan program is intended to complement an existing program offered by OTP. The existing program is described first, and then how the special program can significantly improve the availability of loans for renovation.

Existing OTP Program. For those buildings and owners that are eligible, the owners can take advantage of the existing subsidized loan program for "Renewal and Modernization of Common Areas of Cooperatives and Condominiums." Loan size is limited to 70 percent of the cost of the renovations.¹ The term is for 15 years. The stated interest rate is the same as for loans by OTP for the purchase of a new house (currently 32 percent plus 1 percent service fee.) However, there is a subsidy of 50 percent available (paid by the central government to OTP), not to exceed the interest due.² Repayments at the subsidized rate cannot exceed 33 percent of household take-home wages.³

There are two keys to a building being eligible for this program. First, the building association must open a special renovation account with OTP within 90 days of the first seven units having been sold.⁴ A small sum of about 4 to 6 Ft. per square meter needs to be deposited each month thereafter for at least six months before a loan can be taken. We propose that the District assure that this is done for each privatized building.

The more difficult obstacle for many buildings in making use of this loan program is the need for nearly unanimous participation by the owners. The problem is not that the condominium law requires unanimity to embark on the renovation; only a simple majority is needed. However, financing the renovations does require near unanimity. The program works through loans to individual owners, with a mortgage taken against each unit. Thus, all owners must agree on the

¹ Until recently, the subsidized portion of the loan was limited to 200,000 Ft. The Ministry of Finance has recently determined that this was based on a misreading of the statute and that there is no absolute limit.

² At current rates of interest, this subsidy is roughly the same as the government paying for half of the loan, because the interest portion of the repayment will be more than half until very late in the repayment period. Of course, those who sell their unit and repay the loan in less than 15 years will get less subsidy.

³ In all cases of limits on the ratio of payments to income, the limit applies to the sum of all regular monthly debt payments, including the installment payments for the purchase of the flat, on a loan for the renovation of the flat, for a car, and so on.

⁴ If this account is not initiated at this time, the building would have to wait for five years after opening the account to take a loan.

scope and expense of the renovations and also must qualify for the requisite loans, or, alternatively, the participating owners must pay directly for the costs not borne by the non-participating owners.

Special Renovation Loan Program. The District can help the situation by facilitating lending under two circumstances. The circumstances are:

- 1) When a significant minority of the owners cannot afford to participate in the regular program.
- 2) When a significant minority of the owners choose not to participate in the regular program.

The first case, the inability of some owners to afford the needed loan, will be a common situation in the privatized buildings. There will be pensioners and others with relatively low incomes who cannot qualify for a loan under the regular program, even if they want to participate.

The second case includes those that could afford the loan, but do not want the renovations, as well as those that have enough money and want the renovations, but hope to gain some advantage by refusing to pay for them.

In these two common cases, the special program should make it possible for the building to complete the renovations anyway. In the first case, the special program would make all or a portion of the payments due on the subsidized loans taken by qualifying pensioners or low-income household. The total amount paid for this purpose, plus interest at the OTP lending rate, plus perhaps an insurance fee of one percent annually, would become due and payable at the time of sale of the unit or its inheritance. See below for more details.

In the second case, the share of the expenses due from the owners who could afford the loan but refuse to take it on would be covered by a loan from OTP to the condominium association. Such a loan would not normally be made by OTP because the condominium association has no ability to pledge any security towards repayment of the loan. However, the District would guarantee repayment and would look to the condominium association to enforce payment to itself of the extra assessments due from the non-participating owners.

Specifically, the condominium association would pass a special assessment to fund the renovation. The assessment could be paid either in cash or through higher monthly assessments. Those owners who take a loan from OTP would pay their share in cash and benefit from the government subsidy. Those who refuse to participate would be legally required to pay extra installments of monthly maintenance fees, with the extra amount essentially equal to the payments due on the OTP loan to the condominium association. These payments would be quite high, since this loan would not benefit from the normal 50 percent subsidy. Hopefully, the availability of the subsidy will encourage all owners to take on the regular OTP loan.

Because of the large repayments required in the absence of the government subsidy, these loans to condominium associations would be of a new type of deferred payment design. Interest would accrue on these special loans at the same rate as for the regular OTP loans (currently 32 percent plus 1 percent service), but the monthly payment would be set as if the interest rate were only 10 percent. The unpaid interest would be deferred and added back into the loan principal. A new payment amount would be calculated each year based on the 10 percent interest rate and full repayment of the loan over the remaining life of the loan (i.e., 14 years after one year has elapsed).

Such a loan could also be used for the regular OTP programs if the subsidy were removed in the future. See the Technical Annex for more details on this loan.

Special Program for Pensioners and Low-income Households

A significant number of tenants in the District-owned buildings are pensioners. Some of these, particularly those who are relatively young, may have sources of income in addition to their pensions. Even so, these sources may not be documentable and thus their ability to qualify for a loan may be quite limited. Moreover, it is desirable that they not be displaced to other housing so late in life. A special feature of this group, however, is that the expected time before they wish to sell or their unit becomes part of their estate is relatively short, perhaps on average about 10 years. Further, because they have limited incomes and because they may have little concern about renewing their buildings or little understanding of how condominiums work, they may be vocal opponents of any renovation work.

Thus, as noted above, the District may wish to offer a special program for those over 60 or 65 years old (at least for those who also have low incomes) whereby the District uses cash from the Guarantee Fund to repay the OTP loan for this person's portion of the cost for renovation. This amount would become a loan from the District to the individual due only at the time of sale or inheritance of the unit and due interest at the same rate as OTP loans until that time.

If the unit is sold before the death of the pensioner, recovery of the loan is relatively straightforward. The OTP and District liens will be recorded and the new buyer will know about it. If the new buyer accepts the property with the lien intact, the District will end its payments on the loan and will move for foreclosure. In general, though, the new owner will want the deed to be cleared of all liens before purchase.

If the unit owner dies before the sale of the unit, the payments by the District must stop soon thereafter. To ensure that the District knows that the situation has changed, qualifying unit owners would have to submit an affidavit each year as to their status. If the unit is sold by the heirs, then repayment of the loan should occur at that time. If the heirs occupy the unit or rent it out, they can seek new mortgage loans from OTP of an amount sufficient to repay the loan from the District. In no case should the repayment of the District's loan be deferred indefinitely.

It is important to note that the District is not making the basic loan used for renovation. The pensioner is taking the loan from OTP and the District is agreeing to make the payments on the loan for as long as necessary. In this case, the loan should benefit from the government subsidy and the District will not face the immediate cash burden of the full cost of the renovation.

A similar program could be provided for those with incomes which can be shown to be too low to qualify for the necessary loan. However, it would be advisable in this case that the borrowers be expected to pay what they can towards the loan, e.g., 33 percent of their income. Also, this provision should be used relatively sparingly, since it is open to abuse and it could significantly increase the burdens on the District. This approach could also be used for cases in which the borrower becomes unemployed after the loan is made, but it would be preferable in general for OTP to handle these cases through its usual procedures. As a general principle, the District is probably not in a position to assist every lower income or unemployed owner to stay in their unit. Some may have to sell and use the proceeds to buy a more affordable unit elsewhere.

III. IMPLEMENTATION ISSUES

Office of Condominium Affairs

The District would create an Office of Condominium Affairs to supervise the program. The tasks of this office would include:

- 1) Setting up the OTP reserve accounts,
- 2) Informing owners about the renovation loan program,
- 3) Helping condominium associations in applying for the program and in reviewing their applications, and
- 4) Monitoring the use of District guarantees and repayment assistance to prevent abuse.

This Office would also have a key role to play in overseeing the use and management of the District's share of mixed use buildings. It would represent the District at the membership meetings and on the Boards of the mixed-use buildings.

Underwriting the Special Loans

There are three different underwriting procedures corresponding to the three loan situations discussed above.

First, the owner may be a qualifying pensioner (over 60 to 65 years old and with a low income). If the owner is willing, the loan would be a regular subsidized OTP loan, but with a mortgage against the condo unit that is not due and payable until the death of the owner or the sale of the unit. In this case, all or part of the repayment would be deferred and the only underwriting is to confirm the age of the owner and the ratio of the loan to the cost of the project. If a partial repayment is made by the pensioner, information on all sources of income and other regular loan payments would be needed, but will not be used to qualify the borrower for the OTP loan.

The second case is where the owner is not a pensioner but qualifies for District assistance with repayment because of an income that is too low. In a limited number of such cases, the District may choose to facilitate the renovation of the building by treating these owners as if they were pensioners. Thus, their loan would not be underwritten against their income. All repayments could be deferred or could be set at 33 percent, or some other percent, of the available income.

The third case is where the owner simply refuses to participate in borrowing to finance the renovation work decided on by the majority of the owners. In this case, presumably the owner will not voluntarily reveal his or her income, nor will the person sign a mortgage against their unit. Thus, the loan will have to be a special loan to the condominium association itself, which will then place a lien on the units of the owners who do not pay for the needed special assessment (through cash or loan proceeds). Of course, if such an owner is able to show that his or her income is too low and the owner is willing to take out a mortgage against his or her property, they could be treated as the second type of owner described above, with all or a part of the repayment due being deferred.

District Guarantees

In the case of regular OTP loans to fully-qualified owners, the District would not undertake any special guarantees. In the case of qualified pensioners or low-income households, the District essentially guarantees each loan by agreeing that it will make the payments on the loan as long as the owner of the unit does not properly qualify for the loan himself or herself.

In the case of a loan to a condominium association, the District would guarantee full and timely repayment of the loan. If the association defaults on the loan, the District will make the repayments current and continue making them, while seeking recovery from the association and, ultimately, from the owners on whose behalf the loan was taken. It is expected that no action would be taken against the association by the District as long as the association is taking all legal and other measures to obtain full repayment from the non-paying owners.

Notwithstanding the stated provisions of the program, the District reserves the right not to offer these guarantees in any cases where it believes that the association does not expect to pursue collection, or if there is fraud or abuse of the program involved (e.g., a qualifying pensioner owns a unit, but rents it out to others). The District's Office of Condominium Affairs or other

designated office will review each application for District guarantees for compliance with the specifics and the intent of the program.

Funding the Guarantee Program

There would be two sources of funding for the expenses being borne by the District.

- 1) Each borrower under the special program would pay the District an amount equal to 1 percent of the amount of the loan at the time of origination to partially compensate the District for its risks.
- 2) The District would deposit in a regular interest-bearing account⁵ with OTP an amount equal to the greater of:
 - a) the difference between the cash received during the first two years from purchases under the new price schedule and the old price schedule, or,
 - b) one percent of the fair market value of the units sold.

After three years, if this guarantee fund exceeds 50 percent of the outstanding loan amounts under the special program, the excess can be withdrawn by the District and so on each year thereafter.

If the District adopts a different formula for funding this guarantee fund, it will limit the amount of borrowing under the special loan program to an amount not exceeding twice the amount in the fund.

Projected Cost to the District

The financial involvement of the District depends heavily on how many buildings will take advantage of the loan program, and on the share of units owned by qualifying pensioner or low-income households and on the number of associations which have to take loans to cover the share of expenses of non-participating owners.

Let us assume that only half of the 200 eligible buildings decide to renovate in the next five years, and that they adopt renovation programs that average 200,000 Ft per unit. Further, the buildings have an average of 20 residential units, and of this 15 will be privatized. Of these 15 units, one-third are occupied by qualifying pensioners and low-income households.

⁵ It is important that this account receive a competitive rate of interest at or close to the rate of inflation, so that it will retain its real value and its ability to cover losses.

If all owners agree to participate in the regular OTP program, there will be 100 buildings with expenses averaging 200,000 Ft per unit and with 1000 regular OTP loans averaging 140,000 Ft. The total amount lent to these owners would be 210 million forints (70% x 200,000 X 1500.) Of this, there will be loans for 70 million Ft. that will require repayment by the District on behalf of pensioners or low-income people. All of these loans would receive the 50 percent subsidy from the government. At the current OTP interest rate of 33 percent, and after allowing for the subsidy, the District would have to pay 11.7 million forints per year on the special repayment loans. The net burden on the District would decline in the future as some of the units are sold, both reducing the repayment burden and giving the District some cash inflow.

If only 50 buildings rather than 100 buildings participate, the responsibilities of the District would decline by half. If partial repayments are expected of pensioners and low-income owners, then the District's burden will also be reduced.

These calculations assume that all owners agree to participate in the regular OTP program. If some do not and the District has to guarantee the loans made to the condominium associations instead, the total loans guaranteed by the District would be higher.

The exposure to loss for the District depends on the types of loans taken out and on the strength of the legal remedies available in the future. If the legal and procedural basis for collecting on outstanding liens at time of sale is firm, then the loans to individuals secured by a mortgage on their flat should suffer few losses ultimately. Similarly, the loans to condominium associations should be fully collectible if the association is diligent about imposing liens on members who are delinquent in their assessments. However, there are no direct mechanisms whereby associations can be forced to act in the appropriate manner.

Legal Remedies for Default

Constraints on Debt Collection. There are certain barriers to the District being certain that it can enforce contractual obligations against an owner who fails to comply with the terms of the loan or guarantee documents. These constraints include: (1) gaps and weaknesses in current laws applicable to debt collection; (2) ongoing and anticipated changes in the law that make it difficult to predict how the law will evolve during the term of the loan agreements, which will require the borrower's consent to be modified once they are signed; and (3), perhaps most importantly, a longstanding and pervasive cultural reluctance to use existing laws to enforce debt collection in the area of housing through use of foreclosure and eviction procedures.

More specifically, there is little history or experience with debt collection in the context of condominium housing, making it particularly difficult to predict the ability and willingness of a condominium association to enforce its legal rights against a defaulting unit owner.

OTP's Collection Practices. As noted above in the discussion of OTP's state-subsidized renovation loan program, OTP's underwriting practices require nearly unanimous participation

by unit owners for a condominium common property renovation loan. In addition, each participating unit owner must be willing to mortgage its unit and to allow garnishment of wage income as security not only for its own share of the loan but also to secure payment of the portion of the loan attributable to those unit owners who refuse to participate directly. However, OTP does not have efficient means to pursue collection of delinquent payments through foreclosure or garnishment for either the state-subsidized renovation loan program or its other home mortgage loan programs. To obtain eventual repayment of loans in default, OTP has relied primarily on recorded liens that must be paid off at the time of sale of the property.

Recommendations To District VII. In order to provide maximum benefit to the buyers of privatized units from the funds generated to finance the guarantee program, we recommend that the loan documents include the clearest and strongest default provisions and remedies possible under the existing law. These will serve as disincentives to borrower default and will allow the District to pursue collection of delinquent payments aggressively.

While the District theoretically could require that each owner mortgage his or her individual unit to obtain a subsidized common area renovation fund for a participating condominium, it is improbable that such unanimity can be achieved. Similarly, use of the entire condominium property as security for a loan is impermissible under the Civil Code without the unanimous approval by the individual unit owners. One can expect that there will always be some unit owners unwilling to participate because of disagreements over the type and extent of work to be done, fear of loss of their property, the desire to get the benefit of the renovation program without putting their own assets at risk, or simple contrariness.

We recommend that the District allow participation by condominiums where a majority of the ownership interests, excluding those held by the District itself, approve the program and are willing to execute loan agreements and mortgage their own units. In condominiums where the District is owner of one or more units, the District should also enter into loan agreements and mortgages. We believe the District's voting power should not be used to obtain approval of the program if a majority of the private owners are unwilling to go along, however, to avoid creating feelings of resentment on the part of the unwilling owners, over-reliance on the District to bear the financial burdens and risk of participation in the program, and reluctance on the part of the unit owners association to pursue debt collection remedies against owners who refuse to pay their share of the costs of the renovation program.

Enforcing Payment of Loans to Condominium Associations. In cases where less than all of the unit owners are willing to sign loan agreements and mortgage their units, all unit owners will still be required to share the cost of the common area renovation work on a proportionate basis, as is required by law. The renovation project and the budget required to do the work must be approved by majority vote. Then the cost of the work can be assessed proportionately against all the owners, either as a portion of their regular condominium fee or as a special assessment.

The owners who are willing to participate directly in the loan program by entering into a loan agreement and mortgage with OTP will pay their portion of the assessment for the renovation

work out of the loan proceeds, which will go directly from OTP to the condominium association. The portion attributable to the owners who are not willing to participate directly will be obtained by a loan from OTP to the association, guaranteed by the District. The nonparticipating owners will pay their portion of the assessment to the condominium association as part of their regular monthly condominium fee, which will enable the association to meet its loan payment obligations to OTP.

The association will be able to enforce condominium fee payment obligations against nonparticipating owners through the usual methods available under the Foundation Deed -- income garnishment and liens on the individual units owned by those who fail to pay.

To maximize the association's ability to assure that nonparticipating owners pay their share of the renovation costs through the assessment of condominium fees, which in turn will enable the association to meet its loan repayment obligations to OTP and protect the District's guarantee fund, it is necessary that the revised Foundation Deed which we have proposed for use in District VII be used in all condominiums that participate in the guarantee program. (Condominiums that were created before adoption of the revised Foundation Deed should be required to accept the revised document to be eligible to participate. This will require unanimous approval by the unit owners.)

The District will have to rely on the association to enforce its remedies against nonparticipating owners who default in payment of condominium fees, even though their portion of the funds necessary to do the renovation work will be loaned to the association and guaranteed by the District. The fact that a majority of the owners (excluding the District) will have approved the project and mortgaged their own units should help assure that the association will pursue collection remedies as vigorously as possible.

TECHNICAL ANNEX
Description of Financial and Legal Aspects of Program

A. Designing Alternative Loan Terms

Historically, Hungarian mortgages had been at a fixed rate and fully amortizing, with a level, nominal payment. The fixed interest rate was usually below the market rate. The amount of subsidy became extremely large and variable once inflation rose in the late 1980s.

Since 1990, home loans (other than for the purchase of privatizing flats) have been at a variable rate and with a percentage subsidy which is phased out over the life of the loan. The variable rate is set once per year, depending on the expected level of inflation and interest rates for the coming year. The rate of subsidy for first time buyers ranges from 30 percent to 80 percent of the installment payment in the first five years. The size of the subsidy decreases after the fifth year and again after the tenth year. This subsidy makes it possible for a family to afford a small loan when interest rates are as high as 30 to 40 percent, but 1) the cost to the government is very high in this case, 2) the rate could go even higher, and 3) the amount borrowed is relatively limited despite the large subsidy.

There has been much discussion of adopting an indexing feature in order to resolve these three problems. For example, a dual indexed mortgage (DIM) could reduce the current interest rate by removing the inflation-related part of it, while also protecting borrowers from sharp drops in the general level of real wages. However, there are real uncertainties with respect to establishing the relevance and accuracy of available indexes of either prices or wages.

The District VII program could use a simpler type of such a mortgage for the special loans to condominiums in the program. This alternative loan would also be very useful if the government subsidy to renovation loans was withdrawn. The easiest way to think of the mortgage is as an unsubsidized adjustable rate mortgage of the type currently used, but with the interest rate used for calculating the payment each year being set at a lower, more affordable level. The difference between the payments under the lower rate and the normal market rate would be added back into the principal of the loan during the year. At the beginning of the next year, a new payment would be calculated at the lower rate applied to the higher remaining loan amount.

For example, if the contract rate on the loan were 33 percent in one year and the payment rate was 10 percent, approximately 23 percent of the loan amount would go back into the principal amount and the payment would rise by that amount in the coming year. If inflation was 30 percent during the year, the real value of the loan would still decline significantly. If wages grow by more than 23 percent (i.e., real wages go down by less than 7 percent), then the payment

as a burden on household income will decline. If greater real wage declines are anticipated, a higher payment rate could be adopted.

This type of loan is one of a general class of Dual Rate Adjustable Mortgages (DRAMs) and can be called a Deferred Payment Adjustable Mortgage (DPAM). This particular formulation leaves no uncertainty as to the eventual term of the loan. It is the equivalent of a Price-Level Adjusted Mortgage (PLAM) if the payment rate is set at the real interest rate and the real interest rate does not change over time. But it is easier to understand, since it is the same as the usual ARM except for the deferral of some of the interest, and it does not require any use of price or wages indexes. Its only disadvantages compared to a PLAM or DIM are that 1) the payment rate is higher than the real interest rate (e.g., 10 percent instead of 5 percent), and 2) it would not protect borrowers from extreme declines in the level of real wages.

B. Legal Questions

1. Scope of legal authority of the common representative of a condominium association.

The question we confront is whether a condominium association can receive a loan from OTP under the District VII guarantee fund.

A condominium association is not a "legal entity" as that term is defined in Title III the Hungarian Civil Code. That means the association itself lacks legal capacity to enter into contracts or to sue or be sued in its own name. Therefore, as a technical matter, the association itself--that is, in its own name--would not be an appropriate borrower from OTP. The appropriate nominal borrower would be the common representative or the chairman of the executive committee of the association. Under the Condominium Act, Law Decree No. 11 of 1977, Section 18, this individual is authorized to enter into binding contracts and obligations on behalf of all the other unit owners, so long as such action is taken in the course of administration of the affairs of the condominium. In other words, in this context the common representative or the chairman of the executive committee is empowered to act as an agent on behalf of all of the other owners.

Section 18(2) of the Condominium Act expressly states that the power of the common representative or the chairman to act on behalf of all the owners cannot be constrained against third parties. This means that the unit owners cannot deny the binding effect of an agreement entered into on their behalf by the common representative when an action based on the agreement is brought by a third party. Therefore, if OTP were to bring a legal action or otherwise take steps to enforce a loan agreement it has entered into with the common representative or chairman acting on behalf of all the owners, the owners cannot argue that their representative lacked the authority to act on their behalf and therefore they are not bound by the agreement.

Thus, OTP will be better protected by entering into a loan agreement with the common representative than it would be if the association itself were a legal entity and the borrower. In the latter case, OTP would have recourse only against the association in the event of default. With the common representative acting on behalf of all the owners, OTP would have recourse

against all of the individual owners if the association fails to meet its obligations under the loan agreement. Of course, this protection is in addition to the guarantee of District VII.

Further indication of the scope of authority granted to the common representative to act as agent of all the owners is found in Section 18(3) of the Condominium Act, which provides that the common representative can bring a legal action against a unit owner who has failed to fulfil obligations under the Foundation Deed, and is the party to be named in an action brought by a unit owner who opposes a decision made by the general assembly.

2. Can the loan to the nonparticipating unit owners be made to a management and maintenance cooperative?

During a meeting to discuss the renovation loan program, representatives of OTP suggested that it might be better if the loan to cover the share of nonparticipating unit owners were made to a management and maintenance cooperative, which would be a legal entity able to enter into contracts in its own name.

We do not believe this would be practical in the case of privatized buildings in District VII, for the following reasons.

First, under the Local Government Act of 1990 and the Transfer of Property Act of 1991, giving local governments control of housing stock that had been state-owned, multifamily housing which will be privatized can be converted to condominium but not cooperative ownership. Therefore, for loans to be made to a management and maintenance cooperative, the condominium association would have to be created first and then the association would have to approve the creation of the cooperative to manage and maintain its building. This is not a decision that District VII is empowered to make unilaterally.

Second, in general, new laws have eliminated all favorable treatment previously enjoyed by cooperative associations. A management and maintenance cooperative would be a business entity subject to ordinary taxation and other burdens of business enterprises, and therefore it probably would not be acceptable to an association of condominium unit owners.

Third, it is not clear that the state subsidy, a key component of the District VII loan program as currently designed, would be available if a management and maintenance cooperative were the borrower.

Fourth, even if a subsidized loan to a cooperative were possible, OTP would be no better protected than it would be under the current plan, since only the assets of the cooperative itself (as a separate legal entity) would secure the loan. These assets could be no greater and undoubtedly would be less than the assets of the members of the association, which would be the actual security for a loan to the representative of the association as agent of all the unit owners (in addition to the District guarantee).

If OTP still has reason to believe that creation of a management and maintenance cooperative would be beneficial for this program, we would of course be happy to consider their position if they would provide it in more detail.

3. What percentage of the unit owners is required to approve a maintenance or renovation project?

Maintenance or renovation work in the common areas of a condominium must be approved by a majority of the voting interests present and voting at a general assembly of the condominium, according to Paragraphs 14 and 15 of the Condominium Act, Law Decree No. 11 of 1977. These sections provide that decisions about renovation of the common areas are to be made by the unit owners at a general meeting, and that decisions at a general meeting are to be made by majority vote. There are exceptions to the majority vote provisions, but common area renovation is not one of them.

It is also possible to alter these requirements in the Foundation Deed, that is, the Deed can specify that a higher percentage or even unanimity is required. Such a provision would be extremely ill advised, however, since it could effectively prevent the unit owners from taking necessary steps to protect their property.

While the Civil Code, Paragraph 144, requires a unanimous decision of co-owners of property to incur "expenses exceeding the sphere of normal management," this provision is not applicable to condominiums. This is because Paragraph 149(4) of the Civil Code provides that the general rules on co-ownership shall only apply to co-ownership of blocks of freehold flats (i.e., condominiums) where there is no different provision in Law Decree No. 11. Therefore, under the express terms of the Civil Code, Law Decree No 11 (the Condominium Act) controls when a provision therein differs from the general co-ownership provisions of the Civil Code.

An exception to this rule occurs in buildings with less than six units. In these cases, the Condominium Act states in Paragraph 20, the ordinary co-ownership rules under the Civil Code apply.

4. Can the minority who opposed the renovation project sue to prevent it?

Under both the Civil Code and the Condominium Act, the unit owners who oppose an action taken by the majority can sue on the claim that the action will cause significant injury to their interests. While the association cannot prevent the opposition from availing itself of this right, the mere filing of an action will not prevent the work from going forward unless the court expressly so rules. This presumably would be done only in the case of egregious overreaching on the part of the majority against the minority's interests, and which is not likely to occur in the situations we foresee.

It is always important to try to reach as broad a consensus as possible before an association undertakes an expensive project in a condominium; this is especially true where there may be

wide differences in income and lifestyle among owners in the same building. That is why we are recommending that renovation projects not be undertaken unless there is majority approval among the owners without including the votes pertaining to units that are still owned by the District.

5. Is a loan to the association an encumbrance on the condominium property?

The Civil Code, in Paragraph 144(b) provides that a unanimous decision of the co-owners is required to pledge the condominium property as security for a loan, or to "encumber it in another way." There is no contrary provision in the Condominium Act, so the Civil Code controls.

A loan to the "association" (actually, as discussed above, a loan to the unit owners through their agent, the common representative) would not require unanimous consent unless the entire condominium property were to be pledged as security. The entire property would include all of the units and, as a result, all of the common property.

While it is possible to pledge the individual units, since they are separate parcels of real property, the common property is not separately owned, but is owned on a proportionate basis by all of the unit owners. Therefore, there is no separate common property that could serve as security for a loan.

6. Can the association charge interest on overdue assessments?

We have been informed by the legal advisor to District VII, Dr. Tamás Ruttkai, that a condominium association can charge interest up to the legal maximum for contracts with private parties (currently 20%). It can also charge a late fee in a reasonable amount. Therefore, we are including in the proposed Foundation Deed a provision that an association can charge interest in an amount set from time to time by the executive committee, up to the maximum amount allowable by law. This will permit flexibility as interest rates change over time. We are also recommending a one-time late fee for delinquent payments in the amount of 500 forints.

The interest rate also has been changed in the proposed installment sales contract to 20%, which cannot be changed during the term of the contract.

7. Can the amount of a lien change over the course of time?

The loan program we are proposing includes provisions for payment by the District of principal and interest on behalf of pensioners and low income borrowers. The lien that will be recorded in these cases will reflect all of the terms of the loan, including the fact that the balance will increase over time. This is permissible, just as the balance due to clear a lien that is filed at the outset of a conventional loan declines over time.

At the time of sale or other occurrence that triggers the requirement that the borrower pay the sum due to release the lien, the account will be reconciled so that the parties will know the exact amount required.

8. Can the loans to pensioners require that the lien be cleared upon the death of the borrower?

We have learned that there may be restrictions in the Hungarian law of inheritance that may prohibit a requirement that the loan be paid off upon the death of the borrower. We are having this issue researched by a person conversant with these provisions of Hungarian law, and will provide the information when received.

(Last Rev. 12/24/92)