

**FINANCING OPTIONS FOR NEW
AND EXISTING HOUSING IN
SLOVAKIA**

**SECTOR INVESTIGATION
REPORT**

Prepared for

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EXECUTIVE SUMMARY

The purpose of Part I of the Financing Renovations, Additions, and Major Repairs Program is to enable condominium associations formed in newly privatized buildings to undertake capital repairs, improvements, or additions to existing structures. The program is focused on two activities: (1) determining the feasibility of several prototype projects likely to be considered desirable by many associations, such as building new residential units or other finished space under the roof, increasing energy efficiency, or improving the watertightness of windows, roofs, and facades; and (2) identifying sources of capital, such as short-term affordable mortgage loans to the association or outside investment in exchange for an ownership interest or occupancy rights in the building.

The work is to be carried out in two phases. During Phase One relevant sectors have been investigated to determine project feasibility and constraints. The financial, technical, and organizational aspects of potential participant condominiums have been examined, demonstration sites selected, and specific project plans designed. During Phase Two the projects are to be implemented and a dissemination and replication plan designed.

This report describes the activities undertaken and the findings of Task 1 of Phase One, Sector Investigation. In this task an evaluation was made of the legal, technical and financial framework applicable to rehabilitation projects to determine what constraints exist and the feasibility of eliminating them. Existing institutional lending activity was investigated, as well as other possible sources of capital or in-kind services. As part of this work meetings were held with local government officials, lawyers, architects, engineers, construction firms, bankers and other interested parties.

I. LEGAL EVALUATION

Slovakia's condominium law, passed in 1993 in conjunction with the law on housing privatization, provides a clear and adequate legal framework for creation of condominium ownership. It provides for but does not require an association of the unit owners; the lack of a requirement for an owner's association in each condominium is the major drawback of the law. In the alternative the owners contract with a third party for management and maintenance. What results is a condominium with no owners' association to manage the common property and interests of the owners, but a group of individual owners each of whom has a contract with a maintenance company (which may be private or government owned) which controls the management and administration of the entire property (individually owned units and common property).

When there is an owners' association as a legal entity it can enter into binding legal contracts with individuals and with other legal entities. The association can assess and collect fees from the owners, and can legally enforce the owners' obligations to the association. Each association's ability to take these actions is elaborated in the condominium law and in an association agreement. The condominium law and the association agreement describe the circumstances under which the executive committee may commit the association, or in the alternative the minimum percentage approval by owners in general assembly required to commit the association, to such activities as:

- Undertaking rehabilitation projects.
- Entering into contractual agreements for the design and elaboration of such projects.
- Imposing special fee assessments upon members.
- Borrowing money.

The owners' association, as a legal entity, is legally capable of taking all steps necessary to initiate, plan, execute and finance rehabilitation projects, subject only to the constraints of its association agreement and the condominium law.

Many rehabilitation or improvement projects which affect the exterior of the building must be approved by the municipal government. This is much like zoning approvals in the United States. Each municipality has an office which reviews requests and issues approvals or denials. The addition of flats on roofs or the construction of a sloped roof must have approval. In most cities the addition of flats will be prohibited for certain buildings, based upon location, surrounding buildings and city planning. The law states that any building with more than five stories must have an elevator. Floors can be added only to buildings with four living floors or less, or to buildings already having an elevator (in this case the new top floor resident rides the elevator to the end of its ascent and then walks the final flight). All projects adding additional floors involve mansard roofs. In cases where additional units were added by private owners the added floor was economically motivated. In the municipally sponsored cases, the motivation appears to be more experimental, and the work is often part of a larger project.

II. TECHNICAL EVALUATION

A. Building Standardization

In Slovakia there exists significant standardization of building structures. Prefabricated panel design and construction represents a substantial percentage of the total housing stock; poured concrete slab and column are less prevalent. It has been said that the CSFR was the world's number one producer of multifamily prefab housing in per capita terms. In 1988, over 70 percent of Slovakia's urban housing stock was in the form of multifamily apartment buildings; the vast majority of that stock was prefabricated in design. Located around the country are a number of



large fabricating facilities which produce precast concrete panels and slabs. Despite recognized deficiencies in housing constructed in this manner, there is strong pressure to continue, so as to keep utilizing the fabrication facilities. It is interesting to note that many buildings were constructed with modular, factory assembled mechanical (kitchen and bath) cores in each apartment. Apart from this, however, mechanical systems in buildings are not so standardized.

B. Common Structural Deficiencies

Most housing in Slovakia suffers one or more of the following deficiencies, resulting from some combination of poor design, inadequate materials, shoddy workmanship, lack of maintenance and/or old age:

- *Thermal and hydro-insulation failure of flat roof membranes*, resulting in water penetration into upper floor apartments and in some cases, structural damage to the roof and other building components. Flat roof membranes have finite lives. Life expectancy can be extended by a program of routine preventive maintenance. In the absence of maintenance, life expectancy diminishes, and this is the case in Slovakia — there has been no maintenance. Further, much housing was hastily built, and construction quality was not given priority.
- *Thermal insulation deficiencies around exterior doors and windows*, resulting in significant loss of heat, one of the most significant costs to owners and the association. Some buildings were constructed without any insulation. Where insulation was utilized, it has deteriorated over time. Materials used for these purposes have finite lives and can be expected to deteriorate over time. Periodic replacement is required, but has not been performed.
- *Deteriorated or failed thermal insulation at panel joints in the case of buildings with concrete panel wall systems*, resulting in heat loss and mold and mildew inside apartment units due to moisture penetration. Again some buildings were constructed without insulation at panel joints. As stated above the insulating materials used for these purposes will deteriorate over time and require periodic maintenance and replacement.
- *Failed joints in waste evacuation laterals in technical spaces* resulting in hazardous health conditions. If the original installation of these systems had been better executed, particularly the sealing of pipe joints, such failures would be rare. Remediation and repair are not major undertakings, but left undone they lead to consequences both unpleasant and unhealthy.
- *Leaking domestic hot and cold water supply piping and fixtures*, resulting in higher costs for building residents and insufficient water pressure. Leaks happen, but very infrequently if materials and installation technique are high quality. However, defective pipe material will fail. Inferior joint materials (solder) or sloppy joint finishing will not hold. Use of plastic pipe systems for domestic water supply has been problematic around the world. Leaky taps and toilet fixtures are epidemic, due in some cases to cheap fabrication, but more commonly to lack of maintenance and repair. Water efficient fixtures were not used in construction.
- *One design series of prefabricated concrete panel building is known to have a latent design defect.* The precast concrete floor system relies upon an eight (8) meter span between bearing walls; the floor slabs themselves have insufficient rigidity and as a result bow or sag. This condition is not



thought to pose any danger, but it does contribute to the insulation problems at doors, windows and facade panels.

- *Design deficiencies are frequently found in building heating systems.* A prime example is the “one pipe” system found in some buildings. Here the radiators in a riser are connected in series rather than in parallel. With such a system it is frequently impossible to get enough heat to some units, and it is guaranteed that from unit to unit there will be great variation in heat levels. Such a system is recognized as being the least expensive to install, but is also recognized as being unacceptable for its performance.
- *Tenant alterations that interfere with building structural systems may weaken the structural integrity of the building.* It is well known that tenants frequently make alterations to their apartments and take great liberties in doing so. These alterations are done without designs by qualified architects and engineers and without State or municipal consent. Sources indicate but have not substantiated that such alterations often include interference with the buildings' structural systems.

These problems are examined in more detail in the *Site Selection* Report produced by Inštitút bývania under this Request For Services.

C. Resources for Renovation Projects

Solutions to the above-described problems are available. Sophisticated materials and installation systems commonly used in the West have been introduced in Slovakia, and in some cases are now manufactured in Slovakia. There is an adequate supply of skilled tradesmen and building craftsmen. The only thing preventing implementation in most buildings is the lack of financial resources.

Technical design of rehabilitation and improvement projects is easily accomplished, as there is no shortage of qualified architects and engineers throughout the country. There is considerable spread in pricing for services and the quality of service output, due to the relatively recent emergence of a private construction market and private construction, maintenance and repair firms. Because of the commonality of building designs, architectural and engineering drawings prepared for one building can be used with minor modification for other buildings.

Most of the rehabilitation projects being considered by owners' associations do not require any special studies, analyses or municipal approvals. The key exception to this is the addition of flats on existing roofs. Here a structural analysis of the building is required to determine if the roof terrace will support the additional level. Snow load calculations must be made for the sloped or mansard roof for the new flats. A prototype of this kind of project has been developed in the Project Design Report prepared by Institut byvania (Part IV of this report).

There are many privately owned construction contractors in Slovakia. Many are developing skills to use sophisticated imported materials and installation systems. A large number of these firms are doing work in housing (both new construction and rehabilitation) and have developed skills and experience which is directly relevant to the project at hand. Exhibit A to this Part I presents a representative selection of such contracting firms.

In the Bratislava area, there have been a number of projects to add stories and/or improve the insulation of multifamily buildings, mostly in cooperatives or buildings still owned by the municipality. Stories have been added to both high rise buildings and low rise buildings. In the latter case, sponsored by the municipality, a top floor was added



to four story buildings as part of a larger project, including insulation. A number of buildings have undertaken projects to improve heat insulation. All of these projects are intended to reduce heat loss in the buildings and improve comfort to residents. All involve caulking of joints in the prefabricated concrete wall panels and encapsulation of the building in whole or in part with an insulating skin consisting of 8-10 cm thickness of styrofoam affixed to the building exterior. To the styrofoam is attached a plastic or aluminum grid to which colored or painted stucco is applied. This technology and the materials used have been imported from the West, although stabilized styrofoam is now produced in Slovakia. It is unknown how durable and lasting this treatment will be.

Inside some buildings gypsum wall board has been used extensively as an insulating tool. In common area (vestibules, entries and stairwells), concrete walls and ceilings have been sheathed with wall board finished like the drywall construction used in the West. It is not known what improvement, if any, this will make to heat retention.

The most comprehensive improvement project involved a test building undertaken by the municipality of Bratislava with French financial assistance. This building received a new skin from ground to top including the ground floor technical level. At the top a new roof was installed. New exterior doors and vinyl-clad windows were installed. The new skin consisted of several parts. At the ground (technical) level the exterior walls were clad with an insulated ceramic tile. Above the ground level a combination of insulated enameled sheet metal (probably aluminum) and insulated tile panels were used. The result is a very striking and new appearance. Insulation effectiveness is as yet unknown. Project cost is said to be 35 million crowns (\$1.2 million) for a building of approximately 100 units. Needless to say, if these costs are accurate they are well beyond the means of the typical owners' association.

III. FINANCIAL EVALUATION

A. Current Environment

The government ended its provision of low-interest loans in 1991. A private sector housing finance system is yet to develop. Eviction and foreclosure, though legally possible under the terms of the civil code, are not practical options due to the requirement that alternative housing has to be provided for the evicted household. There is no mortgage law, although recent amendments to the banking law have authorized mortgage lending and the licensing of mortgage banks. A Mortgage Task Force, led by the Ministry of Finance, has been charged with drafting relevant mortgage legislation, and a draft mortgage law is planned for 1997. Most rehabilitation and improvement work is paid for on a "cash and carry" basis.

B. Planning Renovation Projects

Determining the willingness and ability of individual owners to pay and save for building improvements is difficult; ascertaining an association's reserve status is sometimes no easier. It does appear that in most buildings where an owners' association has been established, amounts are being collected for the purpose of repairs and renovations above and beyond monthly routine maintenance expenses. This is a very positive development and signals the recognition on the part of the owners in these buildings that they must rely on their own savings to leverage or carry out building rehabilitation. Some examples appear below.

■ ***Fibichova***



The owners of this prefabricated concrete panel building located in Kosice have chosen to undertake two substantial projects in sequential order.

The first project is to reinsulate the joints between the prefabricated concrete panels that comprise the facade of the building. This project will cost approximately SK 180,000 and will take six to eight weeks to complete. The building representative, who is a civil engineer, has undertaken the management of this project; the project was put out to bid and three bids were received, all priced about the same. Two of the bidders proposed using traditional butyl materials and offered two year guarantees. The third proposed a new acrylate material (certified by the government for use). The material is reputed to have a 20 year life and the contractor will give a five year warranty. They building chose to go with this latter bid, they retained legal counsel to assist with the contract and the work was commenced.

The second project is to insulate around all windows in the building. This project can be done at any time during the year, and the people propose to do it as soon as they have the money saved after paying for the first project. Estimated cost is SK 140,000.

At the time the first project was contracted, approximately one month prior to start of work, the building had SK 170,000 in the repair fund. Residents add approximately SK 20,000 per month to the fund.

Although no estimates were made, residents anticipate energy savings and plan to track those savings.

■ **Amurska**

The residents of this building have a very aggressive savings program for their repair fund. They have already reworked the roof, replaced valves, installed new ball valves in all toilets and painted common spaces.

The major deficiency in this building is inadequate heating. Consideration is being given to installation of a central boiler and separation from the municipal system. The city will probably allow this project to proceed as a demonstration. Such a project is a major undertaking from a design, construction and financing standpoint. A loan from a bank or other lending source will be a potential source of financing for the project. Legum & Norman and Institut byvania are providing USAID sponsored technical assistance to the building in the following areas: design, costing, financial analysis, financial plan development, bidding and construction oversight.

■ **Kuzmanyho**

The residents of this building have elected not to undertake rehabilitation projects in the short term, and have instead put together a list of many very small items having a total cost of SK 47,206.70. This work will be completed during 1996, during which time an additional SK 20,000 will be spent improving common areas.

On the other hand this building is very deliberately developing a repair fund. The balance at December 1995 was SK 100,480; projected balance at December 1996 is SD 401,920. They recently placed SK 60,000 in the Construction Savings Bank (individual accounts) to take advantage of the government subsidy. They are looking forward to major roof repairs in two years' time, assuming they have enough saved by that time; they will not consider borrowing to do the work earlier, which for this project would probably be most difficult to justify economically.

Working with associations to plan and finance rehabilitation or improvement projects becomes an iterative process, as a project's cost is determined and then value engineered to the smallest possible amount on the one hand,



while on the other hand trying to determine how much the association has saved, how much more it can save over what period of time, and what monthly installment or debt payments it can and is willing to make. The importance of this process to the realization of rehabilitation projects is apparent when it is understood that today self-financing is the most viable means of financing such work.

C. Financing Sources

National government and local government financing programs for housing improvement are not yet available, although there is likelihood of such sources in the future, including the establishment of a State Housing Fund to support housing. However, even if such programs are developed, the scale of the rehabilitation problem in Slovakia is such that it would be difficult for public resources to have a major national impact. Construction firms and other related service firms are not viable sources of financing. Some banks make housing loans and others have expressed interest in doing so, so banks represent a very real potential source of rehabilitation financing. Slovaks in general are adverse to borrowing, especially at today's interest rates (12%-17%) which they regard as prohibitively high. In relative terms these rates are quite advantageous compared to those in neighboring countries, and they have been falling slowly, but there still exists a nostalgia for the heavily subsidized loans of the past.

■ **Government Programs**

By law each municipality is required to utilize a part of the moneys it receives from the privatization of housing to fund a community housing development fund. To date only the city of Kosice has privatized enough housing to create a housing development fund of any size. That city has earmarked the moneys collected through 1995 for the completion of housing which was under construction at the time of the revolution. These funds do represent a potential resource for renovation projects in privatized buildings and could be used in a variety of ways. An informal proposal regarding such a use of funds is being prepared for presentation to the city of Kosice, and is included in the Financial Design Report (Part II).

The state government has also mandated the creation of a State Housing Fund to be initially capitalized from the state budget at SK 1 billion; detailed regulations for how the fund would function and what sorts of projects will be eligible for assistance are now being prepared. Sources indicate that renovation and rehabilitation would be approved uses for the fund, but the amounts available will be quite limited.

■ **Construction Firms**

Construction firms go to great lengths to protect themselves from nonpayment for work performed. Collection is difficult and costly, and most companies do not have capitalization sufficient to absorb such losses. Slovakian construction firms typically negotiate a price with the customer for a project and enter into a contract. An up front payment of 30-50% is required and the balance is paid monthly as work progresses. The initial payment is calculated to cover at least the cost of materials for the project, as construction firms do not maintain material inventories and materials are purchased for a specific project. In addition to tying payments to progress, construction companies try to obtain additional guarantees of payment or letters of credit. Within this framework, construction companies do not appear to be potential financing partners for rehabilitation and improvement projects.

■ **Banks**



Most bank credits are short term; a long term loan at market rate might be 7 years at 16%. Rates will vary with length of term and purpose. There are several banks with good liquidity which actively lend for housing. One has made a group of loans for a rehabilitation project in a privatized building, as is described below.

Slovenska Sporitelna, or Slovak Savings Bank, specializes in lending for new construction, the purchase of new and used housing, additions and renovations. Loan terms are for as long as 15 years, with most falling in the 3 - 10 year range. Interest rates are variable; the rate at April 1, 1996 was 11.5% per annum. Prepayment is permitted without penalty. Loan sizes up to a 70% loan to value ratio are made, with the borrower putting up the balance. Generally a lien is placed on the real property and frequently other security is required, because of the difficulty in securing possession in the event of default. The borrower's ability to repay the loan is carefully considered and the bank stays close to all of its loans.

Two banks in Slovakia, First Construction Savings Bank and VUB Wustenrot, j.s.c., offer housing loans through construction savings plans. The advantage of a construction savings plan is that the borrower can obtain a low interest loan based on gradual planned savings supported by a State bonus. The State contributes 40 percent of the amount saved in a year with a maximum contribution of SK 6,000 per year. To maximize benefits of the plan, SK 15,000 would be deposited each year for 6 years (the normal contract period), resulting in an accumulation of SK 137,515 at the end of the period out of a total target amount of SK 250,000 at the end of the period. This enables the saver to take out a housing loan fixed at 6 percent for the balance. Accounts earn 3 percent per annum tax free, and after two years the depositor may borrow up to 100% of the account balance at a slightly higher interest rate for a term of 8 -13 years. The advantages of such a program are forced savings and low interest loans. The disadvantage is the high level of security for the borrowing. The borrower in effect borrows his or her own money.

Other banks are planning to begin to make housing loans, but will probably not offer programs for long term renovation loans. PKB (First Communal Bank) expects to soon begin lending to contractors for new construction. VUB plans to offer loans for the purchase and construction of new homes.

While bank financing is feasible, borrowing by condominium associations is problematic. Bank loans and consumer financing are unknown to most people. Both First Construction Savings Bank and Slovenská Sporiteľňa would require loans be made to the individual owners rather than to an association. These loans would aggregate in an amount equal to that which the association would otherwise have borrowed. The owners would contract among themselves regarding receipt and disposition of funds from the loans, as well as repayment.

This is awkward for a number of reasons, the most important being that every individual in need of a loan must qualify, or the total amount needed to complete the project will not be lent by the lender. This is in contrast to an owners' association taking the loan with the responsibility that the owners make payments on time to the association, and with the ability to avoid a default by utilizing association funds to cover the difference if an individual cannot make payments. Nevertheless, First Construction Savings Bank has successfully loaned money individually to owners in a privatized building in Kosice for the installation of a new roof, proving the feasibility of this type of lending.

An important part of the financing analysis must be an exercise which predicts inflation and interest rates and then compares the option of saving for a project until enough money with earned interest is amassed to fund the repair against the option of borrowing to make the repair now and then repaying the loan. This analysis will be performed in the pilot condominium buildings participating in the *Financing Renovations, Major Repairs, and Additions* project during Phase II of the project.



IV. CONCLUSIONS

In summary there are no serious legal or technical constraints to rehabilitation and improvement projects. On the other hand, financing rehabilitation and improvement projects through borrowing is not attractive to most people. The most viable financing means is self-financing. Nonetheless lending sources do exist; rates and terms are reasonable, although the lending process is complicated. The following points summarize the main obstacles to the development of a viable rehabilitation market in Slovakia:

- The fact that the condominium law does not require the establishment of an owner's association at the time of sale of the units in a building presents serious problems in those buildings where associations were not formed. The ability to organize and carry out improvements to the common area of a building is severely hampered by the lack of legal and organizational structure imposed by an owners' association.
- Unfamiliarity with the concept of owners' associations on the part of the financial sector has made banks for the most part unwilling to lend to an association as a single entity. This complicates the process of borrowing funds for the repair or renovation of common areas. There is a role for technical assistance from USAID in this area to demonstrate the feasibility of this type of lending through pilot projects. Municipalities can also be a factor in helping banks become more comfortable with lending to associations.
- Eviction and foreclosure, though legally possible under the terms of the civil code, are not practical options due to the requirement that alternative housing has to be provided for the evicted household. Owners wishing to borrow funds for the repair or renovation of their housing must provide the lender with security over and above their residence.
- The most significant obstacle to implementing rehabilitation in privatized buildings is the lack of financial resources on the part of owners. Owners struggle to keep up with liberalized energy and maintenance prices, and making any significant contribution to a capital reserve fund for repairs or renovations is not easy. Capital reserves started from zero only recently, and even where buildings are saving, the needs far outweigh the existing resources. Because owners are borrowing-averse, they will naturally overlook a loan as the sensible solution to a particular problem. This will only be overcome by a continuing education process.



ANNEX A

RESOURCES FOR RENOVATION PROJECTS

PRIVATELY OWNED CONSTRUCTION CONTRACTORS

There are many privately owned construction contractors in Slovakia. Many are developing skills to use sophisticated imported materials and installation systems. A large number of these firms are doing work in housing (both new construction and rehabilitation) and have developed skills and experience which is directly relevant to the project at hand. A representative selection of such contracting firms appears below.

DOMBYT

The Domyt construction firm in Martin is owned by Ing. Jozef Brincka. This is a small firm which provides maintenance and repair services. The firm does work for Martico and Real (the two management companies in Martin). It also does private work for individual flat owners (10% of total). Domyt bids public work and just recently won a 150,000 crown contract from the District School Office to do a water installation. It has contracts to maintain elevators in two buildings and a contract with a school to maintain the sewage/waste system.

Domyt does all of Martico's work costing less than 15,000 crowns. Martico bids anything higher. Domyt does all work with its own staff — installation, carpentry, electrical and plumbing. Over the past few years the firm has developed unit labor costs for much of the work it does, i.e., cost to install a bathroom sink. The firm has 15 employees in the field and pays on average a wage of 80 crowns per hour. There are three personnel in administration. The firm is about 3 years old and does about 1.4 million crowns per month business volume.

The company rents equipment as needed, but as a rule does not subcontract labor. It is doing one large job, a fire renovation, that requires additional labor. In a case such as this they hire temporary labor. Labor is available and training is not required.

There are several similar firms and private individuals doing the same work, so there is competition. Most firms started in business about the same time; several have gone bankrupt.

STAMART

The Stamart construction firm, also located in Martin, is directed by Dipl. Ing. Tibor Kocvara. This large, 5 1/2 year old firm has 110 employees and does a volume of 120 million crowns per year. Their minimum job size is 1 million crowns. Stamart is probably the largest construction firm in the area. The State firm, which has yet to be privatized, is virtually out of business. Stamart does not subcontract much, stating that qualified subcontractors do not exist. The firm owns its own equipment, citing availability and timeliness problems in renting equipment.

Stamart's major work has been pharmaceutical industry reconstruction and modernization. Hoechst is now majority owner of Martin's largest manufacturing facility and made a large investment to bring the facility up to U.S. standards of cleanliness, sanitation and sterility. Stamart is now starting a second such project. Banks are another primary customer base. Most of Stamart's work (80%) is reconstruction. As they put it, Slovakia has plenty of buildings; they are just in bad shape. The firm's offices are located in a 100 year old building which was substantially destroyed. Stamart bought the building cheap, restored it, and added an additional story which contains their offices. They rent the balance of the building.



Stamart has developed a number of specialties, such as special purpose industrial floors, installation and finishing of drywall (they are also a distributor) and patterned concrete finishes in driveways and walkways using a U.S. process. Housing construction is not a factor in their business because of lack of a mortgage law. They have not done any multifamily work, with the exception of a recent job in which they converted an army barracks to housing.

BOLDA

The construction firm Bolda is located in Kosice. This firm dates from the 1940's; it was nationalized in 1948 by the state, and in 1989 was privatized, being purchased by the son of the founder. The company has 40 employees. Annual volume is around 10 million crowns. Business is split evenly between government and private owners.

Bolda does both new construction and reconstruction. New construction involves high-priced family houses. Reconstruction involves a variety of work, mostly housing. Primary emphasis of the firm is reconstruction of infrastructure, new plumbing cores. In Kosice all prefabricated concrete panel buildings, and some others as well, have factory-built modular cores (bathroom, toilet room and kitchen plumbing). There are chronic problems with the plumbing. Further, the walls of these cores are flimsy metal and plastic fabrications. As a result there is a thriving business in rebuilding the cores, including walls. Bolda has added flats to the top level of buildings. They recently reconstructed an entire block, converting student housing to 1 and 3 room flats. They have unique experience in penetrating bearing walls using diamond carbide drills and saws, and are able to connect adjacent flats laterally or vertically. Bolda is also a participant with the government and the First Construction Savings Bank building subsidized flats for physically disabled persons.

STAVOTERMSERVIS

The construction firm Stavotermservis, operated by Dipl. Ing. Martin Jez and Julius Holan, is also located in Kosice. This 1 1/2 year old firm with 15 employees and an annual volume of 50 million crowns (including revenues of two related firms) is very different from the others discussed herein. The firm is highly specialized and emphasizes heating and the improvement of heating and thermal efficiency. The firm's main activity at present is the reconstruction of heating systems and equipment using microcentrals and other energy-efficient equipment from Sweden. They are qualified to do other thermal insulation work, including installation of rubber membrane roofs, mineral wool insulation, exterior panel insulation systems and storm window systems. Their work is design-build.

SCARABEUS

Another firm in Kosice is the construction firm Scarabeus. This private firm founded in 1990 by a husband and wife team by the name of Kopcova has 40 employees. During the first years the firm did repair and emergency work and gradually transitioned into construction work. They do mostly interior work, but do some exterior panel work. They do a lot of the core reconstruction work described above. They arranged a tour in the field to see a job in process and a finished job. They also do reconstruction work in cottages, cabins and small houses, as well as some industrial work. They work with the canalization for hazardous waste materials.

As to how customers finance their work, 50% is out of pocket, 30% if from cooperative reserve and replacement funds, and 20% is from the Construction Savings Bank. Coops are a problem, as reserve funds are



generally not large enough to fund full payment. As a result the balance must be funded from rents, which are frequently not paid. Collection delays are common. The firm always asks a 30%-50% deposit.

NEOM

In Bratislava Ing. Peter Skopal and Ing. Ladislav Nemeth operate the NEOM construction firm, a small traditional firm which has been in business about 4 years. They do small projects: small houses, service business work, restaurants, hotels. For new construction work they are promoting a post and beam framing system using laminated wood structural elements. They have three basic models: 6X6 meters, 7.2X7.2, and 8.4X8.4. This firm installs the structure on a foundation prepared by others and can deliver a finished house of the largest size having one floor plus a loft for 970,000 crowns all in except land. They have built only two houses, but have designs for restaurants, hostels and offices. They see no reason the concept could not be adapted to apartment terraces.

These people also have another firm, Hanas, which deals in bathrooms. They supply ceramic and porcelain tile, adhesives, caulking, fixtures, faucets, etc. They are developing millwork packages for walls, kitchens and even furniture. They are looking ultimately at being suppliers to the "do it yourself" trade.

This firm, unlike many other firms described herein, does not do "installations" — electrical, plumbing, mechanical. They subcontract that work to others — basically a consortium of close, though independent, firms. They work with First Construction Savings Bank and with Vub-Wustenrott, another similar institution. In collaboration with these banks they are developing a facade insulation project.



ANNEX B

MUNICIPAL HOUSING FUND AS A FINANCING SOURCE FOR CONDOMINIUM ASSOCIATIONS

INTRODUCTION

In Slovakia former state-owned housing has been transferred to municipalities which are slowly privatizing the housing stock. Multifamily apartment buildings are being sold to tenants at an extremely nominal value. Typically local governments set a 2 percent rate of annual depreciation on the original value of the housing (at the time of construction), thus leading to cases where tenants pay a fraction of what it would cost to reproduce the housing at the time of privatization. However, this implied windfall does not in fact exist. Years of deferred maintenance and rehabilitation on top of inefficient and sometimes inferior design and construction have resulted in buildings which are in very poor condition. In some cases even the structural elements and engineering systems are in critical need of repair.

Privatized multi family housing is governed by the Condominium Law 182, as amended by Law 151. The primary feature of a condominium is that owners of individual units have property rights not only for their unit, but also for a certain proportion of the common areas of the condominium. Owners are therefore obliged to share the coverage of cost of operation, maintenance and repairs of the common parts and common equipment of the condominium. Responsibility for correcting and improving the condition of buildings rests with the owners.

The options for financing needed rehabilitation are few. In an ideal environment condominium associations would finance their own rehabilitation through special assessments and savings. Urgency might dictate that the condominium borrow funds to accomplish the repair quickly; the loan would be repaid from special assessments or higher fees. It is also true that some unit owners will not want to or legitimately cannot pay higher fees or special assessments. There is the opportunity to place liens on individual units in the event funds are borrowed or if owners do not pay their fair share. However, to perfect the lien and secure possession, alternative housing must be provided to the resident. As a result the security offered by the lien is ephemeral.

If a condominium association does decide it needs to borrow funds to finance a rehabilitation project its options are limited. While there are 30 commercial banks operating in Slovakia, most are cash poor and as a result have limited funds to loan. Many banks have no experience with housing loans. At this time it is unclear if a condominium association can legally borrow funds; it is known that some banks cannot lend to such entities. There are no real housing finance mechanisms in Slovakia.

In summary, while purchasers have benefited from low prices, they have assumed the burden of substantial rehabilitation requirements. If the only viable means of financing this work is through savings, the needed improvement in Slovakia's housing stock will not be realized.

MUNICIPAL HOUSING FUND

By law a percentage of the revenues realized by the municipality from housing privatization is to be placed in a Housing Fund, which is to be reinvested in the housing sector. We suggest that a portion of the housing fund be dedicated to improvement of privatized housing through the program outlined conceptually below.

In cooperation with one or more private banks the municipality will develop a condominium rehabilitation project loan program. A portion of the Housing Fund will be placed with the bank(s). The tax laws will determine how these



funds are actually transferred. The transfer may occur as a loan, in which case the bank will pay interest to the municipality (the Housing Fund), or it may be in the form of a deposit, which should earn interest.

This funding from the Housing Fund is critical to the program, because it serves a number of important purposes.

- The municipal money seeds the program. It provides necessary liquidity. But it should be leveraged. Any participating lender must provide matching funding in some multiple (to be negotiated) of the municipal contribution. In this manner a public-private endeavor is commenced.
- The municipal money will provide a partial guarantee for loans. Because there are no real housing finance mechanisms in Slovakia, guaranty of debt repayment is a concern to all banks. To encourage bank participation, but at the same time to ensure proper loan underwriting and servicing by the bank, the municipal money will provide a pro rata guaranty (for example 25-30%) against loan loss.
- The municipal money will fund grants to or on behalf of individual unit owners in condominium associations who cannot afford to borrow or make their pro rata share of loan payments.

In this program funding from the Housing Fund responds to three fundamental weaknesses in housing finance in Slovakia — lender liquidity, repayment guarantee and needy households. A program can be developed in which Housing Fund monies are used for only one or two of these purposes. Such a program may succeed, but to maximize the utilization of funds and effectiveness of the program all three needs should be addressed.

We suggest a market loan program administered by the bank(s). In other words condominium associations desiring to borrow funds for rehabilitation projects will make application to the participating bank(s). The bank will underwrite the loan and the creditworthiness of the borrower as it would any market housing loan. It is preferable that the partner bank have housing experience, as for example Slovenska Sporiteľňa. Loans should carry pricing and terms usual for housing loans; this is not a subsidized program. Association members must permit liens to be placed upon their units and/or provide such other guaranty as standard underwriting dictates.

Additional underwriting will be required for these loans due to the existence of needy households in most condominium associations. Provision must be made for hardship application and as unit owners so apply, they must be individually underwritten to determine the degree of hardship. In each case it must be ascertained what, if any, percentage of the pro rata share of the loan the petitioner can afford and the grant amount for the differential established. By lien on the petitioner's unit the grant will be repaid upon sale or transfer of the unit. We suggest the participating bank is best qualified to perform this underwriting and grant management, subject to municipal oversight and concurrence. The bank is entitled to an fee for this additional service.

It is unclear that condominium associations have legal standing to borrow money, at least from banks. In such event the participating bank will make individual loans to association members and the members will contract among themselves regarding receipt and use of loan proceeds and repayment. Such a procedure has been used by the First Construction Savings Bank.



In Slovakia the city of Košice is the only city which has privatized enough housing to create a Housing Fund of any size. There are a substantial number of condominium associations which are now facing up to the problem of making overdue repairs to their buildings. Košice meets the criteria for implementing the program outlined above. In Košice there exists at least one bank, Slovenska Sporiteľňa, with experience in real estate lending. All of the elements are in place, and we suggest that the city of Košice dedicate a portion of the receipts anticipated by the Housing Fund for 1996 to the establishment of the program described herein.

The Urban Institute and its subcontractor, Legum & Norman, are available to assist in the development of the program as part of their ongoing USAID-sponsored work in Slovakia. They have the capability to design the entire program, including the structure, procedures, the banking relationship, documentation, etc. if that extent of involvement is necessary or desired. They have been working with a number of condominium associations in Košice, some of which are perfect candidates for this program. The first loans can be produced under controlled conditions.

CONCLUSION

The condition of Slovakia's housing stock, both municipally and privately owned, must be improved. Given the magnitude of the task and the absence of housing finance mechanisms, that goal is unattainable for condominium associations. Dedication of a part of the Housing Fund to seed a revolving loan fund, to partially guarantee loans and to fund need-based grants will bring improvements within the reach of condominium associations. Participation of private banks provides the underwriting, lending and servicing experience and skills needed to make the program work. The resulting public-private partnership answers a social need while furthering market reform.