PUBLIC SECTOR HOUSING FINANCE POLICY STRATEGIES FOR POLAND

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ABSTRACT

A team of housing finance experts of the Urban Institute Consortium has reviewed the public sector housing finance policies proposed in the Housing and Urban Development Authority's (HUDA) Strategy Report, particularly those policies in which the central government has the predominant role or a strong supporting role with the gminas or other levels of government. This report looks at proposed housing finance policies and discusses options, goals, and strategies. It attempts to provide recommendations which the government of Poland might use in continuing to formulate and carry out its strategies based on a review of the HUDA Strategy Report and discussions with HUDA officials, other government institutions, and other housing experts in Poland during late June 1998. This paper is produced in conjunction with the United States Agency for International Development's Poland Housing Finance Program, directed by Michael Lee.

LIST OF ACRONYMS AND POLISH NAMES

BGK	Bank Gospodarstwa Krajowego
BISE	Bank Inicjatyw Społeczno-Ekonomicznych
BKHF	British Know-How Fund
CHF	Cooperative Housing Foundation
CRH	Caisse de Refinancement Hypothécaire (Bureau of Mortgage Refinance, France)
CEE	Central and Eastern Europe
CSH	Contract Savings for Housing
DIM	Dual Index Mortgage
EBRD	European Bank for Reconstruction and Development
GINB	Generalny Inspektorat Nadzoru Bankowego (General Inspectorate of Banking Supervision)
Gminas	Local authorities in Poland
GOP	Government of Poland
GUS	Central Office of Statistics
HRI	Housing Research Institute (Instytut Gospadarki Mieskaniowej)
HUDA	Housing and Urban Development Authority
IBRD	International Bank for Reconstruction and Development
IFC	International Finance Corporation
IREM	Institute for Real Estate Management
LGPP	Local Government Partnership Program of USAID
MOF	Ministry of Finance
NBP	National Bank of Poland
NHF	National Housing Fund
OECD	Organization for Economic Co-operation and Development
PBA	Polish Banks Association
PLN	New Polish Złotys
PKO-BP	Polska Kasa Opieki Bank PańÅ›twowy
Sejm	Parliament
TBS	Towarzystwo Budownictwa Społecznego (Public Housing Association)
TA	Technical Assistance
UIC	Urban Institute Consortium
USAID	United States Agency for International Development
VAT	Value-added tax
Voivodship	District (between the national and gmina levels)

PUBLIC SECTOR HOUSING FINANCE
POLICY STRATEGIES FOR POLAND

1.0 EXECUTIVE SUMMARY AND OVERVIEW

1.1 Introduction

The goal of this paper is to provide the United States Agency for International Development (USAID) with a review of current and proposed public sector housing finance policies in Poland so that they may be in a better position to assess the need for technical assistance and cooperation.

A major analysis of public sector housing finance policies was recently completed by the Housing and Urban Development Authority (HUDA), resulting in a comprehensive document entitled “Town and Country Planning, Real Estate, and Housing Construction: Medium-Term Strategy for the Industry,” Warsaw, April 1998 (hereafter referred to as the HUDA Strategy Report). This compendium reviews a wide variety of housing, infrastructure, and utility policies, including tax and legal issues, from the perspective of central government policy reform actions and support of gmina policies.

A housing finance team from the Urban Institute Consortium (UIC), which undertakes the Poland Housing Finance Project on behalf of USAID, has reviewed those portions of the HUDA Strategy Report that focus on public sector housing finance policies, especially where the central government has the predominant role or a strong supporting role with the gminas or other levels of government. This paper is based on our review of the HUDA Strategy Report and discussions with HUDA officials, other government institutions, and other housing experts in Poland during late June 1998. During these interviews the team sought to clarify its understanding of the proposed housing finance policies and to discuss options, goals, and strategies. We have attempted to provide recommendations which the government of Poland (GOP) might use in continuing to formulate and carry out its strategies.

USAID’s urban program in Poland currently involves multiple projects and contractors, including the Local Government Partnership Program (LGPP) and projects undertaken by the Cooperative Housing Foundation (CHF). The vast majority of these efforts are being carried out at the gmina level and involve gmina planning and financial strategies for housing, infrastructure, and broader economic development activities. In contrast, the UIC Housing Finance Project operates largely at the central level with counterparts including the Ministry of Finance (MOF), the Polish Banks Association (PBA), and the National Bank of Poland (NBP), in addition to HUDA.

The Housing Finance Project was initiated in November 1996 when USAID sponsored a broad-based review of housing finance activities in Poland. The resulting report—*Building on Progress: The Future of Housing Finance in Poland* (hereafter referred to as the Assessment Report)—has been widely distributed in Polish and English. In addition, the Assessment Report's topics, which include both private and public sector housing finance, were discussed at a conference in April 1997. Currently, the Housing Finance Project is working on, or has recently completed, a number of studies with a direct bearing on the topics to be addressed in this statement of work. These studies include analysis and training system development regarding Poland's proposed mortgage banking system, analyses of the *Bausparkassen* system, the problems posed by the statutory lien, and current status of rent reform policies and housing allowance participation.[1] Finally, the UIC team is familiar with efforts in housing finance undertaken by the British Know-How Fund (BKHF), the European Bank for Reconstruction and Development (EBRD), International Bank for Reconstruction and Development (IBRD), and the German Mortgage Banks Association. The recommendations presented in this report are designed to complement or supplement these multiple ongoing efforts.

1.2 The HUDA Strategy Report and Priorities for the Housing Sector

The HUDA Strategy Report is a major accomplishment: a comprehensive review of housing and urban problems and issues and a compendium of the institutional responsibilities and the proposed strategies and actions needed to address these concerns. Overall, the UIC team finds the HUDA Strategy Report, together with the additional information provided by our discussions with HUDA and other officials and the supplementary documents provided to us by HUDA (further detailing certain strategies), to be a thorough and valuable guide to the development of housing policies in Poland. HUDA has structured its approach in a manner consistent with the "enabling strategy approach" to the role of the central government that has formed the basis of USAID's approach to housing sector development. As stated in the introduction of the HUDA Strategy Report, "*[the] role of the State in economic processes with regard to real estate and housing should be restricted—the State should promote competitiveness and limit its interference to a minimum. The most fundamental task in this area should be providing a balance between the production sector and the consumers (landlords and tenants), especially in such cases where due to social or economic reasons free market mechanisms fail to operate*."

Thus, the recommendations and critiques that follow must be viewed in the context of our approval of the large majority of HUDA's policy suggestions; we have attempted to assist HUDA in making its strategies and recommendations more fully integrated, internally consistent, and more operational. Our suggestions have attempted to undertake the following:

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[1] Please refer to the bibliography for a selected listing of relevant UIC Housing Finance Project reports and other relevant reports.

- To recommend a framework for analysis of housing policies and help clarify these policies within the long-term goals for the housing sector.

- To distinguish the "need" for housing in Poland from "effective demand." Housing "need" is a subjective estimate of housing requirements based on a particular standard for adequacy. Effective demand, in contrast, indicates what is affordable to households based on their income. Housing subsidies improve both affordability and demand.

- To provide a clearer notion of the priorities for various subsidy policies, based on their analysis within the "analytical framework" and the feasible set of long-term goals noted above, so that limited government funds can be more effectively targeted.

- To develop internal consistency among important proposals, such as those for rent reform and housing allowances; among the roles of Bank Gospodarstwa Krajowego (BGK), the National Housing Fund (NHF), and the proposed Renovation Credit system; and between the two contract savings systems.

1.3 A Framework for Housing Sector Development and Principles of Subsidy Design

The HUDA Strategy Report details many housing issues and then suggests the expansion of existing programs or the creation of new programs, or both. However, although HUDA clearly expresses many ideas for policy reform and makes many suggestions to ameliorate constraints to both demand and supply in the housing market, HUDA suggests no mechanism for prioritizing the issues and programs. Furthermore, there is little analysis of the costs of many of the programs; given better cost estimates, which could then be compared with the likely level of state funds available, a clearer sense of priorities would have been established.

Underlying HUDA's proposals is an assumption that Poland suffers from an extremely large shortage of housing. Various estimates of the shortage have been made; they are generally based on an analytical methodology that compares the number of households and the number of existing housing units (now and a decade or more into the future). This approach to estimating housing needs—although it is certainly illustrative of Poland's housing problem—is not especially useful for designing a housing subsidy program. The real economic cost of housing is high, and nothing can change that fact no matter how the housing is paid for. Poland (and most other countries in the world) cannot "afford," in the near future, to build the number of housing units yielded by these various estimates of the excess of households (existing now or to be newly formed) over acceptable dwellings. Rather, for the purposes of program design, "need" must be defined in terms of effective demand—or affordability—and a realistic assessment of both private and state resources available in the short and medium term. In this manner, priorities can be better established (please refer to Box 1.1).

Box 1.1
Housing Need and Long-Term Housing Goals

Housing "need" is defined by many Polish analysts as the gap between the number of households (now or in the future) and the number of adequate housing units. While this is an "illustrative" definition, it is not a good program design definition.

For subsidy program design, policy makers should focus on "effective demand" and affordability -- that is, what is feasible given realistic assumptions about income, central government and gmina subsidies, other economic background factors, and legal and administrative constraints.

In this manner, long-term goals can be set which define the need "gap" for given household groups and the manner in which both households and the GOP can work to reduce the gap.

Given this context, Section 2.0 of this report proposes a general framework that is intended to help analyze and prioritize the programs and initiatives. In addition, Section 8.0 addresses the interface between current housing programs and the distribution of income in Poland. Although much more data and analyses would be needed to conduct a full simulation of program impacts by income groups, this analysis does attempt to identify gaps in coverage.

There is no single "model" through which a housing subsidy program can be designed or analyzed. Ultimately, decisions about the level of state subsidies and the manner in which they are directed at various income groups and housing types are a matter of societal preferences and national resources. There are, however, certain guiding principles for establishing goals and enabling the most efficient and effective use of public resources; these principles, which simply need to be more explicitly applied to HUDA's existing policy formulations, may help Poland quantify or refine its housing strategies (please refer to the summary in Box 1.2).

Box 1.2 **A Framework for Analysis of Housing Policies**
• An analytical approach to establishing long-term housing goals guided by effective demand and affordability. In this context, the gap between "housing need" and "housing availability" would be more directly linked to specific subsidy programs and economic assumptions over the long term. • A focus on policies that most strongly encourage the development of market-based rental and homeowner sectors, responsive to "market" signals for demand and supply for new construction, rehabilitation, and housing finance. • The design of subsidy policies that are as efficient and effective as possible in supporting the development of a private housing market: that is, which provide incentives for, and are complementary to (do not compete with), private sector investment. Subsidies should also redistribute income in the manner that Polish policymakers have chosen, and be well-targeted, transparent, and perceived to be fair.

The major elements of this framework include:

An analysis methodology in which "effective demand" and "affordability" guide development of housing subsidy policies over the long term. As discussed above, housing "need" in Poland has been defined in terms of the very large gap between the housing stock and the number of households. However, goals for the closing of this gap over the long term need to be addressed in terms of what is affordable and feasible in the context of concrete subsidy policies. To understand issues of affordability from a program design standpoint, the following questions should be addressed:

- How can estimates of long-term "housing need" be translated into specific and feasible long-term policy goals?

- What would be the extent of the affordability problem for households in Poland if there were no assistance from the state? This type of estimate serves as a "baseline" from which to quantify housing goals from an affordability perspective.

- Given the programs that Poland is developing to help solve the problems of affordability and supply (difficult problems in every country in the world), to what extent do different income groups, and correspondingly, different elements of the housing stock need to be assisted, consistent with some "reasonable" goal of funding from central and gmina budgets?

The development of market-based rental and homeowner sectors, responsive to "market" signals for demand and supply for new construction, rehabilitation, and housing finance. Major elements include:

- The pressing need for market rents, combined with a more supportive housing allowance program designed with the rent goals as an actual program parameter.

- An improved legal, administrative, and regulatory framework.

- The urgency of achieving macroeconomic stability and lower interest rates, not only because these have a dramatic impact on affordability but also because the risks associated with volatility can be reduced, thereby reducing risk premiums and allowing more conventional mortgage instruments to be used.

- Public initiatives to increase mobilization of private resources for housing and to increase the roles of the banking and investment sectors in housing provision.

Subsidy policies that are as efficient and effective as possible in supporting the development of a private market and redistributing income in the manner that Polish policymakers have chosen. General principles of subsidy policy include:

- **Targeting:** policies that implement the "redistribution" of income cost-effectively—that is, policies that are well targeted and do not subsidize those who can pay.

- **Transparency:** subsidy policies that are clearly understood and administered in a clear and equitable manner according to codified rules.

- **Fairness:** policies that are transparent and deemed fair by most stakeholders. Generally, if the subsidy policy is regressive rather than progressive, it should be justifiable on other grounds, that is, it should support an important and clear policy goal. An example of this is using regressive tax benefits in the interest of an efficient approach to stimulating supply. Alternatively, providing rent-controlled housing to higher-income households is both inefficient and discourages market development.

- **Maximum use of private sector resources:** policies that elicit the maximum contribution of resources from households and the private sector in general and that clearly place the role of capital allocation for housing primarily with the private sector.

- **Policies that encourage and maintain private market development:** policies that work best in conjunction with the private sector and do not “compete” with market mechanisms (such as market interest rates, market pricing of “risk,” and development of the mortgage bond and municipal bond markets) and thereby do not undermine the development of commercial finance for households, gminas, and developers.

- **Economic efficiency and minimization of redundancy:** policies that achieve the desired impact with as little public expenditure as possible and, most especially, policies that are not redundant, that is, *that do not undertake to do what the private sector will do on its own*.

- **Administrative efficiency:** policies designed to minimize administrative time and cost.

1.4 Overview of Recommendations

Our recommendations regarding public sector housing finance are summarized below. As noted above, the team generally agrees with most of the proposals put forth by HUDA. However, we have established certain priorities in the policies which imply a somewhat different emphasis or allocation of funds than HUDA might undertake.

Table 1.1 summarizes the key HUDA proposals we have reviewed, HUDA’s recommendations from the Strategy Report, and the team’s comments and recommendations. Again, Boxes 1.1 and 1.2 and also Box 1.3 below summarize our analytical framework and our suggestions for effective and efficient subsidy policies. In addition, the team has attempted to link the recommendations to subsidy and framework principles, as are discussed in Section 2.0.

Box 1.3 **Effective Subsidy Policies**
• Targeted at only those in need • Transparent (understandable, with clear rules) • Fair and equitable • Complementary with private sector activities • Encourage private sector investment • Economically efficient • Administratively efficient

Rent Reform. HUDA's Strategy Report clearly states that rent reform is important. The team believes that rent reform is absolutely crucial to the development of a market-based housing sector and should be the top priority. There are three important points regarding rent reform:

- Only concerted action in raising rents by all (or at least most large or growing) gminas will result in incentives leading to an infusion of private capital into housing and creation of a private rental market. In the long term, the "whole" of rent reform will be greater than the sum of its parts: again, only action by all gminas will lead to a robust private housing market.

- The vast majority of gminas, however, have not raised rents anywhere near "market" levels and they appear extremely reluctant to do so. It is probable, therefore, that the central government will have to develop a more effective approach to ensuring that rent reform actually takes place as soon as possible. Reform could be accomplished either through legislation concerning rents or by providing some carrot-and-stick incentive policies to ensure that reluctant gminas—which describes nearly all of them—actually undertake the necessary increases and restructuring.

Table 1.1 Overview of Major Recommendations

POLICY	*HUDA RECOMMENDATION*	*UIC TEAM COMMENTS*
NATIONAL HOUSING STRATEGIES AND SUPPORT SYSTEMS		
RENT REFORM	**INCREASE RENTS**	The UIC team suggests that rent reform is the most crucial policy change outstanding. Only concerted action by all gminas will result in a rental "market" supported by private resources. This may require incentives from HUDA and/or a "carrot-and-stick" approach to achieve adequate results; gmina education and "stakeholder" participation can assist.
HOUSING ALLOWANCE REFORM	**REFORMS IN ELIGIBILITY AND ASSOCIATED RULES**	Housing allowance reform is both crucial to supporting rent reform and should ultimately be the key subsidy policy. The housing allowance formula should be further revised as follows: (1) in the short-run, eligibility could be linked to 3 percent of replacement cost; (2) in the long-run, it would be linked to the "fair market cost" of adequate housing; (3) also in the long run, household contribution should be increased.
OVERALL HOUSING POLICY PILOT DEMONSTRATION	**(TO BE DISCUSSED WITH HUDA)**	The UIC team wishes to emphasize the important inter-relationships among policy elements and the need for consistency among them. A key example would be a demonstration project linking increased rents, housing allowance reform, and rehabilitation, thereby supplementing increased rent revenues with NHF credits.
BUDGETARY LEGACY OF PAST PROGRAMS	**(TO BE DISCUSSED WITH HUDA)**	Support investigating methods to change the time horizons of those obligations, such as zero-coupon bonds, in order to relieve pressure on the budget.
GROWTH OF THE HOUSING STOCK		
FISCAL INCENTIVES FOR NEW CONSTRUCTION	**RETURN TO 1996 APPROACH TO TAX BENEFITS (LARGER BENEFITS)**	Suggest that current 1997 tax incentive approach is adequate to increase supply. Preferably, better-targeted policies should be encouraged, such as first-time homeowner grants and mortgage default insurance. The 1996 policy is highly regressive, very costly in terms of taxes foregone, and will be difficult to eliminate at a later date.
NHF AND THE TBS SYSTEM OF NEW RENTAL CONSTRUCTION	**HUDA HAS PROPOSED NUMEROUS "MICRO" IMPROVEMENTS TO THE SYSTEM**	Support HUDA's "micro" suggestions and propose adding long-term "macro" strategy: lessons learned from low-cost rental housing in US & Europe. Key problems there have included poor management, lack of incentives for private participation, inadequate funds for capital repair, and lack of tenant default policies.
VAT TAX	**MAINTAIN OR DECREASE CURRENT VAT RATES**	Limit VAT housing exemption to a simple lump sum per dwelling. Funds could be better utilized elsewhere.

Table 1.1 Overview of Major Recommendations (Continued)

POLICY	***HUDA RECOMMENDATION***	***UIC TEAM COMMENTS***
MAXIMUM USE OF EXISTING STOCK		
REHABILITATION	**NUMEROUS HUDA PROPOSALS: RENOVATION CREDIT SYSTEM THE MOST IMPORTANT; TAX RELIEF; AND LEGAL AND ORGANIZATIONAL ISSUES**	Rehabilitation demands more immediate attention and increased funding. The backlog in capital repairs is a "national legacy" which deserves state assistance. Two-pronged approach includes: (1) gmina-based pilots stressing gmina "best practice" (2) finalization of national strategies and credit and funding systems
SOCIAL HOUSING	**NEW CONSTRUCTION AND BUILDING CODE CHANGES**	New construction not recommended. Make maximum use of existing stock and housing allowances. Understanding, measuring, and addressing homelessness have proved very difficult worldwide; "housing" and "social" policies should be integrated once causes are assessed.
INCREASING PRIVATE RESOURCES FOR HOUSING		
CONTRACT SAVINGS SYSTEMS	**IMPROVE AND MAKE COMPLEMENTARY**	It is suggested that HUDA support MOF's proposed amendments to Bausparkassen. Merger of the two systems should be considered. The Mortgage Bank Simulation Model (provided by USAID) can be used as an analysis tool.
MORTGAGE FUND	**CONTINUE TO DEVELOP CONCEPT OF MORTGAGE FUND; PRIVATIZE BUDBANK**	Privatize Budbank; maintain but transfer the Mortgage Fund. Consider sale and privatization. Universal banks may need liquidity in the future to support increased operations.
ENABLING STRATEGIES		
STATUTORY LIEN	**INVESTIGATE AND REDUCE DEGREE OF THE PROBLEM**	UIC has prepared a report addressing solutions to this problem in other CEE countries, the U.S. and Western Europe. It is proposed that mortgages be granted improved status and that a "level playing field" exist between universal and mortgage banks.
CONDOMINIUM MANAGEMENT STRATEGIES	**PROMOTE RATIONALIZED OWNERSHIP STRUCTURE**	UIC strongly agrees. Best practice/lessons learned from CEE and other countries should be analyzed.
TITLE REGISTRATION	**MAJOR IMPROVEMENTS REQUIRED**	UIC strongly supports. Integration of multiple ongoing efforts might be sought.

- In the long run, rents should be at market levels, rather than tied to any particular index. This is true even for housing still owned by the gminas, where rents should be set to mimic both market levels and variations according to quality and location. Thus, households who are able will bear the full cost of housing and those who are not should be supported via housing allowances or other programs.

Housing Allowance Reform. HUDA is also clear that reform of the housing allowance program is necessary to support rent reform. We concur; as discussed in Section 8.0, the newly-proposed eligibility rules would greatly assist affordability. We suggest, however, some alternative parameters for housing allowance reform. *First and foremost, the formula used to improve the allowance program should be tied to the rent policy reform goals, rather than to more arbitrary income ceilings that pertain to pension policy*. Affordability would thus be ensured as rents move toward their replacement cost target. In the long run, the formula should be linked to a rent parameter that estimates the cost of “modest, standard” housing in a given geographic area (rather than to actual rent). We also propose that households gradually begin to pay a higher share of the housing cost, more in line with payment burdens now in place in the United States, Western Europe, and elsewhere.

Fiscal Incentives for New Construction. HUDA has proposed returning to the 1996 approach to the tax incentives for new construction, which is far more generous that the current (1997) approach. *Although the team concurs that tax relief policies that affect the highest-income households may be an efficient method for increasing the housing supply, we believe that the current level of benefits is a sufficient incentive*. The previous tax relief program was very expensive and is, of course, a highly regressive policy. The funds saved (by forgoing tax revenue) could be more usefully spent on other housing policies, such as housing allowances and rehabilitation. In addition, we predict that, on the margin, there would be little difference between the two programs’ desired impact on new housing starts.[2] Finally, once such generous tax benefit systems have been put in place, it is generally difficult to alter or eliminate them, as is so well demonstrated by the generous but very regressive tax policy for housing in the United States.

Rehabilitation. In the team’s view, rehabilitation should receive far more attention than it has in the past, for at least two important reasons:

[2] It is not possible to prove this contention because long-term data on housing demand are not yet available in Poland. We suggest that some higher income households would build new housing in the absence of any incentives; many others would respond to the lesser incentive. Analysis of a limited number of year-to-year changes, especially without considering other variables in a demand model, cannot give a definitive answer. The more generous benefit, however, might simply result in larger houses rather than more units.

- The various estimates of rehabilitation, whatever their differences, all indicate that the problem is immense.
- The backlog in major capital repair should be viewed as a "national legacy." It is the result of many decades of previous housing policies that did not provide either adequate funds to undertake major repairs or incentives to have others (tenants, gminas) undertake steps necessary to forestall deterioration (apparently severe in many cases). As a result, the problem transcends what most households could (or should) be expected to pay for its resolution.

Despite the magnitude of the problem, almost no major funding or policies are in place to deal with the important (and relatively straightforward as compared with urban renewal) rehabilitation problem: the capital backlog needs of major building systems. Nor are policies in place to address so-called complex revitalization, although Polish experts and legislators have discussed it at length; see Section 5.0. As noted above, the team suggests that the capital repairs backlog in communal and newly privatized housing is a national legacy that the central government must share in redressing; the backlog is beyond the reach of almost all households, but must be addressed quickly as a vital part of maintaining Poland's housing supply. HUDA has proposed a Renovation Credit System, but many officials noted that it was "just a concept" at this stage. It would be advisable to operationalize this concept, or alternatives, and to seek funding as soon as possible.

Social Housing and Homelessness. The HUDA Report also addresses the increasing problem of homelessness and special needs, and has suggested that state funds be allocated (and that the building code be relaxed) for building "social" housing. In general, the team does not recommend the use of scarce state resources in this manner; building new "substandard" or special housing is not an efficient use of GOP resources. It is preferable to use existing housing, modifying it as required, rather than increasing supply for a segment of the market that has few funds and should be supported through housing allowances. These households should use housing allowances in conjunction with whatever other social safety net funds they are eligible to receive.

Strengthening Private Sector Finance and Public Access to Private Capital and the Banking Sector. As noted above, the UIC team has been undertaking a variety of training and technical assistance activities designed to strengthen private sector finance. Section 7.0 of this report makes additional recommendations about the contract savings system and the *Bausparkassen*, the Act on Mortgage Banking, and the mortgage fund. In addition, we have made a proposal to help the government adjust the payment structure for the debts from the old policies. We also support increased efforts to enable the public sector to access private funds from the capital market, such as the issuance of bonds by BGK to fund NHF activities and the strengthening of Towarzystwo Budownictwa Społecznego (Public Housing Association) (TBS) to attract private capital.

Enabling Strategy Issues. The HUDA report provides recommendations regarding a wide variety of legal and administrative "enabling" strategies, including the statutory lien, condominium and housing association issues, mobility within the housing stock, eviction, title registry, and privatization policies. USAID and other donors are assisting with a number of these important issues and we encourage HUDA to continue its emphasis on these important enabling issues. The UIC team has recently completed a study of the statutory lien, which draws on experience in the United States and Europe as well as progress made in other Central European countries.[3] In addition, because of our emphasis, as noted above, on the importance of rehabilitation, and the constraints to rehabilitation caused by mixed ownership patterns and weaknesses in homeowners' associations (*wspolnota*), we place particular priority on improved privatization strategies, development of condominium associations, and strengthening of homeowners' association management. These issues can also benefit from a cross-regional assessment of best practices.

Housing Subsidy Policies, Target Income Groups, and Home Purchase. Section 8.0 presents the results of a "simulation analysis" that looks at the affordability of housing for different income groups and how Poland's subsidy policies impact affordability. We looked in particular for "gaps" in assistance: groups needing assistance but not covered by any major program. The results are extremely revealing. *Depending on the circumstances of the key variables in the simulation—household income, program eligibility limits, level of rent, and level of utility payments—the simulation clearly shows that rent burdens for some households caught in the "program gap" between the housing allowance and the TBS programs can range from merely difficult to clearly infeasible as an element of a household's budget. In addition, there can be no rent reform unless the housing allowance program is greatly improved—many households simply cannot afford higher rents. Finally, depending on income, the cost of new construction, prices of existing homes, and the geographic location, even moderate-income households may be able to purchase a new or existing home if they obtain a sufficient down payment and a mortgage loan.*

1.5 A Three-Tier Approach to Program Development

As noted above, both USAID and other donors are actively engaged in supporting local government and assistance to the housing sector in Poland. Our recommendations are designed to be integrated with and supplement these efforts. Much of the technical assistance is being delivered at the gmina level; our proposals also suggest additional efforts by HUDA, other central government institutions, and banking sector institutions to (1) provide needed policy incentives and regulation at the central level, including policies

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[3] See Carol Rabenhorst, Peter Follack, Jacek Łaszek, and Tomasz Stawecki. "Analysis and Recommendations for Revision of Statutory Lien Policy in Poland," prepared by the Urban Institute Consortium for USAID/Warsaw, August 1998.

to further engage private funds in housing (and infrastructure) development; (2) more fully develop and operationalize the high-priority programs; and (3) establish within HUDA a Research and Policy Analysis Division, devoted to providing program development, quantitative assessments of long-term need, and statistical analysis of program impacts. Thus, we recommend a three-tier approach to program and policy development—further central government policy design, gmina pilots and demonstrations, and central government encouragement of, and regulation of, financial institutions and participation by private capital. Recommendations include:

- More development of long-term quantitative goals and refinement of key strategies at the central level, including establishment of a research facility as noted above.

- Implementation of a variety of gmina-based programs, such as pilot projects and dissemination of best-practice case studies.

- A gmina demonstration pilot to test a combination of *integrated strategies:* rent reform, housing allowance reform, and rehabilitation, for example.

- Assistance to the private sector housing finance institutions, the banking sector, BGK, and other financial sector institutions to enhance the participation of private capital in housing development and housing finance**.**

1.5.1 Central Government Policy Formulation

Although the main responsibility for housing rests with gminas, without central government leadership in key areas, certain gmina policies cannot be as effective as they should (or could) be. *Recent rethinking of the role of liberalized government in transition countries remains in accord with reducing the size of central government and eliminating its direct provision of services; however, the mandate for central regulation, policy guidance, and support of private sector financing is viewed as increasingly crucial*. At a minimum, central government must address rent and housing allowance policies, rehabilitation strategies, and enabling framework strategies. In addition, effective regulation of private and public/private financial sector activities in housing development is critical.

Rent Reform. In Poland's case, rent reform is a gmina-based program. It continues to be difficult for individual gminas to overcome political opposition to increasing rents; from a national perspective, however, such an action by all gminas would ultimately produce a very large economic benefit. As we stress elsewhere in this report, concerted action on rents is crucial to stimulating greater private involvement in housing development. Central government should seriously consider introducing both incentives and “punishments” to help gminas overcome resistance in the interest of producing a nationwide benefit.

Enabling Capital Market Access. As another example, the history of subsidized rental housing programs in the United States and Europe provides many (often painful and costly) lessons learned; if enthusiasm for TBS-type projects overtakes the organizational, monitoring, and long-term planning functions that must support them, failed projects, or those deemed uneconomic, could doom efforts to attract private capital for financing various BGK programs.

Private Sector Complementarity: **Government and Private Funds for Housing, Rehabilitation, and Infrastructure.** The team recommends that the government, HUDA, and BGK, for example, should rationalize the roles for BGK and develop a consistent set of goals and funding strategies, including access to private capital, for the NHF, the Renovation Credit System, and other proposals now being developed for infrastructure finance, loan guarantees, and so forth. Will the NHF, for example, finance rehabilitation? If so, on what terms? Are these terms consistent with proposals regarding the Renovation Fund? How many housing and infrastructure funds will actually be (should be?) established within BGK?

To maximize complementarity with the private sector, it is recommended that central government focus its spending on activities that the private sector is unlikely (or less likely) to undertake. A central focus on rehabilitation with a gmina/private sector focus on infrastructure is discussed below and also in Section 2.0.

An important topic within this context is the strategy of providing subsidies for rehabilitation and infrastructure and the potential trade-offs between the two. It is possible, for example, that infrastructure can be largely financed with gmina and private resources—commercial borrowing and municipal bonds—because utility prices have been greatly liberalized and the revenue flows can be collateralized.

In contrast, rehabilitation is less likely to be funded by the private sector; rather, the case has been made by the team that the problem is, in part, a national legacy and should receive preferential funding from the state. Even with rent reform, rents could be expected to cover only current operating and capital costs, not the huge backlog of capital repair requirements. On the premise that the state should intervene only where the market will not, it is tentatively suggested that scarce state funds be devoted to rehabilitation, and that much of the funding for infrastructure be conducted at market rates. For gminas too small (or inexperienced) to fund their infrastructure through the market, BGK could raise market-rate funds through bond issuance and on-lend to these gminas.

1.5.2 Gmina Best-Practice Dissemination and Pilot Projects: A "Mega Demonstration Project"

Innovative and successful approaches to many of the important housing issues addressed by HUDA—TBS housing development, rehabilitation strategies, privatization strategies, housing association improvements, and so forth—have been initiated by gminas. USAID continues to be active in these types of projects and we recommend further dissemination of gmina best-practice and additional pilot projects. The team also wishes to stress integration of a consistent set of housing policies. We therefore recommend a "mega pilot project" that combines a number of housing policy reforms. Two recommendations are noted below:

- **Rent and Housing Allowance Demonstration Project.** A pilot project could be undertaken to combine rent reform with a restructured housing allowance program. As discussed in Section 4.0, it would be useful to test a modified housing allowance, linking the allowance payment to selected rent parameters.

- **Gmina Rehabilitation Pilot Within the Rent Demonstration Project.** The housing allowance demonstration could then be combined with other gmina-based projects. For example, in the team's view, rehabilitation is associated with, or driven by, nearly all the elements of the policy framework: increased rents; the likelihood of increased privatization as a result of increased rents; the depth of the privatization discount in rehabilitated and nonrehabilitated buildings; the rationalization of the ownership structure in privatized buildings to better garner private resources to share in rehabilitation costs; and so forth. *This recommendation for technical assistance could be viewed as a "mega pilot" which would test the consistency of an integrated policy set: rent, housing allowances, funding strategies for rehabilitation, and, as another element, the management skills of best-practice TBS or building associations or both*.

1.5.3 A HUDA Research and Policy Analysis Division

HUDA could greatly benefit in its policy analysis efforts if its technical staff had more access to data to support their analyses. Development of the appropriate information systems and databases is a long-term effort, but well worth it. Emerging from a system in which market data did not exist, transition countries have never developed the type of long-term databases necessary for some of the fundamental analyses and estimations that should be undertaken. Ideas that deserve more research are mentioned throughout this report: for example, estimation of the demand for housing and the long-term price and income elasticities; estimation of the long-term cost of capital; and simulation analysis of alternative subsidy policies. Subsidy policy development, which depends on the demand function parameters, is especially important. For example, the team recommends further work on demand-side subsidies that reduce cost of housing to targeted households and maximize the mortgage financing undertaken by the private sector (such as grants to homebuyers or government mortgage insurance). Other things being equal, it is preferable to deliver the subsidy not through credit policies, but rather through demand-side subsidies; because this approach requires up-front cash; however, it is a medium- or long-term consideration for Poland, consistent with the time needed to build up the analysis databases.

1.6 Organization of the Report

Once again, please note that this report addresses only housing-related policies from among the very much broader set of urban policies set forth in HUDA's Strategy Report.

The report is organized as follows:

Section 2.0 provides a further discussion of the analytical framework. These principles for promoting private sector development and utilizing effective subsidy policies are then applied to the discussions of specific policies in Sections 4.0 through 7.0. In many instances, HUDA's strategies are based on, or have already incorporated, the framework and subsidy principles; in some cases, however, the framework leads the team to suggest modifications or additions to HUDA's suggested policies.

Section 3.0 briefly assesses central budget expenditures on housing. It is important to note that resources for housing should also include tax benefits and gmina spending. Thus, the MOF's estimate of the tax revenues forgone from the 1996 housing tax benefits are presented; however, no figures are available for gmina expenditures on housing. Finally, the substantial impact of past housing policies on current resources is noted, and suggestions are made for partial solutions to this problem.

Sections 4.0 through 7.0 look at housing policies for rationalizing rent reform, increasing the supply of new units, making maximum use of the existing housing stock, and developing public/private programs to help channel private resources into housing. Thus, Section 4.0 presents the team's recommendations for both central government and gmina policies on rent and housing allowances, emphasizing that because of the need for nationwide rent reform, central policymakers should take a very proactive stance in this area. Section 5.0 looks at policies to increase new construction, and Section 6.0 discusses policies to maximize utilization of the existing stock. Public/private initiatives, such as contract savings, are discussed in Section 7.0.

Finally, Section 8.0, the simulation analysis, addresses the issue of who is being served by current and proposed policies: what policies impact which income groups? Are there gaps in assistance to very needy, or somewhat needy, households?

2.0 A FRAMEWORK FOR HOUSING SECTOR DEVELOPMENT

The three main elements of the analytical framework developed by the team were introduced in Section 1.0 (and summarized in Box 1.2). The main elements include:

- **Estimation of Feasible Housing Goals**. An analytical approach to establishing long-term housing goals guided by effective demand and affordability. In this context, the gap between housing need and housing availability would be more directly linked to specific subsidy programs (and economic assumptions) over the long term.

- **Market Allocation of Resources.** A focus on policies that encourage the development of market-based rental and homeowner sectors and that are responsive to "market" signals for demand and supply for new construction, rehabilitation, and housing finance.

- **Efficient Subsidy Policies**. The design of subsidy policies that are as efficient and effective as possible in supporting the development of a private housing market; that redistribute income in the manner that Polish policymakers have chosen; that are well targeted, transparent, and perceived to be fair; and that are complementary to (and not redundant with) private-sector investment.

Each of these is discussed in turn below.

2.1 Establishing Long-Term Housing Goals: Housing Need Versus Effective Demand

Polish experts estimate the current housing shortage in Poland to be as large as 1.5 to 2.0 million units.[4] For further evidence of the severity of Poland's shortfall, comparisons are also made with other European countries: whereas Poland has 303 units for every 1000 persons, Germany has 427, Finland 459, France 471, Hungary 379, and the Czech Republic 360.[5]

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[4] In addition to the HUDA Strategy Report, see Hanna Kulesza, "The Housing Crisis in Poland and the Remedy Options," developed for the Social and Economic Strategy Council of the Council of Ministers, March 1998. See also Irena Herbst, "Directions and Policy Employed in Overcoming the Housing Crisis in Poland," developed for the Social and Economic Strategy Council of the Council of Ministers, June 1998. An earlier estimate developed by the Central Office of Statistics (GUS) in 1994 placed the 1995 shortage at 780,000 units ("Economic Activity of the Polish Population," GUS, Warsaw, 1994).

[5] See Hanna Kulesza and Irena Herbst, op. cit. Also see the regional comparisons in "Building on Progress: The Future of Housing Finance in Poland," Annex B.

A number of estimates of housing need in Poland have also been established for the period 1995 to 2010. Assuming that "each household should have an (adequate) separate apartment," a Housing Research Institute (HRI) study takes into account the stock lost to deterioration and then makes a variety of assumptions about the growth of households and the rate of housing construction.[6] It is assumed that by 2010, fully 10 percent of the stock, or about 1.0 million units, should be decommissioned because of deterioration.[7] The estimates of total construction activity during the period 1995 to 2010 range from 2.6 million to 3.8 million. Depending on assumptions about the growth of households during the period, the housing shortfall in 2010 is expected to range from 839,000 to 1.16 million units.

Although these estimates of need are certainly illustrative of the overcrowding and "doubling up" that many Polish households face, of the plight of new households as they search for affordable units, and of the severe backlog in repairs that must be addressed, it is ultimately not useful to rely solely on this "needs" approach in developing either the structure of subsidy programs or the desired budgetary outlays. In the context of program design and submission of budget requests, the problems with the needs/gap type of approach include the following:

- Most important, the needs approach is a statistical measure of shortage—the gap between households and housing units—and does not consider the constraints imposed by either shortfalls in demand or barriers to supply. Thus, the gap is not tied to effective demand, that is, what households can afford. The goal, rather, should be to estimate policy-relevant measures of shortfall—to assess demand, supply, and affordability with a variety of assumptions about the macroeconomic scenario, the possible supply constraints, and alternative government support policies and subsidies.

- Even as a statistical measure, the estimates of the gap cited in the HRI study noted above may be too low. The annual production assumptions for all three five-year segments for the 1995 to 2010 period greatly exceed what now appears to be feasible. The assumed rates of new construction—from about 150,000 units per year to 200,000 per year from 2001 to 2005, for example (the rates increase after that)—are far higher than current production. [New construction in 1997 was 73,706 as estimated by the Central Office of Statistics

[6] See J. Adamski, "Estimation of Scope and Structure of Housing Needs of the Polish Population up to 2010," Housing Research Institute Manuscript, 1995.

[7] Housing Research Institute, "The Housing Issues," Vol. 2, 1995.

(GUS).][8] Even though the 1997 results exceeded initial estimates for the year and represent an improvement over 1996, it is not clear who is going to produce this number of units. Improved estimates of both demand and supply should be developed (possibly by a research department within HUDA, as we recommended in Section 1.0).

- It is not useful from a programmatic perspective to compare Poland with Western Europe, because, at a minimum, both income and production capacity differ markedly. Many other factors also influence demand and supply and should be taken into consideration. Comparisons within the region are much more relevant. Poland's relative position among Central European countries with regard to housing quantity and quality has been poor.[9]

In short, at this time, Poland cannot afford to fill a housing gap of this magnitude, nor is the "statistical gap" itself, whatever its true magnitude, the relevant measure for program design. Thus, development of more realistic assumptions about both effective demand (affordability) and supply, in the short-and medium-term, would assist HUDA in establishing priorities among its programs and estimating annual budget requests over a five- to ten-year period.

As discussed in Section 3.0, HUDA has expressed dissatisfaction with the low level of expenditures on housing in the central budget. What would be a "correct" level of subsidy? There is, of course, no simple answer to this question; ultimately, it is a result of society's expressed preferences for housing relative to other goods and services in conjunction with some agreement on the redistribution of income necessary to accomplish these preferences. We recommend that HUDA provide to other policymakers, and especially those setting budget figures, a set of more realistic and feasible assumptions about demand and supply; about which income groups should be assisted; and with estimates of the subsidy requirements over the longer term that are necessary to accomplish the specified outcomes.

The 1995 HRI study may have based its construction estimates on the higher levels achieved prior to transition: for example, 150,000 units per annum in 1989. See "Building on Progress," Section 2.0. It might be noted, however, that some experts believe the actual ratio of new construction to be higher than that implied by official completion rates.

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[8] See *Gazeta Wyborcża,* No. 196, p. 26, August 1998. It might be noted, however, that some experts believe the actual rate of new construction to be higher than that implied by official completion rates. The 1995 HRI study may have based its construction estimates on the higher levels achieved prior to the transition; for example, 150,000 units constructed per annum in 1989.

[9] See "Building on Progress," Section 2.0 and Table 3.8 in Annex B.

2.2 Market Allocation of Resources

Assumptions about housing market reform policies—for example, about rent reform, privatization, and enabling legal and administrative policies—will themselves be important in estimating future demand and supply, particularly regarding the extent to which private resources will be devoted to housing. In the team's view, any attempt to prioritize the elements of the HUDA Strategy should flow from the principle that private (nongovernment) resources must account for the vast majority of spending on housing. In all market economies, most of the resources for housing come from mobilization of private resources, particularly the savings of households and firms.

The HUDA Strategy Report correctly suggests that the state should focus on those areas where free-market mechanisms fail to operate. It must be emphasized, however, that in Poland, as in other transition and many other countries, "old" state policies contribute to market failure. To develop a market-based housing and housing finance system, Poland must first address those aspects of the market that it has under its control—namely rents and the legal/regulatory framework.

2.2.1 The Need for Market Rents

A fundamental aspect of the free market is the role of prices as a signal to consumers and producers. Market-determined prices are essential in the mobilization and effective allocation of resources. Without market-determined prices, the following problems will continue to constrain development of a market-based housing sector:

- Market-determined rents are crucial to the development of a private rental housing market. More broadly, market rents provide incentives for the private sector to invest in new, privately-owned housing. Housing prices (rents) for communal and other housing are controlled by the gminas, and somewhat contrary to expectations, the vast majority of gminas have not increased rents anywhere near the ceiling of 3 percent of replacement cost (which itself is probably not near "market" in most gminas). As noted in Section 1.0, without concerted action by at least all major gminas, the move to an effective private market will continue to be stalled.

- The deterioration of the quality of the existing stock continues and accelerates because the resources available for maintenance and improvement are insufficient. As discussed below, there is demonstrable evidence of significant quality problems in the existing housing stock. Gminas do not have sufficient funds for major rehabilitation and thermal upgrading and look to the central budget for resources. Private owners do not have an incentive to even maintain, much less upgrade their units, unless they can be converted to commercial use.

With higher rents, gminas and other owners will have more revenues available to invest in maintenance.

- Household and labor mobility is reduced. Households are reluctant to move and give up their below-market-rent apartments. This reduces labor mobility at a critical time in the economic transformation of Poland. It also leads to misallocation of space, as small families inhabit large apartments and large families inhabit small apartments. It also contributes to a black market in rentals where higher-income households construct owner-occupied dwellings and sublease (at market rates) rent-controlled apartments (at the expense of owners, whether private or gmina).

- Construction is not viewed as a profitable investment, because controlled rents are well below market clearing levels. Three percent of replacement cost is probably also well below a market level: at best, it may cover operating and maintenance expenses, but it will not provide an adequate rate of return to investors nor full recovery of the cost of the investment in new rental housing.

- It is impossible to determine the extent, if any, of a “real” housing shortage in Poland. Without market-determined rents, there is no signal of excess demand or supply. If a shortage exists, the private sector should produce new units as long as the returns on such investment equaled or exceeded the risk-adjusted returns on alternative investments.

We applaud HUDA’s recognition of the importance of rent reform and their focus on increasing the use of housing allowances and facilitating long-term budget planning by gminas to help bolster rent reform. However, because gminas are not now acting with regard to rents, we believe that it is essential that rent reform be made the top priority of HUDA and that HUDA press for stronger rent reforms (with incentives and even possibly with penalties for failure to act). At this time, rent reform is more crucial than various new construction programs. In addition, as discussed in Section 4.0, we believe that HUDA must take a more decisive stance, either through education or more likely through a carrot-and-stick approach combining mandatory nationwide increases in minimum rents with, for example, increased funding for housing allowances and various rehabilitation and upgrading programs.

2.2.2 Improving the Legal and Regulatory Framework

A market-based system relies on the private ownership of property. This means that owners of property have the right to rent, own, transfer, lien, or assign beneficial interest in property. Property ownership has both a legal and economic definition. If legal owners (landlords) do not have the right to set rents or evict tenants for nonpayment of rents, they do not have economic ownership, at least while the tenant enjoys such privileges.

An important component of a private market for housing is an effective title registry system wherein property ownership is clearly identified and can be transferred and liens can be registered and enforced. The HUDA strategy clearly identifies the inefficiencies and weaknesses of the current registration and lien system, noting that only 30 percent of all land is titled. They recommend full computerization of their system, increased efficiency in the title registration process, and removal of the statutory lien that reduces the attractiveness of housing as collateral for lending. However, as HUDA notes, the Ministries of Finance and Justice are primarily responsible for these areas. HUDA might take a more active role in coordinating the government's policies regarding title registration and lien enforcement.

2.2.3 Macroeconomic Stability and Public Expenditures

High interest rates are an extremely significant barrier to the housing sector. A reduction in interest rates, through its impact on reducing the cost of long-term credit, will have a far greater impact on housing affordability than any state program. Significant progress has been made in controlling inflation. However, real interest rates are very high owing to a number of factors (continued inflation and fears of volatility, legal and administrative constraints, regulatory uncertainties, inefficiencies in loan production, and so forth). High real interest rates may very well be temporary, however, and new programs aimed at improving affordability should not be predicated on their continuation.

Budgetary discipline is a key component to controlling interest rates. We believe that focusing on a large increase in the percentage of the budget (and gross domestic product) spent on housing is not appropriate in the current macroeconomic environment. We recognize that a major portion of budgetary expenditure must be devoted to paying off the legacy of old policies; a proposal to ameliorate this situation is presented in Section 3.0. Currently, the state budget is under pressure to fund reforms in education, health care, and social security as well as nationalize the mining and heavy industry sectors, but the deficit must be kept under control if Poland hopes to join the European Union between 2002 and 2004. Large increases in the state budget can be inflationary and can undermine investor confidence in the economic policies of the government.

The level of support the state provides for housing has, in fact, been significantly higher than the 0.6 percent quoted in the strategy because of generous tax incentive policies. If HUDA reinstates, as it proposes, the version of the tax benefit in effect in 1996, significant revenues will be forgone in the future. It should be recognized that all such incentives are counter to the avowed policy of the government to seek to reduce the drag on economic growth caused by the deficit and the current tax system, because these incentives increase the deficit and feed the public's desire to reduce their tax burden by offering greater deductions and credits rather than instituting lower tax rates.

2.2.4 Mobilizing Private Resources for Housing

Facilitating the expansion of private resources for housing investment is an important priority for the state. In market economies this is accomplished through the development of an effective housing finance system and savings targeted toward housing.

Although more universal banks have been entering the mortgage market over the past few years, for the most part their lending has been conservative, small scale, and targeted toward higher-income customers. A major reason for this cautious approach is the high perceived risk of mortgage lending. Removal of the statutory lien and improvement in the title registration system will significantly reduce the risk of housing lending for banks and lead to greater involvement. Development of a mortgage bond system will increase the supply of funds from institutional investors (in particular the newly created private pension system) and reduce the liquidity risks of housing lending.

Until the economy stabilizes and interest rates fall, affordability of mortgage lending will be an issue in Poland. The dual index mortgage (DIM) and other deferred payment mortgages are methods of improving affordability without subsidy that have enjoyed some success in Poland. There continues to be a need for this instrument in Poland and HUDA should support its continued use (for example, through continuation of the Mortgage Fund as discussed below).

Contract savings for housing programs may lead to an expansion of funds available for housing. However, they will not lead to meaningful investment in the housing sector for another 3 to 4 years. Furthermore, experience has shown in other countries that these schemes are at best a supplementary form of finance for housing. As discussed below, they may be well suited to mobilize resources for rehabilitation and improvement.

We recognize, however, that it will take time for the private sector to significantly increase the volume of mortgage lending. Until rents can produce sufficient cash flow to support mortgage loans and until interest rates fall to a level at which they are affordable to the average household, the sector will not receive sufficient funds to support needed rehabilitation and improvement. Subsidy programs can only very partially compensate: capital is expensive, and improving the housing stock will be a long-term process. Thus, obviously, subsidy policies should be as efficient as possible; however, they must also reflect Poland’s goals for income redistribution and assistance to the housing needs of different household groups, that is, be “fair” and properly targeted. These issues in subsidy policy are discussed below.

2.3 Principles of Subsidy Design

The team recognizes the serious need for government budgetary support for the housing sector. Assuming a role for government subsidy programs, what are some of the principles in subsidy design that can serve as “lessons learned” from subsidy policies in the United States, Europe, or elsewhere? Section 1.0 introduced a number of subsidy design principles, which the team has used to assess the various programs in Poland. Each of these is further defined below; please refer to Table 2.1 for a summary.

Ultimately, as noted above, subsidy policies are based on political decisions about social and economic goals: the need for housing relative to other goods and services, the types of households who should receive subsidies, the importance of encouraging new production, and so forth. There is no model that can dictate society’s decisions. There are, however, various relative criteria such as efficiency and fairness. Our comments must be interpreted in this light.

Table 2.1
Poland’s Housing Strategies: A Framework for Analysis

Housing Program	Advantages	Disadvantages	Comment
Rent Reform	• vital to promote market allocation of resources • economically efficient • no targeting efficiency without it	• requires action by all gminas in concert • benefits not immediately “transparent”	• rent reform is the single most important housing policy reform in Poland today
Housing Allowance Program	• fair (progressive) transparent (if rules are simplified) • economically efficient	• must be administered well to be fair and effective	• major modifications necessary to support rent reform
Tax Incentives for New Construction	• generally efficient as a means to increase supply	• regressive 1996 version may be “inefficient” and redundant (overly expensive) • could be targeted at selected metro areas	• difficult to eliminate • 1997 policy adequate to achieve supply increase • introduce homeowner grants
VAT Tax on Building Supplies	• somewhat efficient	• regressive may be “inefficient” (overly expensive) as proposed could be targeted at selected metro areas	• reduce to lump sum per dwelling
TBS Housing	• appears to target an appropriate group • reasonably efficient	• administratively challenging	• long-term monitoring is vital

Housing Program	Advantages	Disadvantages	Comment
Rehabilitation (Renovation Credit System)	• needed for efficiency, to slow further depreciation of the stock	• not yet fully defined (regarding transparency, fairness, efficiency, etc.)	• should be defined in detail as soon as possible • a national legacy which deserves GOP support
Rehabilitation (current tax benefits for interior rehabilitation)		• regressive • may be redundant (households would do on their own)	• does not address major rehab problems; should be a means-tested supplement at most
Infrastructure Finance proposals	• some action may be necessary to reduce housing supply constraint	• may be redundant with private sector financing • state guarantees may be redundant (not complementary) with development of municipal bonds	• incentives for private sector finance must remain strong • subsidies, guarantees could be limited only to eligible gminas
Funding for New Social Housing		• not efficient use of GOP funds • often not solely a “housing” problem	• should rely on modification of existing stock, social programs, and housing allowance
“Enabling” Administrative Strategies	• vital to development of private housing finance and reduction of real interest rates		• HUDA should continue strong support of reforms
Contract Savings Systems	• may assist in pooling private resources	• need (and risk profiles) for two systems not transparent • two systems may not be administratively efficient	• only a supplementary source of funds • consideration of merger of the two systems should be made

Targeting. Policies that implement the “redistribution” of income cost-effectively, that is, policies that do not subsidize those who can pay. Currently, the most important aspect of targeting (not subsidizing those who can afford to pay) would be greatly helped by raising rents. Rent control in Poland is probably the major example of a poorly targeted subsidy. Without data on the income distribution of households in rent-controlled housing, there are no estimates of the “unnecessary” subsidies accruing to higher-income households. However, there may be a considerable number of households receiving housing at much less than full cost, but who would actually be able to bear that cost (and, as we have stressed, rent reform would not only improve targeting, but it would assist in the development of a private sector housing market).

In one way or another, the issue of targeting impacts nearly all subsidy policies, demand and supply-side alike, and also becomes linked with fairness, efficiency, and redundancy with private sector funding. For example, a reformulated housing allowance program in conjunction with rent reform would provide Poland with a well-targeted subsidy program that would also be fair and efficient. Also, HUDA should assess whether the TBS program is actually targeting the income groups it seeks to assist (BGK has been developing a monitoring system for the TBS program and will shortly be able to address this question). The question of long-term eligibility in TBS units, as the income of some tenants goes over eligibility limits, will again raise targeting issues. Finally, as discussed below, if infrastructure subsidies or guarantees, for example, were provided by the state to all gminas, regardless of their resources, the program would likely be poorly targeted and redundant with what the gmina and the private sector would do.

Fairness. Policies that are transparent (see below) and deemed fair by most stakeholders. There are several aspects to fairness, including (1) the degree of progressivity (as opposed to regressivity) and (2) the share of housing costs that should or could be borne by low-income households receiving subsidies. In the United States, progressive subsidy policies are referred to as “means-tested”: that is, benefits decrease as income increases.

HUDA addresses the importance of fairness by recognizing that households with different income levels have different housing needs. However, no clear prioritization is given to these needs. How should regressivity and progressivity be viewed in assessing HUDA policies? Also, what is a fair share of the burden that should be borne by households in different circumstances? For example, what proportion of housing costs should be borne by housing allowance recipients? At present, the “share of income” parameter in the housing allowance formula in Poland (12 percent of income) is much lower than is now the case in U.S. subsidy programs, where payment burdens have increased to at least 30 percent in most programs. Western Europe has also raised payment burdens over the past decades. The team has thus recommended that Poland gradually increase this parameter, especially for those with relatively higher income.

Policies now being developed to finance rehabilitation will also no doubt face tests for both fairness and targeting. For example, what share of major rehabilitaion costs should be borne by owners versus tenants, by owners in newly privatized but badly deteriorated housing, and so forth? As discussed elsewhere, the team suggests that the major backlog of capital repairs is a national legacy and it is therefore fair that the state assume some portion of the cost of rehabilitation. Should the policy also be progressive—that is, should there be an income (means) test that determines what proportion of costs the household might assume—or should all households be treated equally in this respect? Should the means test include a measure of assets—that is, should a person with relatively low income but a high level of wealth be eligible for certain subsidy programs?

With regard to one of the current rehabilitation policies—the tax benefit for rehabilitation of the interior of units—lack of any means test is also a fairness issue. This program may, in fact, fail two tests: (1) it should be made progressive via a means test and (2) it should not be applicable to those with higher incomes because these households will, ultimately, rehabilitate (or not) the interior of their units according to their own preferences. (See the principle of redundancy below, of not pursuing a policy the private sector will do on its own.) The current program thus results unnecessarily in tax revenue forgone.

Finally, some subsidy policies may not be deemed fair, that is, progressive, but are still desirable because they are designed to achieve another purpose. In Poland, the tax subsidies for new construction are regressive, but it must be assumed that the benefits to be gained from increasing the housing supply more than compensate. Similarly, although subsidies for contract savings programs are also regressive, they are assumed to increase savings for housing (although it is, in fact, open to dispute as to whether net savings increase). Generally, if the given subsidy policy is regressive rather than progressive, to be justifiable it must support some other important and clear goal; in the case of tax benefits for new construction, for example, the goal is an efficient approach to new construction.

Transparency. Policies able to be understood and administered in a clear and equitable manner according to codified rules. Many of Poland's subsidy policies, such as the housing allowance, appear to be quite transparent. On the basis of our work with rent policy, the UIC team feels that many gminas have, for the most part, done well in advertising and explaining the housing allowance program. Whatever the reasons for the less-than-expected participation rate, lack of transparency is probably not the major cause.[10] However, HUDA is correct in desiring to simplify the rules regarding space, and thus both transparency and administrative efficiency; it is certainly desirable to have better unit/tenant matches, but gminas should pursue this policy goal separately from the housing allowance.

A major reason for lack of support of rent reform policies is the failure to understand the benefits of increasing and restructuring rents and the support that a reformulated housing allowance program would offer—which, in fact, would make the rent reform program both well-targeted and fair. Thus, as discussed in the Rent Report cited in note 10, gminas that have successfully increased rents have involved the important stakeholders in the decision, which is an important part of the process for achieving transparency.

[10] See the forthcoming UIC report on rent policy in Poland by Sally Merrill, Harry Garnett, Rebecca Lawrence, Wanda Urbanska, Edward Kozłowski, and Jacek Łaszek, "Local Government Rent Policy and Best Practice in Poland: The Need for Rent Reform and an Improved Housing Allowance Program," Urban Institute Consortium for USAID/Warsaw.

Finally, consistency is another aspect of transparency (and also fairness). For example, it would be beneficial for reasons of consistency (as well as reducing regressivity) to maintain the tax benefit to new construction initiated in 1997, and similarly to declare that no further changes would be made for a specified period. Households can then adapt their behavior to a "steady state" with regard to consumption/investment decisions, and HUDA would ultimately be better able to obtain adequate data for estimating price and income elasticities, which are key to predicting future demand.

Supporting Private Market Development. Policies that work best in conjunction with the private sector and do not compete with market mechanisms (such as market interest rates, market pricing of risk by banks lending to households and gminas, and market pricing for municipal bonds and BGK bonds). Altering or competing with these market signals, especially in programs that are not well targeted, can undermine the development of commercial finance for households, gminas, and developers. Subsidy policy should not compete with, and thereby stifle, development of private sector market-based financing. Thus, any interest rate subsidies that are approved should be used in areas where the private sector would not undertake the financing on its own without subsidy. TBS projects fall into this category.

Similarly, if the private sector is to be encouraged to assess and monitor the financial viability of projects on its own, state guarantees may not be needed in many circumstances. HUDA should therefore carefully review its policies with regard to proposals for state guarantees; guarantees should be minimized for infrastructure and some other types of loans. Not only may state guarantees not be needed, the existence of guarantees all too often produces a moral hazard effect and inhibits development of one of the key functions of the private financial sector; estimating risk and pricing its products (loans, bonds) accordingly. In some cases, partial guarantees—with the state and private sector sharing the risk—may be feasible and desirable. This important issue is further discussed below with regard to policies for funding rehabilitation and infrastructure; in addition, in Section 2.4, a new program of government-sponsored mortgage insurance is discussed.

Economic Efficiency and Limited Redundancy. Policies that achieve the desired impact with as little public expenditure as possible and, most especially, policies that do not undertake to do what the private sector will do on its own. These issues are closely related to the issue of encouraging private-market development. As discussed, economic efficiency means accomplishing the desired change with the least subsidy cost: the most "bang for the buck." Economic efficiency also means maximizing the use of private sector resources; policies should elicit the maximum contribution of resources from households and the private sector in general and clearly place the role of capital allocation for housing primarily with the private sector.

For example, tax benefits to higher-income households for new construction should result in increased housing supply for only a portion of the cost of the transfer necessary to build a new unit for households of very modest means. For this reason, the team does not recommend spending state funds for new social housing; in general, this is the most expensive way of increasing the stock because there would be no private contribution. Thus, it would be preferable to rely on existing communal or other stock to accommodate the need for social housing.

In addition, a modified TBS program, with a “shallower” subsidy, may be useful (see discussion in Section 5.0). Similarly, alternative policies, such as subsidies to first-time homebuyers, could be efficient, targeted, and administratively simpler. Both of these options could be highly efficient and encourage household participation.

Economically efficient policies are not redundant. Program resources should be focused on those economic agents who will change their behavior with some inducement (such as inducing more people to rehabilitate or construct their homes) as opposed to those who would engage in the activity without the government’s support. Thus, the team believes that the 1996 tax benefit policy may have a large element of redundancy. We have already mentioned redundancy with regard to both rehabilitation benefits for unit interiors, which should at least be better targeted to avoid redundancy, and subsidy funds unnecessarily spent.

Possibly the key topics of the efficiency/redundancy issue will be the strategies ultimately selected for providing subsidies for rehabilitation and infrastructure. Especially because Poland has very limited state funds, important trade-offs may have to be made.

- **Infrastructure.** Many gminas, may be able to finance infrastructure with a combination of gmina resources, commercial borrowing, and municipal bonds. Utility prices have been greatly liberalized and are approaching or have reached true cost levels. A number of gminas have already issued bonds to finance infrastructure; bonds can be general revenue or infrastructure revenue (whereby the revenue flows are collateralized). To the extent that infrastructure can be financed via the banking sector and capital market, it could be counterproductive or inefficient or both to now introduce interest rate subsidies, tax breaks for banks, or state loan guarantees. Rather, every effort should be made to continue to assist gminas with financial planning and funding strategies, to assist banks with designing and pricing loans, and to help investors understand the risks and benefits of municipal bonds. Thus, in this context, to introduce public funding via gurantees and subsidies is inconsistent with the subsidy principles of (1) redundancy and economic efficiency and (2) maximizing private sector participation. If funding is required for infrastructure in some less well-off gminas, block grants or loans from NHF could be employed in a limited, well-targeted program.

- **Rehabilitation**. In contrast, some types of rehabilitation may be less likely to be funded by the private sector. As was mentioned above, a case can be made that the problem is, in part, a national legacy and should receive preferential funding from the state. There are, in general, no revenues to be collaterized, nor in many cases would the new owners of recently privatized buildings have sufficient funds to address the immense backlog of capital repair. Even if rent reform were to take rents well above 3 percent of replacement costs, revenues could be expected to cover only current operating and capital costs, not the full backlog of capital repair requirements. Thus, again, on the premises of redundancy and efficiency—the state should intervene only where the market will not—it is tentatively suggested that scarce state funds be devoted to rehabilitation, and that much of the funding for infrastructure be conducted at market rates. As noted above, for gminas too small (or too poor or inexperienced) to fund their infrastucture through the market, central government could provide block grants or BGK could raise market-rate funds through bond issuance and on-lend to these gminas.

Administrative Efficiency. Policies designed to minimize administrative time and cost. There are two aspects of efficiency: economic, as discussed above, and administrative. Administrative efficiency refers to the costs—as well as the transparency—of program administration. For example, as discussed above, HUDA wishes to further simplify the space requirements impacting eligibility for the housing allowance. Though a better match of units and households is extremely desirable, it is more efficient to link these changes to gmina-based “switching” rules rather than to a national income support program.

2.4 Summary of Recommendations and Suggestions for Alternative Approaches to Subsidy Policies

In summary, our review suggests that priority be given to housing allowances and other mechanisms that facilitate the raising of rents to market levels; to improving the legal and regulatory framework governing the sector; and to supporting the mobilization of private sector funds. The housing allowance program should remain Poland’s premiere subsidy policy. This demand-side policy is progressive (fair); efficient in helping target subsidies to the extent that it supports rent reform; efficient, therefore, in encouraging a private sector supply response in the rental or even homeowner sector; and administratively efficient subject to simplifying some of the eligibility rules. It is also easily portable: qualifying households can use it in any kind of housing stock if Polish policymakers so wish.

Second, HUDA’s proposed tax policy may be less economically efficient than assumed; a supply response is encouraged, but at higher cost than necessary.

Admittedly, this critique is only a "guess" on our part. A complex study would be needed to sort out the impact of the tax break as opposed to other factors in encouraging new construction; data for this type of study are simply not available in Poland at present. The team considers that a return to the 1996 policy may be needlessly generous, redundant, and highly regressive. Also, because the proper incentives for consumers and producers are not fully represented in the system, heavily subsidizing new construction in this manner may be somewhat ineffective. Rather, new construction subsidy programs could be better targeted; they might be most justifiable in metropolitan areas with substantial excess demand or supply constraints that are particularly difficult to remove. Preferably, however, Poland's proposals for a simplified tax system would eliminate such benefits completely.

Alternative Subsidy Policies. In the long run, HUDA should focus attention on mechanisms that facilitate the mobilization of private sector funds. We recognize, however, that it will take time for the private sector to significantly increase the volume of mortgage (and commercial) lending and bond financing. Thus, until rents can produce sufficient cash flow to support mortgage loans, and interest rates fall to a level at which borrowing is affordable to the average household, the housing sector will not receive sufficient private funds to support increased supply and needed rehabilitation.

In light of the discussion of subsidy principles, it is useful to ask whether there are alternative subsidy policies that HUDA might consider that "pass the test" on a large number of the subsidy principles. Alternative "market inducement" policies include partial loan guarantee programs and direct subsidy programs linked with obtaining a market-rate loan. HUDA is well aware of the need to address both demand- and supply-side issues in its housing policy. For example, should HUDA wish to consider demand-side policies with a more progressive profile, two options could be studied: (1) means-tested grants for first-time modest income homeowners and (2) state-supported mortgage insurance to enhance affordability for qualifying would-be home purchasers. In addition, with regard to supply-side subsidies, block grants to gminas may be preferable to subsidized loans or state loan guarantees.

- **Homeowner Grants**. Grants, as opposed to subsidized loans, are generally a nondistortionary approach to stimulating demand. Eligibility criteria could be designed to balance progressivity with efficiency, that is, with the expectation that the grant, along with the household's own resources, and bank loans, would enable purchase of a new or existing flat. (A grant-based subsidy is analyzed in Section 8.0).

- **Mortgage Insurance.** A recent USAID-sponsored study of the feasibility of mortgage insurance in Poland concluded that private insurers were not likely to introduce default insurance in the near future.[11] However, many countries—the United States and Canada are two important examples—use government-sponsored mortgage insurance as a means to enable households to purchase a unit with a commercial mortgage loan but with a higher loan-to-value ratio than would normally be granted by the banks. The insurance covers that “band” or portion of the loan-to-value ratio that is in excess of the level that would have been offered without the insurance. The policy was initially used in the United States to assist persons returning from military service, who presumably would not have been able to accumulate the same level of down payment as similar persons who had not served. This policy has some parallel with the pretransition period in Central and Eastern Europe (CEE) and newly independent state (NIS) countries, where households received subsidized housing services rather than the income necessary to accumulate capital.

- **Block Grants to Gminas.** Block grant policies can be extremely flexible with regard to targeting rules—or lack thereof—and may be usefully focused on rehabilitation programs or infrastructure development or both. Block grants can be economically and administratively efficient. Also, block grants do not conflict with market-based finance as subsidized interest rate loans and state loan guarantees might do. This approach does require substantial up-front state funding, however.

In summary, the relative advantages and disadvantages of these alternative subsidy policies could be further addressed by HUDA. For example, both homeowner grants and mortgage insurance can be structured to be relatively progressive. The trade-off occurs in economic efficiency. Also, from the perspective of the central budget, all three policies require up-front cash, because mortgage insurance would require building up a contingency fund. If the policies are well targeted, however, such as for gminas with specific pressures on supply and for households that are relatively well-off and wish to build in supply-pressure areas, then the funding requirements can be kept relatively more limited.

3.0 OVERVIEW OF GOVERNMENT EXPENDITURES ON PUBLIC HOUSING FINANCE AND THE LEGACY OF PAST POLICIES

3.1 Current State Support for Housing

[11] See Roger Blood, “The Prospective Role of Mortgage Insurance in Support of Housing Finance in Poland,” Urban Institute Consortium for USAID/Warsaw, August 1998.

Government expenditures on housing include those from the central budget (HUDA's budget), from tax revenues forgone in housing-related tax benefit programs, and from gmina budgets. Thus, the true "state-generated" level of support to housing is not known; clearly, however, the total value of the subsidies to the sector are far higher than the figures that appear in the housing sector budget as developed by HUDA and the Ministry of Finance. Other expenditures and resources include (1) the degree to which local governments and private landlords charge rents lower than those that would appear in rental housing in a free market; (2) housing allowances and many other gmina-level subsidies; and (3) the tax subsidies (that is, credits or deductions that represent revenues forgone) at the central level. Please refer to Table 3.1 for details on central government direct expenditures since 1991 and to Table 3.2 for a Ministry of Finance estimate of tax revenues forgone in 1996.

The responsibilities for the housing sector that have been shifted to the level of the gminas include not only the ownership of most of the remaining government-owned rental housing, but also a portion of the funding of housing allowances, the decision about the terms under which the units might be privatized, the responsibility for maintaining and renovating the communal stock, and the potential for supporting (through TBS or directly) the creation of additional regulated rental units. There are, however, no comprehensive data on the budget and off-budget support that the gminas provide.

If we restrict our focus only to central government expenditures that are not associated with past commitments, there is still a fair degree of support for the housing sector. The largest explicit outlay is for the central government portion of housing allowance payments. This is budgeted at new Polish złotys (PLN) 497 million in 1998, a 15 percent increase from PLN 429 in 1997. HUDA estimates that for 1997, actual state outlays were PLN 323.3 million with an equivalent amount being provided by the gminas, for a total of PLN 646.6 million; this total provided allowances for 646,800 households. In 1998, state expenditures are estimated to be PLN 477.3 million, about 0.1 percent of forecast gross domestic product (GDP); with gmina contribution, the total increases to 0.2 percent of expected GDP.

It is notable that the inflation-adjusted amount spent on this subsidy has been increasing steadily since the start of the program in 1994. This apparently reflects both increases in rents and other housing expenses and in the share of eligible households that actually participate.

Table 3.1
Central Government Expenditures for Housing (mln PLN)

	1991	1992	1993	1994	1995	1996	1997	1998	Percent change 1997 to 1998
Total	1226.7	2349.9	1943.9	2760.3	2816.6	3397.7	3511.0	3005.8	(14.4)
I. Housing Allowances									
Subsidy for gminas for housing allowances			—	38.9	229.7	265.3	429.3	497.3	15.8
II. National Housing Fund					58.7	342.0	220.0	270.0	22.7
III. Thermal Renovation Programs									
Subsidy for co-ops for thermorenovation	—	—	—	—	10.0	39.9	49.8	—	—
Subsidy for creation of Thermorenovation Program	—	—	—	—	—	—	—	30.0	—
Subsidy for producers of heating	—	—	—	—	—	—	—	54.0	—
IV. Contributions to the Mortgage Fund			32.5	1.1	5.9	13.2	17.0	22.3	31.1
V. Past National Subsidy Policies									
Buy off of housing credits interest	67.2	699.1	975.0	751.1	829.5	1415.6		1105.0	
Writing down of housing credits	422.3	702.6	0.2	—	0.1	—	—	—	—
Refunding of guarantee premium	121.7	264.3	261.7	1404.6	1125.7	817.7	908.0	826.0	(9.0)
Compensation for candidates to housing co ops			—	25.1	31.7	44.8	286.9	15.0	(94.7)
Subsidy for housing co-ops	615.5	683.9	530.4	449.6	435.7	404.2	398.7	146.2	(63.3)
VI. Infrastructure Subsidies									
Subsidy for gminas for infrastructure for housing			144.1	89.9	89.6	55.0	90.0	40.0	(55.6)
Housing expenses as proportion of:									
Total State budget expenses percent	5.1	6.1	3.9	4.0	3.1	3.1	2.8	2.1	12.5
Total State budget revenues percent	5.8	7.5	4.2	4.4	3.4	3.4	3.0	2.3	11.9
Gross Domestic Product percent	1.5	2.0	1.2	1.3	1.0	0.9	0.8	0.6	18.9

Source: Ministry of Finance, 1998

Table 3.2
Housing-Related Tax Deductions in 1996

Deductions	Amount	Proportion
Total amount deducted from income	PLN 11,817,264,000	(6.4 percent of total income)
Number of applications with deductions	3,684,525	(31.6 percent of total applications)
Number of taxpayers receiving deductions	5,825,576	(24.9 percent of all taxpayers)
Average deduction by taxpayer	PLN 2,029	
Average deduction per application	PLN 3,207	
New construction and prepayments		
Total deductions	PLN 6,915,510,000	(58.5 percent of all housing deductions)
Number of participating taxpayers	1,068,992	
Average deduction	PLN 6469	
Purchase of land (plot):		
Total deductions	PLN 384,974,000	(3.3 percent of all housing deductions)
Number of participating taxpayers	59,318	
Average deduction	PLN 6490	
Contractual savings		
Total deductions	129,472,000	(1.1 percent of all housing deductions)
Number of participating taxpayers	28,679	
Number of applications	18,012	
Average deduction	PLN 4515	
Average deduction by application	PLN 7188	
Renovation and modernization		
Total deductions	PLN 4,137,843,000	(35.0 percent of all housing deductions)
Number of participating taxpayers	4,539,285	
Number of applications	2,907,092	
Average deduction	PLN 912	
Average deduction by application	PLN 1423	

Deductions	Amount	Proportion
Housing credits repayments		
Total deductions	PLN 249,465,000	(2.1 percent of all housing deductions)
Number of participating taxpayers	129,302	
Average deduction	PLN 1929	

Source: "Materialy Informacyjne. Biuletyn Skarbowy Ministerstwa Finansów" ("Information Materials: Treasury Bulletin of the Ministry of Finance." Number 6(18), 1997.

The second largest state expenditure on the housing sector is the annual contribution to the NHF. For 1998, that amount is budgeted at PLN 270 million, up about 23 percent from 1997. This amount is not entirely a "loss" to the central government, however, as most of it will go to loans that have a significant present value upon repayment. Also, the NHF is lagging in actually making these loans; thus, much of the cash will stay in the BGK for the moment. This cash is nevertheless accounted for as a full expenditure. The major program funded through the NHF is the TBS system, which itself can be used to finance a variety of housing-related investment projects. The TBS system also requires gminas to commit to providing subsidies, but the amount of that subsidy cannot be determined.

It must be emphasized that Poland has chosen to convey major subsidies through tax-related benefits. A number of such subsidies exist (see Table 3.2), and in the aggregate the MOF estimated the programs to have cost the government revenues of about PLN 2.6 billion in 1996, or about 0.75 percent of GDP in 1996. As a point of comparison, the total of all subsidies in 1998 allocated for housing allowances (PLN 497 million), the NHF (PLN 270 million), and the new thermal renovation fund (PLN 30 million) is about PLN 800 million. The tax revenues forgone in 1996 were more than three times this amount. In addition, this substantial tax figure does not include any estimate of revenues forgone from the favorable rate of VAT applied to housing.

It is possible that the total of all expenditures taken together is somewhat closer than generally thought to the 4.5 percent of GDP that has been declared as a desirable level of government support of the sector.[12] An estimate can be made for 1996. For example, in 1996, central budget expenditures of PLN 3.398 billion were 0.9 percent of GDP. Tax revenues forgone, at PLN 2.6 billion, were 0.7 percent of 1996 GDP, for a total of 1.7 percent of GDP. To this figure must be added gmina expenditures and tax revenues forgone from VAT benefits.

[12] See, for example, the HUDA Strategy Report III.22, which cites this 1994 guideline.

On the other side of the ledger, however, central government expenditures on housing have been falling since 1994 as a percentage of both total state expenditures and of GDP (see Table 3.1). And, as discussed below, given that approximately two-thirds of the central budget expenditures are devoted to paying off old programs, it is apparent why HUDA feels special urgency to address the “legacy” issue.

3.2 The Legacy of State Resources Devoted to Previous Housing Policies

As has been stressed, the legacy of the old programs is a major burden to the state budget and a major obstacle to the implementation of new housing programs. Two previous programs use a large portion of the current state housing budget. The first provided loans to participants in a contract savings program run by Polska Kasa Opieki Bank Państwowy (PKO-BP). Originally the funds had to be used for new construction but in 1994 the program was expanded to include loans to buy existing units. The other major program was the provision of indexed mortgage loans for members of cooperatives. PKO-BP holds nearly PLN 4 billion of these loans and the government pays the deferred interest to the bank.

In the 1998 housing budget (PLN 3005.8 million), buyouts of loan interest (PLN 1105 million, or 37 percent of the budget) and reimbursement of guaranteed premium payment for owners of contract savings-bank books (PLN 826 million or 27 percent of the budget) constitute a majority share of state budget housing expenses.

Taking into consideration the importance of maintaining trust in the state—and the fact that premiums paid are probably used in part to finance purchase or construction of new units—it does not appear feasible to alter the rules of calculating the premiums and thereby decrease state expenses for that purpose in real terms. However, some recipients may not be interested in acquiring a dwelling and receiving the premium; they should be given an opportunity to exchange the premium for another type of benefit, such as exchanging savings-bank books for long-term Treasury bonds.

At the same time, the current situation in the housing industry indicates an urgent need for government action directed at other policies to, for example, increase maintenance of the housing stock. It will be necessary to undertake measures shortening the interest buyout period to gradually reduce expenses. This might be achieved in a number of different ways:

- By providing greater incentives for repayment of the loan all at once.
- By securing debts of some cooperative members who possess cooperative ownership rights by a mortgage, preceded by the transformation of cooperative ownership rights to regular ownership rights and by securing an agreement to new terms of a loan contract between the bank and homeowners.

- By introducing limitations on interest buyout and replacing or modifying this form of state liability.

Issues and Options. The subsidy on the cooperative loan portfolio consists of payments to PKO-BP on the difference between the payments made by borrowers and the payments required under the loan terms. Borrower payments are based on a complex formula related to both the size of a unit and average income. The accrual rate on the loan is the 26-week Treasury Bill rate. The difference is deferred interest that is paid quarterly to PKO-BP and capitalized as an asset on the government's balance sheet.[13]

The residential portfolio (more than 90 percent of the total) is performing well. For example, PKO-BP reports a delinquency rate of approximately 3 percent of the residential portion of the old cooperative loan portfolio. But the much smaller commercial portfolio has a default rate exceeding 60 percent. The NBP would like to develop an alternative structure for the portfolio to enhance the prospects of privatization of the bank. The bank has been satisfied with the performance of the residential portfolio, particularly because the government advances capitalized interest. However, the bank is concerned that the NBP will require substantial reserves to be held against the deferred interest. Because the deferred interest is an asset of the government, it is unclear whether the NBP is applying a general policy of reserving against deferred interest on all mortgages for all banks (including Mortgage Fund participants) or just for PKO-BP.

From a policy standpoint, the issue is one of timing. Borrowers can defer part of their mortgage payment, which is capitalized into the loan balance to be paid at a later date. The government pays any difference between a fully amortizing payment and the actual borrower payment to the bank.[14]

The rationale for converting the deferred interest payments into current cash is that PKO-BP is funding the loans with non-indexed deposits that require the payment of current interest. Although deferred interest mortgages subject the bank to liquidity risk, the bank is the most liquid financial institution in Poland. By virtue of its historical position as the only retail depository institution in Poland and extensive branch network, it has a very large and stable deposit base. As of December 31, 1997, 46 percent of its assets were in the form of government bonds. Most of its loans are short-term interbank loans. Although

[13] Borrower payments are allocated first to principal, then to current interest, and then capitalized interest. If borrower payments are insufficient to cover principal and current interest, the government makes up the difference to PKO-BP. The debt has a 20-year term and any outstanding balance remaining at that time will be canceled.

[14] The loans are currently producing a 1.2 percent monthly payment amount. Although still less than a fully amortizing payment, this level of payment suggests that the loans will amortize in another 8–12 years. Note there are differences across vintages. However, conventional wisdom is that much of the current deferred interest owed to the government will never be repaid, as it will be forgiven at the end of the loan term. A more detailed analysis of the loan is needed to establish its projected payment and remaining term.

more analysis of its financial position is needed, it likely could finance the future deferred interest with no material erosion in its cash flow position.

If this is true, the government could stop paying deferred interest to PKO-BP. In that event, the bank would record the capitalized interest as an asset on its balance sheet. This change would reduce the current budgetary obligation for the cooperative portfolio. The government would have a contingent liability if the loans did not pay off—a liability it holds anyway.[15] The complicating factor is the prospect of privatization. If the government plans to privatize PKO-BP within the next 5 to 7 years, investors may discount the value of the portfolio because of a lack of understanding of the loans or concerns about future cash flow or both.

An alternative approach is to swap the cooperative loan portfolio for an equivalent amount of zero-coupon, indexed government bonds. The maturities of the bonds would be staggered (for example, from 1 to 15 years) to reflect the forecast cash flow from the loans. Although the bonds would pay no current coupon, their value would adjust periodically to reflect past inflation. The bonds would be issued at a discount in order for their yield to equal that of comparable market investments. *Note that the yield would have to be inferred for cash flows beyond current long-term government bond yields.*

The loans could become assets of the government (for example, in BGK), and the bonds would be assets of PKO-BP. The government's current cash needs would be reduced by not having to pay the current interest on the loans to PKO-BP. The bank would receive government- guaranteed assets that will facilitate its eventual privatization. PKO-BP is very liquid and can afford to have zero-coupon bonds on its balance sheet.

Recommendations. The financial condition of PKO-BP may allow the government to stop paying deferred interest on cooperative mortgages to the bank. This would reduce the current burden on the state budget and perhaps free up resources for other programs. Alternatively, the government could swap zero-coupon indexed bonds for the cooperative loan portfolio.

The feasibility of these approaches cannot be established without more information on the characteristics and performance of the loan portfolio and PKO's financial condition. A detailed analysis of the loan instrument, using a modified version of a simulation model already in use in Poland by the UIC team is needed. The analysis would include a forecast of the cash flows of the residential portfolio under different macroeconomic assumptions and development of a financing strategy for PKO-BP under the two scenarios of discontinuing payment of deferred interest and the bond swap.

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[15] Note that we are referring to future deferred interest, not the capitalized past interest on the government's balance sheet.

4.0 INCENTIVES FOR DEVELOPING A PRIVATE SECTOR HOUSING MARKET: RENT REFORM AND AN IMPROVED HOUSING ALLOWANCE PROGRAM

4.1 Overview

As has been stressed throughout this report, the UIC team considers rent reform to be the most crucial aspect of housing reform in Poland. The framework for housing sector development describes the importance of a market-determined rent structure in furthering private sector participation in increasing housing supply, both rental and homeowner. Maintaining subsidized rents not only dampens incentives to increase supply, but also provides an unnecessary "income transfer" to households living in rent-controlled stock but who do not require assistance to make their housing affordable.

We therefore support HUDA's call for rent increases, their proposals to strengthen the housing allowance program, and their recommendation that gminas increasingly rely on long-term planning and budgeting to help set a rent reform plan in place. *However, almost no gminas are now acting to increase rents in any major way; without such action—concerted action on a national scale—the incentives for private capital to support housing development will not materialize.* Our recommendations, therefore, are designed to strengthen and integrate HUDA's rent and housing allowance proposals. Our recommendations to HUDA and the GOP include the following:

- Gminas, for a variety of political and social reasons, are reluctant to undertake rent reform. In addition, gmina concerns about affordability are well founded, and the housing allowance program must be improved. We recommend therefore that the GOP find some mechanism whereby gminas are propelled into rent reform via strong incentives and a better understanding of rent policy, or even pushed into it via legislative mandate.

- We recommend that HUDA ultimately introduce policies that actively encourage the increase of rents beyond the 3 percent of replacement cost target toward a market level. The 3 percent rent level is probably not a market level, especially in the long run, as it generally cannot support proper capital repair of the housing stock.

- We recommend that HUDA reform the housing allowance program to be consistent with the increase in rents—that is, so that the units are affordable at a specified target level of rent and so that all households face an equitable eligibility standard no matter what the rent level in their geographic area. HUDA may also wish to further simplify the (space-related) eligibility rules.

- Increased rents are likely to lead to further privatization of communal stock. For those units that do remain under gmina ownership, however, we recommend that HUDA help gminas institute improved rent structures which “mimic” free-market rent structures as much as possible. Thus, the variation in rents would more accurately reflect differences in unit and building quality and locational and neighborhood amenities.[16]

Box 4.1 **The Urgency of Nationwide Rent Reform**
• Increased housing supply in Poland should be propelled by a dynamic market-driven housing sector supported by private capital. This will not occur without nationwide rent reform. • Increased rents would also provide increased support for rehabilitation. The capital repair deficit is a serious national legacy which requires both central government and gmina support. • Rent reform, supported by an improved housing allowance program, would provide a fair, equitable, and well-targeted approach to paying for rental housing.

4.2 The Rent and Best-Practice Study

The information on rents and housing allowances discussed in this report has been drawn in part from a USAID-sponsored study currently being completed by the UIC team. The study, “Local Government Rent Policy and Best Practice in Poland: The Need for Rent Reform and an Improved Housing Allowance Program” (hereafter referred to as the Rent Study), examines rent policy, housing allowance utilization, and a variety of related topics, including the best-practice processes through which a few gminas have managed to overcome considerable resistance to rent reform. In addition, as has been noted in Section 1.0, a simulation analysis has been carried out for this report to assess the housing affordability problems for different income groups in Poland. The results are presented in Section 8.0.

The Rent Study used data from the HRI, which collects information from 120 gminas on an ongoing basis. The HRI sample is a representative sample of Polish gminas, differentiated by geographic location and gmina size. Thus, the summary statistics are

[16] Rent structure was discussed at a USAID-sponsored workshop in Poznań in 1995. It may be time to revisit this issue, as the gminas have now had some experience in adjusting rents according to quality and location. A “How-to Manual” on rent restructuring was translated and distributed following the conference; this manual could be more broadly distributed, perhaps through a follow-up conference on rent “best practices.” See Sally Merrill, Duncan Maclennan, and Bengt Turner, “Ustalanie wyśokosci czynszów w Polsce, Punktowe metody ustalania czynszów” ("Rent Setting in Poland: A How-to Manual on the Hedonic Technique"), prepared by PADCO for USAID/Warsaw, 1995.

assumed to represent "all Poland" reasonably well.[17] To make maximum use of housing data collected by the Housing Research Institute, as well as to better understand gmina decisionmaking processes with regard to rent reform, three separate tasks were undertaken to analyze current rent policy and to discover best-practice strategies:

- Analysis of existing data in order to assess the current situation with regard to rent level, rent structure, rent burden, privatization, and housing allowance participation.

- Interviews with a sample of 15 gminas to ascertain their overall policies and goals for rent management and the role of rent policy in their housing strategies.

- A more detailed study of a small sample of gminas that have developed "best practices" in rent policy and housing management. From the initial sample of 15, 5 gminas were selected that represent a best practice in one or more aspects of rent setting or housing management or both. Follow-up interviews were conducted with this subsample to focus on the best-practice aspects of their housing policy.

The 15 gminas in the interview sample provide a wide distribution of city size, geographic location, and the current status of economic well-being. The gminas include Lublin, Żyrardów, Śrem, Tarnów, Płock, Dzierżoniów, Sopot, Lębork, Łódź, Poznań, Gdynia, Ostrów Wielkopolski, Radom, Kraków, and Szczecin. (Of these, the last five make up the best-practice sample.) Major findings include the following:

- **Rent Level**. Rents in communal and other rent-controlled housing in Poland are still well below what could be considered either economic or market levels. Furthermore, the pace of increase has generally slowed since the initial boost—from extremely low levels—between 1994 and 1996. When the legislation was first passed (1994), central government imposed a ceiling on rent increases (3 percent of replacement cost). However, the majority of gminas do not appear to be in the process of bringing rents anywhere near the ceiling level. Nationwide, the average rent for a typical unit in March 1998 was somewhat less than PLN 1.5 per square meter. For the 15 gminas analyzed in more detail in the Rent Study, rent for a typical unit ranged from PLN 0.55 to 1.98 per square meter in March 1998. As of March 1998, this rent represents from 0.5 to 1.7 percent of replacement cost for a typical unit for these gminas; for Poland overall, the average is estimated to be about 1.0 percent of

[17] The HRI data were specially tabulated and presented for the Rent Study by Wanda Urbanska. HRI staff Jan Kornilowicz, Hanna Kulesza, and Wanda Urbanska prepared two special reports for the Rent Study: "Residential Rents, Funding of Municipal Housing Maintenance, and Housing Allowances," and "Rent Levels and Rent Reform Analysis in Polish Gminas."

replacement cost. Thus, from the point of view of rent reform, the ceiling has now become a target.

- **Housing Allowance Utilization**. As of September 1997, only 6.2 percent of households and only 10.5 percent of tenants in communal housing received housing allowances in Poland. Many fewer households participate in the housing allowance program than was originally expected. According to the discussions with gminas, some households do not apply for housing allowances because of pride or a wish to disguise their actual income. Although most gminas in the interview sample have active programs to seek out those who qualify for allowances, some gminas noted that outreach could be improved.

- **The Opposition to Rent Increases.** This is a complex issue, involving (1) social and political opposition; (2) misunderstanding on the part of gminas who fear that rent increases will leave them worse off, on balance, because of the resulting increase in housing allowance payments; (3) a genuine—and correct—concern that some of the households not eligible for a housing allowance will face severe affordability problems; and (4) the perception that rents are already very high because of increases in utility prices. In part because of local elections in 1998, some gmina councils have recently either rejected rent increases or decreased previously planned-for shifts in rents toward the target of 3 percent of replacement costs. Strong political resistance to raising communal rents continues.

In addition, without housing allowance reform, lower-income tenants who are not currently eligible for an allowance will suffer if rents are raised. There are very few data with which the rent burden situation can be accurately assessed. We have therefore simulated the impact of various increases in rent on households just above the eligibility limits for the current housing allowance program; the findings (see Section 8.0) indicate that rent burdens would be in excess of acceptable (or even payable) limits for households in substantial segments of the income distribution. (See Box 4.2.)

Box 4.2
The Importance of an Improved Housing Allowance Program

- An improved housing allowance is crucial to support of rent reform. Without it, rent burdens would be unacceptable for a substantial proportion of households if rents were to be increased to 3 percent of replacement cost.
- Eligibility should be linked to an acceptable rent target that would vary by the level of rents actually evident in different voivodship sizes or city sizes.
- In addition, households should gradually assume more of the burden of payment (to levels closer to those in effect in Western Europe, the United States, and elsewhere in CEE).
- Such a formula would then provide
  — An equitable subsidy whereby eligible households would face a similar rent burden no matter what their geographic circumstances.
  — A well-targeted subsidy in which only households who need assistance actually receive it.

HUDA's proposed increases in the eligibility limits go a long way toward addressing this problem. However, because of great variation in construction costs across voivodships (districts), and thus also presumably in market rents, the housing allowance formula should be able to take the rent variations into consideration to provide an equitable subsidy program. Finally, it appears that substantial increases in utility payments have, in fact, increased gross rent burdens, perhaps significantly so for some households; again, there appears to be considerable variation in the cost of utilities across different areas and housing types and this too should be subsumed into an equitable formula.

Best-Practice Rent Reform. Three of the five best-practice gminas were selected because of successes in rent policy. Gdynia and Szczecin were selected because they have raised rents to a much greater extent than most other gminas; Kraków, although it has not yet undertaken significant rent increases, has initiated a sophisticated process of creating a "market-based" rent structure.

- **Gdynia and Szczecin.** Both of these gminas have aggressive rent policies; they are among the few gminas that have planned for regular rent increases, and both plan to achieve the 3 percent goal on or before 2004. For typical units, as of March 1998, rents were 1.7 percent and 1.4 percent of replacement cost in Gdynia and Szczecin respectively; rents for full-standard units were at 2.2 percent and 1.9 percent of replacement cost. Szczecin and Gdynia have shown that it is possible to overcome the political and social opposition to rent increases by carefully involving all housing market stakeholders (council members, tenants, citizens, and gmina officials) in discussing proposals for increasing rents to market levels. And, as noted, these gminas have also made rent increases part of comprehensive and long-term plans for the housing sector.

- **Kraków.** Gminas are acting with widely different schemes and approaches to varying the structure of rents as well as the rent level. Most have addressed this requirement in some fashion, and some have developed detailed "point" schemes. Only Kraków, to our knowledge, has initiated the process of establishing variations in rents through application of a market-based methodology (the "hedonic" technique). This technique was introduced in the Poznań Rent Conference in May 1995 (cited in footnote 16). It could ultimately be very helpful for most large gminas as they adopt market-based rent structures in the gmina-owned portion of the stock and in the stock for which the gmina continues to set rent. Kraków's experience in gaining the approval of this approach by the gmina council is interesting in itself.

4.3 Recommendations

Rent Reform. HUDA's Strategy Report clearly states that rent reform is very important. It seems likely, however, that merely encouraging rent reform or undertaking education campaigns will not suffice to overcome resistance to rent increases. *The central government will have to develop a more effective approach to ensuring that rent reform takes place as soon as possible. This would need to be done either through legislation or by providing some carrot-and-stick incentive policies to ensure that reluctant gminas actually undertake the necessary increases.* And, as noted, further housing allowance reform will be critical to supporting affordability if rents are increased.

Also, we recommend that HUDA consider altering its long-run rent target to a figure above 3 percent of replacement cost. It is unlikely that this figure will be sufficient to cover capital repairs; thus, improved long-term maintenance, one of the main reasons for introducing rent reform, will not be properly supported.

Finally, although gminas have complied with the general requirements of rent restructuring, most have adopted simple "point count" structures, whereby percentage discounts or premiums or both change rents to account for negative and positive unit features. Although some gminas have included numerous features in these schemes, they could be improved with some market-based methodologies used to price housing in Western Europe and the United States.

UIC proposes that HUDA develop incentives to push rent reform forward. We also suggest a pilot program for testing rent and housing allowance reforms.

Stronger GOP Incentives for Rent Reform. The GOP could implement an incentive program that offers more generous revenue sharing in housing allowance programs if rents are increased or, for example, that makes rehabilitation (or other preferential) assistance dependent on a specified plan for rent increases. Or, the GOP could combine these "carrots" with some type of a "stick": revenue-sharing in the housing allowance program could be made less generous if plans for rent increases are not implemented, or borrowing from the NHF would occur on less favorable financial terms if suitable plans for rent reform were not adopted.

Rent and Housing Allowance Demonstration Project. A pilot project could be undertaken to combine rent reform with a restructured housing allowance program. Rent reform is likely to be a gmina-based program, although some attempt could be made to have all gminas within a given administrative district address rent policy. The demonstration could also be combined with other gmina-based projects. As noted in the overview, this recommendation for technical assistance could be viewed as a "mega-pilot" that would test the consistency of an integrated set of policies: rent, housing allowances, and funding strategies for rehabilitation, for example.

Housing Allowance and Rent Structure Reform. HUDA has also recommended reform of the housing allowance program. In summary, HUDA has proposed that income eligibility be increased to a higher proportion of the minimum pension and that the rules regarding space and other eligibility requirements be made more flexible. The eligibility cutoff points have already been made gradual (to avoid the cliff effect seen in many means-tested programs).

Our simulation analysis examined affordability based on the household income distribution in Poland and various assumptions about rents and utility payments across voivodships. Our estimates indicate that without any reform of the housing allowance, rent burdens for households just above the income eligibility level could be unacceptably high (depending on voivodship and level of utility payments) if rents were immediately increased to 3 percent of replacement costs. However, according to HUDA's new income eligibility limits, rent burdens would be much more affordable for households not eligible for an allowance (depending on voivodship and assumptions about utilities) if rents were boosted to 3 percent of replacement costs.

A more detailed quantitative analysis of housing allowance design could be carried out in conjunction with HUDA. We suggest a number of additional reforms and alternative parameters for reform of the housing allowance. *First and foremost, the formula used to improve the allowance program should be tied to the rent policy reform goals, rather than to more arbitrary income ceilings that pertain to pension policy*. In this fashion, affordability would be ensured as rents move toward their replacement-cost target in any voivodship; because great variation in rent level occurs across region and gmina size, it is important to establish equitable rent burdens under different circumstances.

This approach to the formula ensures that no matter what the level of rent (up to a defined ceiling), households would pay some portion of their income—perhaps 20 to 25 percent—and the allowance would cover the rest. This is the system that the United States has developed over many decades. In fact, technical assistance on the U.S. system has been provided to countries such as Germany and Australia when they were reforming their allowance policies. Recently, technical assistance has been provided for other housing allowance systems in CEE, as well as the NIS, which have adopted the "fair rent" approach.

Also, once the rent burden situation is clarified, we recommend gradually moving household contribution levels closer to the standards now in place in most Western countries. Housing assistance programs in the United States, for example, require households to pay about 25 to 30 percent of income on housing. Differences in the level of real income in Poland have to be analyzed, however, so that very poor households are able to afford other necessities. Thus, the payment parameter might range from 15 percent to 20 or 25 percent, for example.

Gmina-Sponsored Best-Practice Rent Workshop: Long-Term Planning and Stakeholder Analysis. Interviews conducted during the USAID-sponsored Rent Study noted above suggest that gminas that have successfully implemented higher rent increases have adopted two important tools:

- Stakeholder involvement.
- Long-term planning for housing policy.

Councilors and city hall departments played a very important role in preparing long-term reforms in housing policy, and various stakeholders in rent policy were actively involved in setting rent levels. In general, the rent-setting processes were very transparent. It has also proved to be important that the gminas are very proactive in seeking out those who qualify for housing allowances, thus minimizing the number of potential opponents of the rent increases.

The best-practice gminas that have already introduced “unpopular” policy changes are convinced that the way can be smoothed through:

- Intense and ongoing involvement of the important stakeholders.

- Education of council members and other stakeholders as to the importance and benefits of rent reform. Topics in an education campaign might include:

  — The revenue impacts of increased rents, emphasizing that gminas will cease subsidizing those not in need.

  — Revenues required for adequate maintenance and rehabilitation.

  — Support offered by a restructured housing allowance program and the *net* revenue impact of rent and housing allowance increases.[18]

5.0 INCENTIVES FOR NEW CONSTRUCTION

5.1 Fiscal Incentives for New Construction

The HUDA Strategy Report makes several recommendations about fiscal incentives on both the demand and supply sides for new housing construction. First and foremost, Section III.3.1 seeks reinstatement of the rule allowing deduction of the permitted

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[18] See, for instance, Sally Merrill and Tony Phipps, “Śrem Housing Stock Management Information System,” PADCO for USAID/Warsaw, November 1996 and Ewa Bończak-Kucharczyk, et al., “Program Dodatków Mieszkaniowych: Informator o Procedurach,” PADCO for USAID/Warsaw, July 1995.

investments in housing instead of simply taking a credit set at the lowest tax rate. In 1996, the actual amount of the rebate was determined by the value of the tax deduction according to the tax rates applicable to that income. Because the maximum tax rate was 45 percent in 1996, a household with very high income could benefit from a rebate of up to 45 percent of PLN 64,400 (the limit on the eligible expenditure). In 1997, the amount of tax savings was capped at an amount roughly equal to the lowest tax bracket (19 percent) times PLN 64,400.

HUDA proposes to return to the higher benefit scheme. As discussed in Section 3.0, this is a very significant subsidy; the MOF estimated that in 1996, the subsidy—or taxes forgone—equaled PLN 2.6 billion. Of the total housing-related deductions from income of PLN 11.8 billion (which resulted in revenue forgone of 2.6 billion), PLN 7.3 billion, or 61.8 percent of the deductions, were for new housing investment.[19]

Issues and Options. The team supports the use of fiscal incentives as a policy to increase the housing supply. However, we propose that the GOP simply retain the lower (1997) benefit structure. Our reasoning is as follows:

- A very large tax break, such as proposed by HUDA, may be predicated on three presumptions. First, large social benefits accrue to all of the stock from additions to the top end of the housing stock.[20] Second, incentives should be weighted toward those with ready cash, rather than just those with reasonable access to long-term finance. Finally, Polish experts are assuming that because the extra subsidy derived by fairly high income households is a deduction rather than an allowance, the subsidy actually causes a significantly larger number of these households to start houses than would otherwise be the case.

- In addition, the use of fiscal incentives has at least two advantages over direct state or gmina investment in new housing. First, the housing, whether owner-occupied or rental, would be built in the private sector, with clear incentives for appropriate allocation and maintenance. Second, the approach is administratively efficient (as well as economically efficient) because such subsidies do not have to go through bureaucratic or allocative channels to take effect, thus avoiding political considerations in their allocation as well as additional administrative costs, such as the overhead of the BGK under the NHF/TBS system.

[19] Note that we cannot directly estimate the revenues forgone because of new construction with the data available to us (in Table 3.2) because we do not know the income brackets for those who deducted.

[20] There is some controversy over whether such additions have beneficial effects on housing in the lower- quality portions of the stock. There is strong evidence in support of this claim in free-market housing markets, but its applicability in the Polish market is not certain.

- A number of caveats, however, lead us to prefer the lower benefit scheme. These caveats are especially relevant for the longer term. First, the proposed tax policy is highly regressive. Second, it is difficult to believe that the number of additional houses built is worth the extra loss of revenue from making it a deduction. (The only households with a significant gain from this provision have the highest incomes in Poland and are probably already in the market for a better house than they had under the previous system.) Thus, we suggest that the state's funds (those "saved" by keeping the lower tax benefit scheme) are best spent elsewhere. In addition, it must be emphasized that such major tax advantages generally have a relatively hidden, long-term, insidious effect. As the deduction becomes more entrenched and commonly used, taxpayers view it as a major softener of the burden of high marginal tax rates. In effect, for many taxpayers facing rates as high as 40 to 45 percent, continuing to make large investments in housing will reduce their actual taxes paid as if the top rate were only 30 to 35 percent. Yet the actual high marginal rate will continue to weigh upon their work-effort decisions and choices in making investments with fully taxable returns.

- These distortions can be very serious for the economic evolution of the society and are a good basis for argument for avoiding marginal tax rates that are so high. However, it becomes very difficult to orchestrate a reduction in tax savings for housing expenditures in return for lower tax rates, as illustrated by the difficulty in the United States of significantly scaling back the very regressive tax break for housing.[21]

In summary, in terms of the analytical framework developed for the critique of subsidy policies (see Section 2.0), we agree that HUDA's tax proposal is both economically and administratively efficient and places full responsibility for housing production in the private sector. However, it may be less efficient than generally assumed if its benefits are excessively generous. It is very likely that the private sector would have taken some action without such a large incentive, and thus some portion of the benefit is redundant. Finally, given that the more generous policy is highly regressive, and that it risks becoming entrenched as a permanent policy, its advantages may be overshadowed by its negative features.

[21]Moreover, certain abuses may be creeping into the Polish system. The deduction is understood to apply to annual qualifying expenditures, even for the same residence. If so, there is a significant potential for construction to be spread out over several years, or for additions to be made to a house that has already benefited from the subsidy. Cumulative deductions should be limited to the total ceiling for a single residence and not be applicable for small additions or improvements.

Recommendations. The UIC team offers to HUDA both short-term and long-term recommendations to continue consideration of this extremely important policy issue.

Poland's Tax Reform. In the short term, the GOP may wish to continue this discussion of tax policies with appropriate consultants. Reform of Poland's tax system is currently a major topic of discussion. The advantages and disadvantages of various tax subsidies is an issue that has received extensive attention in most developed countries and has engendered many efforts to reduce marginal tax rates and other distortions created by taxes and tax advantages. The discussion also includes the difficulty of ending a policy intended to be a short-term stimulus rather than a permanent feature of housing policy. Policymakers who may wish in the future to eliminate the tax break entirely or reduce its generosity will find that once entrenched, such benefits are difficult (or impossible) to remove.

Long-term Policy Assessment: A HUDA Research and Analysis Division. The efficiency and effectiveness of alternative types of subsidy policies—for a wide variety of social welfare issues, including housing, health, and social security—are issues that are addressed on a continuous and ongoing basis in most Western countries. As recommended in Section 1.0, HUDA would be well served to institute its own research and analysis division. There is no simple way to determine what the actual net impact of the proposed tax policy is—in other words, how housing starts/production in 1996 and 1997 differed from what would have occurred in the absence of a subsidy benefit. First, one must consider the normal cyclical factors, with ebbs and falls in permits, starts, and completions being impacted by a variety of short- and long-term macroeconomic factors. Second, major "switching" of activity from year to year—that is, adjustment of the timing of housing activities in anticipation of policy changes—probably occurred. In the United States and Western Europe, much effort has been expended in estimation of the long-term demand for housing and the long-term cost of capital. The parameters resulting from these estimations (complex in and of themselves) must be the starting point for seeking evidence of the additional impact of particular government policies. In addition, however, the shorter-term cyclical effects must also be controlled for in this endeavor, so that prying the sought-after answers from the data requires a long-term database and appropriate statistical and econometric techniques.

In addition, Poland and all transition countries face particular difficulties in analysis because (1) the economic systems, particularly those emerging as primarily market-based, are not yet in long-run equilibrium and (2) the evolution of long-term demand for housing is not known. Thus, while at present we can only guess at the impact of alternative tax policies, the UIC team feels that the 1997 benefit level may be adequate to achieve the desired effect because, given the shortage of housing adequate for higher-income households, this group is not likely to be highly price- sensitive at present.

We recommend that HUDA consider establishing a research department so that Polish experts can begin developing the necessary information systems. Because housing subsidies—of one type or another—will likely be as important to Poland as they are elsewhere in the West, the research division would be a permanent institution for housing policy analysis.

5.2 Preferential Treatments Under the VAT

Issues and Options. HUDA has argued that because of a perceived urgent need for more housing construction, existing VAT advantages should be preserved. The UIC team suggests that providing a somewhat less generous benefit is a better approach; one solution is to grant a rebate on only a portion of the full VAT, thereby providing most people with a lump-sum offset to the cost of building a house without encouraging overbuilding. This policy has advantages and disadvantages similar to those for the tax benefit for new construction.

The advantages, again, are economic efficiency in promoting increased housing supply (more impact per złoty of benefit) and encouragement of fully private market activity.

However, we find two weaknesses in the argument for full VAT advantages. First, it is not clear why just one of these tax advantages would not be sufficient to evoke sufficient supply response; in other words, why is the VAT benefit required in addition to the tax benefit? Further analysis is needed as to what the marginal cost in forgone revenue is for an additional unit built. It is possible that adding the tax deduction to the VAT preferences is a very costly way of further boosting production. The second weakness is that a lower VAT rate for housing-related costs results in a reduction in cost of additional housing space and quality, not just a lower cost of building an additional unit. In other words, it encourages people to build larger and better units, not just more units.

Recommendation. Our recommendations are similar to those detailed above for the tax benefits for new construction. First, we suggest that discussions be held with the relevant institutions regarding the costs and benefits of alternative tax incentives. As mentioned in the HUDA Strategy Report, Section III.3.3, the movement toward a single uniform tax VAT rate is now being discussed; it will perhaps be lower than the current maximum rate. In that process, if favoring housing investments is still a priority, the subsidy amount should be limited through a specific amount of exemption per housing unit. Second, this issue would benefit from long-term assessment by a housing research department.

5.3 The NHF and the TBS System

The steady decline in construction of multifamily housing and the perceived inability of a majority of Polish families to purchase housing at full market prices led the GOP to prioritize programs and policies to increase the development of rental housing. The existence of additional rental housing options could support greater labor mobility, facilitate economic restructuring, and ultimately increase household incomes. Inspired by the Western European not-for-profit housing sectors that build, renovate, and manage housing for a range of income groups, the government passed legislation and ordinances to support the development of the TBS not-for-profit housing sector and mechanisms to finance rental housing. Preferential credit has been given to TBS and cooperatives for rental housing production and to gminas for housing-related infrastructure.

To date, the NHF has granted loans totaling PLN 137 million to 60 projects producing 2,590 units. Of these loans, 15 are to cooperatives and the remainder to TBS. Ten loans are now being repaid and 661 apartments have been completed. Currently, 84 loan applications (30 from cooperatives) for new residential construction and modernization are under consideration for a total requested amount of PLN 315,080,374 to develop 5,227 units. NHF President Irena Herbst estimates that by the end of 1998, 6,600 units will have been financed with NHF credits.

HUDA's Strategy foresees the NHF and TBS playing major roles in strengthening the housing sector in the near term. Already the program is generally considered a success and is in a period of rapid expansion. It has elicited significant initiative, particularly from gminas and co-ops, to develop additional rental housing. It has also brought into play significant resources from would-be residents, in the form of both up-front payments and rents that are at least twice the level of those in most gmina-owned units. On the other hand, the majority of TBS units are wholly gmina-owned, and to date have not benefited from an infusion of private capital.

Key to attracting private sector financing are good lending practices and adequate monitoring and supervision of loans and borrowers. Although HUDA registers the TBS, they do not review the financial status of the TBS and have no plans for organizational monitoring. A long-unresolved issue is the lack of procedures for deregistration of TBS that do not comply with statutory responsibilities or that violate other regulations. A similar issue centers around the need to clarify BGK procedures to address potential loan default and TBS bankruptcy.

In addition, as the NHF system is financing long-term projects developed and managed for the most part by inexperienced new organizations, it is crucial that the loans and borrowing organizations be carefully monitored for the NHF to be attractive to private capital, as envisioned in its initial development. Good monitoring aids understanding of the demand for various types of rental and other types of housing products and the clients served.

However, because of the unexpected and major tasks involved in handling credits for the flood program, the NHF is just developing its portfolio monitoring system. They have recently reorganized, establishing a financial monitoring unit through BKHF assistance that will expand their efforts to include performance monitoring in their evolving computer system. A committee of users consisting of representatives of BGK departments is aiding program design. Monitoring should facilitate better tracking and assemblage of data on the TBS, rental housing products, and their tenants, which currently do not exist in any consolidated form (to our knowledge) and are essential for loan portfolio and overall program management. To improve information concerning the nature of TBS and characteristics of areas in which TBS is evolving, the BGK is commissioning a market research firm to survey the existing TBS and the officials of the gmina.

HUDA's Proposed Improvements. HUDA has proposed a large number of improvements to the TBS program which, as a whole, the team considers very sound. The first step is for the NHF to continue its efforts to finalize loan and organizational performance monitoring. This finalization is essential for good loan management, obtaining private funding for capitalization, and for monitoring the program from a policy perspective. Absent clear information as to the costs and affordability of housing products and the income levels of clients served, it is difficult to measure program success or determine incremental changes for program improvement.

Second, training and technical assistance for this emerging TBS sector and support of the Consultation Points to provide regional information and technical assistance bases will lead to a stronger and more independent nonprofit sector and warrant donor support. Strengthening TBS should reduce incidents of organizational failure. Attention should be paid to the issues of TBS deregulation and a process to cover defaults and housing management takeover. Without these provisions, the risk for private investors is greater. Finally, review of the program goals should be conducted in light of the various suggestions for more radical program modifications, such as selling rental units.

Issues and Options. We believe it is a good time to pose some additional and difficult questions, especially those with a longer-term horizon. Our concern is that the program mature with a solid financial and management structure. The salient questions include:

- How well is the TBS management infrastructure developing and to what extent are their goals being met?

- What income groups are being served and at what cost? Is this the best programmatic approach and the best use of public funds to meet the housing needs of middle-income families? Or should alternatives such as one-time new homeowner grants also be introduced?

- Are there ways that the system can garner more equity participation from the private sector? Can it better contribute to movement toward market-based rentals drawing primarily upon private capital and management?

- Finally, are there any significant long-term hazards in the workings of the system, especially as it moves toward large-scale operation?

These cautionary queries are based upon extensive experience (some very negative) with subsidized rental-production programs in the United States and Western Europe. In these U.S. and other programs, there has been a pattern of introducing a financing package that proves to be initially very popular, but flaws have later emerged in the financial and/or structural design of the programs. These flaws can be remedied, but (as evidenced by certain United States programs) can also be extremely costly if the program has made extensive commitments before critical evaluations are done. Similar flaws, if they were to occur in Poland, could undermine the potential for the NHF to tap into private funding without a state guarantee.

Recommendations. Our overall recommendation is that HUDA and BGK be supported in their proposed efforts to expand and improve the NHF/TBS system. We suggest, however, that HUDA and BGK go beyond the recommendations in the Strategy Report and take a broader and longer-term view of the future for this program. In the rush to gain momentum for a new program, TA has focused mainly on the “micro” issues of individual TBS or monitoring data points; a “macro” and long-term look has not yet been undertaken. Our general recommendation is that Poland should not hastily let expanding the number of units under production take precedence over securing long-term financial planning, monitoring, and management. Without these activities, the hoped-for participation of the private sector, and even the ability of BGK to raise funds in the capital market, will be threatened.

- **A Review of Lessons Learned in Affordable Housing Schemes in the United States and Western Europe.** Our key recommendation is that a critical analysis be made as to potential long-term weaknesses in the program design. A review of best practices, costly mistakes, and relevant experience in the United States and Western Europe (and possibly other subsidized rental housing sectors in the region) could be very useful to illustrate issues, pitfalls, and strategies for long-term sustainability of management, maintenance, capital repair, and so forth.

- **Experience throughout the United States and Western Europe suggests that there can be a thin line between a successful program and a costly failure.**[22] One problem is that the very success of the program can imply a large scale of production that overwhelms the administrative infrastructure. Other sources of such failure have included too much reliance on, and not enough monitoring of, inexperienced development organizations and untested financial projections; unclear responsibilities in case of fraud or bankruptcy; indeterminate sources of financing for long-term rehabilitation; incentives for inefficient or corrupt management; and unclear rules for setting rents, treating delinquencies, and offering ownership. Now that a popular financial structure has been developed, it becomes more important to refine the model to make it more robust.

- **Dissemination of Gmina Best Practice.** The most effective TBS development has occurred in gminas with a strategic approach to defining and resolving their housing problems. Conversely, barriers to positive TBS development exist in gminas that have a poor understanding of their local housing systems and problems. And though national awareness has increased concerning the TBS, many TBS initiators cite a lack of awareness of the potential benefits of TBS or a distrust of the concept on the part of local officials as their major barrier to successful organization. This suggests that HUDA should strengthen efforts to assist with gmina-based public information campaigns on housing issues, problems, and solutions. A constant problem cited is the lack of understanding of the TBS/NHF concepts or the real housing options.

- **Assessment of Additional, Less Costly Subsidy Programs.** Another related recommendation is that some consideration be made of how the NHF/TBS system can promote the movement toward reliance on private-market provision of rental housing. In some ways, the system is evolving toward a second tier of municipal rental housing, with rents closer to but still well below, full market cost. In the current NHF program, subsidies cover a significant portion of development costs. (The NHF financing can cover as much as 70 percent of the total cost.) The subsidy conveyed by this financing—at one-half the “discount rate”—is roughly 40 percent of the market interest rate, or about 28 percent of the total cost. In addition, a portion of the loan—equal to about 10 percent of the total cost (not the loan)—is then forgiven at the completion of the building. Because part of the loan (about 14 percent) is forgiven, the financing subsidy drops from 28 percent to 24 percent of total costs. With the loan forgiveness, however, the total cash value of the state subsidy is about 34 percent (24 percent plus 10 percent of total cost). In addition, gminas may contribute land

[22] See, for example, the recently issued “Sustaining Non-Profit Housing Development,” Washington, DC: Fannie Mae Foundation, 1998.

and infrastructure, so that about one-half of the total cost may be provided. Can an additional program be structured that provides a shallower, more sustainable degree of subsidy, actually bringing rent levels closer to market levels? Are there ways to better integrate such systems with an income-tested housing allowance subsidy?

- **Continue TBS Technical Assistance and Build TA Capacity in Local Organizations.** Training and technical assistance directly to TBS, with an emphasis on building capacity in the Consultation Point gminas or other local organizations which can then increasingly undertake this type of assistance, should continue to be supported. The NHF, in conjunction with the TBS Forum, has devised a system of Consultation Points through those mature and successful TBS that have experience to share with those in formation. Initially, the BGK was to provide financial support to the six or seven TBS that provide consultation and training services; however, funding has not been forthcoming. This also might include continued access to Institute for Real Estate Management (IREM) training (offered through the Polish Real Estate Federation); general business management, business, real estate finance, and project development planning; and overall community development training.

- **The Role of Subsidized Rental Housing in Housing Sector Strategy and Increased Private Sector Involvement.** In addition to the “lessons learned” study proposed above, analysis of several related issues is important for assessing the long-term role of the TBS program. Among other efforts, the BKHF is helping BGK structure an approach to obtaining funding from the Polish or international capital markets or both. HUDA and BGK should continue to formulate long-term options for making the NHF/TBS system as supportive and consistent as possible with eventual privatization of rent-controlled housing. As we proposed in the discussion of rent reform, rents in that portion of housing not privatized should ultimately aim to be closer to market levels, that is, above 3 percent of replacement cost. TBS rents must also provide sustainable returns. A related issue is the so-called investment index—a cost index more suited to the investment costs facing the TBS; although the index should be devised internally, by GUS, for example, assistance could be offered in its design.

6.0 INCENTIVES FOR MAXIMUM UTILIZATION OF THE EXISTING HOUSING STOCK: REHABILITATION, PRIVATIZATION POLICIES, AND SOCIAL HOUSING

6.1 Rehabilitation

The need for renovation of various housing stock types in varying stages of deterioration has long been a policy concern in Poland. The policy initiatives and the legislative debates, however, have not yet produced programs that even begin to measure up to the problem. There are multiple problems, for one thing: renovation of individual units and individual buildings; so-called complex renovation, which includes major urban renewal and historic preservation; and finally, thermal renovation. In addition, estimates of how much various initiatives cost, and who should pay, is complicated by the complex—and apparently extremely large—legacy of the capital repairs backlog. This backlog sets in motion equity issues and pricing problems: for example, why should owners of newly privatized (communal) housing pay for building renovation when their counterparts still in communal housing would be supported with gmina or state funds? One answer is that the unit was likely privatized at a great discount, in part because of the backlog; on the other hand, will gminas who renovate their buildings be able to privatize them at a price that would capture the renovation cost? The renovation challenge in older stock is further complicated by the mixed ownership of much of the stock in the form of *wspolnotas* (housing associations), which have not been able to obtain agreement from their members on financing of major building repairs (as opposed to those in individual units).

As noted above, in the team's view, rehabilitation policies are associated with, or driven by, nearly all the elements of the policy framework: increased rents; the likelihood of increased privatization as a result of increased rents; the depth of the privatization discount in rehabilitated and nonrehabilitated buildings; and the rationalization of the ownership structure in privatized buildings to better garner private resources to share in rehabilitation costs. *In addition, as discussed in Sections 1.0 and 2.0, rehabilitation policy development should be guided by a recognition by the state that the capital repairs backlog is a national legacy that the central government must share in redressing.*

Estimates of Poland's renovation needs and projected costs range considerably. Data provided by HUDA state that according to 1995 estimates, approximately 7.3 million units require renovation, of which 1.1 million require capital rehabilitation, 1.3 million require renovation and preventive work, and the rest require only moderate renovation and conservation. The estimated cost for this work is PLN 30 billion[23] or U.S. $9 billion. A recent report by the Housing Research Institute (HRI) drawing on recent analyses of Poland's housing conditions provides further descriptive information on the renovation needs and the following cost projection:

- The renovation gap is estimated to be at a level equivalent to the construction costs of approximately 750,000 dwellings—a figure considerably higher than

[23] Data taken from the Housing and Urban Development Authority's "Concept Paper on the Renovation Fund" (draft, June 1998). Estimate is based on 30 percent of potential needs in 3.5 million apartments based on an average cost of PLN 30,000.

that projected by HUDA. As little as one-third of this required amount is being spent for renovation purposes in Poland.[24]

- Every third dwelling is located in a building 50 years or older. Because of insufficient maintenance, many of these buildings are nearly completely depreciated.

- According to GUS data, only 1.4 million dwellings, or 12.3 percent of the total dwellings in Poland, were renovated after 1970. More frequent renovations occurred in older buildings.

- Between 1971 and 1995 only 11 percent of dwellings located in municipal buildings were thoroughly renovated. According to HRI's 1997 research, 50 percent of Polish gminas did not allocate funds to renovate municipal buildings.[25]

- According to estimates, by the year 2010, 1.0 million dwellings, or 10 percent of the total existing stock, will be demolished.[26]

In addition, regarding the type of households occupying the units, substandard apartments in older buildings are more frequently occupied by elderly households: 20 percent of pensioner households lack bathrooms and 46 percent live in dwellings without any gas or central heating.

In urban households with an income below the poverty line, the average floor area per capita is 13.3 square meters and only 73 percent of such households live in the apartments equipped with basic facilities. In households above the poverty line, the respective ratios are 19.1 square meters per person and 91 percent living in the flats with running water, toilets, and bathrooms.

Surprisingly, there are currently no major national programs to address this complex problem. The efforts of the current HUDA administration to address this growing problem will thus be filling a major gap. An important element of any approach is to stimulate private investment in renovation of the housing stock wherever possible; however, the low income level of a good portion of owners and residents dictates that they will require financial assistance. HRI and other researchers cited above concluded that the renovation backlog is so huge that building owners and managers will probably not be able to catch up using only their own resources.

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[24] Jan Kornilowicz and Hanna Kulesza (Housing Research Institute), "Assessment of Building Renovation Requirements in Polish Cities," in *Urban Construction and Economy*, Vol. 7–8,1996.

[25] op. cit.

[26] "The estimate of the likely reduction in the number of dwellings occurring due to deterioration between 1994 and 2010." Housing Research Institute, "The Housing Issues," Vol. 2, 1995.

Over the past eight years, one of the few tools supporting renovation was very modest tax relief for the renovation of apartments and a slightly more generous allowance for re-building common areas.[27] Such relief provides minimal assistance, especially given the magnitude of the problem. *Little of the renovation stimulated by this type of tax relief addresses major building systems and building-wide deterioration—a problem of much greater urgency.*

Other assistance may now be offered through the NHF following changes in its ordinance in mid-1997 to allow credits to be granted to cooperatives or TBS for renovation of rental housing stock. The contract savings systems also provide a mechanism for owners to save and later borrow to finance renovation. However, both of these systems are new and, in the case of the NHF credits, limited in their application.

The major focus of local government lobbying for state assistance for renovation over the past three years was the proposed Act on Renovation and Modernization of Urban Buildings, designed to provide a shared state and local financing mechanism, organizational structure, and process for complex renovation and revitalization of carefully selected urban areas.[28] A complex approach is sorely needed in many urban areas with deteriorated and inappropriately used historic downtowns. However, the proposals contained in the Act were controversial, considered by some to be too prescriptive, too complex, and too centralized. Negotiations over two years, however, were thought to bring divergent positions to a compromise. However, the MOF has indicated that the financial obligations on the state budget would be too great.[29] Thus, the Act was withdrawn, considered infeasible in the current financial climate. This issue is addressed in the HUDA Strategy (II.1.12) but it is unclear whether a new Act will be drafted or the previous draft will be presented (without the financial component).

Parliamentarians involved in the issue prefer to address other issues crucial to complex renovation strategies before reconsidering the Act. They recommend that greater support for historic preservation of landmarks be included in the Act on the Protection of Cultural Buildings before moving to pass an Act on Renovation and Modernization of Urban Buildings. Many buildings and targeted areas in older cities have some type of historic designation; this designation currently results in arduous preservation and conservation restrictions. However, the Ministry of Culture has few funds to support historic preservation, leaving owners strapped with stringent conservation conditions that may

[27] Current tax relief for rehabilitation of common areas is 0.5 percent higher than for apartment renovation (2.5 percent versus 3 percent of the price of a 70 square meter flat, or roughly PLN 3,000). But only one type of tax relief can be taken. It has been recommended to the MOF to allow both, as the “one only” tax relief benefit limit acts as a disincentive for building repair.

[28] A detailed description of this Act is contained in “Building on Progress: The Future of Housing Finance in Poland,” Urban Institute Consortium for USAID/Warsaw, May 1997.

[29] Proposed state funding for 10-year program in million PLN: yr. 1: 33, yr. 2: 74, yr. 3: 111, yr. 4: 148, yrs. 5–10: 185.

prevent them from upgrading or, in some cases, from using their property commercially. Resolution of the renovation problems presented by stringent conservation requirements without accompanying financial assistance is essential. This is proposed generally in HUDA's Strategy Section III.1.3, which suggests a range of management improvements, clarification of ownership issues, and sources of financing for building rehabilitation.

The concept of the complex renovation strategy emerged from local governments, which, in the early 1990s, began grappling with the challenge of urban revitalization. Relying solely on local budgetary funds and private investment leveraged from local citizens and other investors, several cities have developed successful multifaceted renovation programs. They are testing the varied tools of grants and preferential credits to enlist owner participation and equity in building-wide renovation. As HUDA contemplates financial tools to support renovation, they should look to these local programs for tools that are being used successfully and are efficient and sustainable.[30] Again, in the area of financial incentives for *wspolnotas*, a variety of financing options have been developed by local governments and should be monitored for their ability to leverage private investment and cost-effectiveness.[31]

HUDA Strategy Report. The most significant element of the HUDA Strategy (III.3.4) for renovation is a new proposed Renovation Credit System which offers up to 10-year preferential credits through commercial banks for building-wide renovation of predominantly residential buildings. The credit will be available to housing condominiums, private owners, gminas, and other legal entities. The credit will be provided at a preferential rate that is subsidized by tax exemption for banks' earnings from the renovation loan portfolio (if maximum interest rates are kept below a specified level). The second subsidy would be provided to participating banks through the NHF from state funds. Private owners will be further encouraged to upgrade their rental properties by a decrease in the rate at which rental income is taxed (from 40 percent to 20 percent).

Legal and organizational barriers to renovation strategies, particularly complex revitalization remain; many of these could be addressed in a new renovation law, but some require other state and local government actions. These issues are identified in the HUDA strategy (II.1.12 and III.1.3); these suggestions should be carried out to allow local governments to use all potential tools in designing renovation assistance programs and strategies to best address their local needs. Other barriers, such as the barrier to grant provision, require changes in the Public Finance Law. Introduction of legislation to support

[30]For example, Szczecin's program is multifaceted, with renovation financed with funds from the gmina budget, public/private partnerships through the TBS system and with private developers, and grant incentives for owner investment in common areas and energy-efficiency programs. Płock, Bielsko Biala, and Lublin have commenced old-town revitalization programs using a variety of different financing and organizational mechanisms.

[31]Sopot and Gdynia have organized loan programs for building-wide renovation by wspolnotas through private banks with the cities paying all or portions of the interest on 3- to 5-year credits; other cities are providing grants upon completion of targeted building-wide renovation.

complex revitalization (II.1.12) was discussed above. Some who favor this Act suggest that without the financing component the Act is rather unnecessary. Others recommended creating regional funds rather than one national fund, given the current administrative reorganization that will establish larger, stronger voivodships. A variety of assistance tools—grants, preferential credits, and tax relief—are perceived as necessary to support complex renovation. As noted, it is not clear what HUDA plans as a next step in this difficult issue.

Recommendations. UIC proposes a two-pronged approach that combines gmina pilot projects with further development by HUDA and other public agencies of national priorities with regard to the various types of renovation (that is, major building systems, urban renewal, and so forth) and the funding strategies appropriate to cost-sharing by the state, gminas, and owners. In addition, the team suggests a review and modification of current tax relief policies.

- **Further Development of State-Funded Policies for Financing Renovation**. Poland needs to finalize the development of its state-supported policies. It is also our opinion that as soon as possible, a more significant amount of central government funds should be made available to address the rehabilitation problem. All persons interviewed by the team indicated that the Renovation Credit system is simply a "concept" at this time. However, a concrete approach should be developed as quickly as possible. HUDA should continue its efforts regarding the following types of issues:

  — A national rehabilitation assistance program which better defines priority problems and the probable costs;

  — Funding approaches consistent with funding from NHF (if NHF is to be used for this purpose);

  — Cost-sharing formulas for gminas and owners;

  — Means-tested approach to elicit "fair" contributions from tenants and owners;

  — Privatization policies whereby gminas can better mandate the ownership structure—and therefore the responsibility structure—for privatized buildings; and

  — Comparison of alternative funding approaches with regard to cost, administrative complexity, and equity: for example, a grants system, a block grant strategy, preferential credits, and tax breaks.

- **Modification of Current Tax Relief Policies.** The HUDA Strategy (III.3.2) suggests a modification of tax relief for renovation, increasing the levels of allowable deductions; however, HUDA indicated that this will not occur until the year 2000. It is our view that absent any new revision, HUDA should push for the possibility for owners to take both the deduction for apartment rehabilitation and the slightly higher deduction for building-wide renovation rather than deciding between the two. This will remove the current disincentive for participation in building-wide renovation. In fact, the building policy is by far the more important of the two; the unit interior deduction should require a means-test for eligibility, on the grounds that higher-income households will undertake such renovations on their own (the redundancy principle introduced in Sections 1.0 and 2.0).

- **Gmina-based Best-Practice Studies and Pilot Projects.** USAID is already involved in a variety of technical assistance activities in rehabilitation through LGPP, CHF, and the Revitalization Forum. A number of gmina-based pilot projects are under way or in planning stages. Some further suggestions for pilot projects are noted below; the gmina-based assistance should continue to be supported because local initiatives (rather than centrally funded assistance) have been, by far, the most important to date. In addition, as has been discussed, at least some of the gmina pilots might test a number of elements of "overall housing strategy"—combining rehabilitation, rent increases, improved support from housing allowances, and a more functional ownership structure in privatized units and buildings. Support should be offered to the following types of projects:

  — **Analysis of Gmina Best Practice in Renovation**. As stated above, local governments now provide good examples of various programmatic approaches. HUDA should review the successful cases (looking for cost-effectiveness and sustainability) and analyze the impact of various forms of subsidies. Assistance could be provided for both the review of national proposals and the existing local programs to discern optimal methods to encourage renovation in various types of housing stock with different ownership structure. Examples of successful renovation programs addressing similar issues (from the United States, Western Europe, and Central and Eastern Europe) could also be undertaken.

  — **Gmina Pilot Project in "Overall Housing Strategy."** As has been discussed, the problems associated with renovation are linked to numerous other aspects of housing strategy: rent increases, improved housing allowances to support rent increases, privatization policies and discounts, and condominium ownership and management structure. We therefore propose a pilot project combining rent increases with increased housing allowances, renovation strategies, and funding policies for capital repair of major building systems. This pilot project might also be combined with TBS management, as described below.

— **TBS-Managed Renovation Pilot Projects and Other Pilot Projects**. USAID and a gmina partner might utilize a TBS that focuses on management of existing stock to undertake a rehabilitation pilot. TBS management would move the gmina away from direct provision of supervisory services. The TBS may also be able to use its new construction program as one form of replacement housing. Many other issues also need to be tested:

Relocation strategies or renovation processes with tenants in place;

Various financing mechanisms: preferential loans, grants, means-tested funding;

Good management practice and tenant involvement in management; and

Pilot projects with *wspolnotas* for rehabilitation planning, financing, and rent restructuring.

— **Public Education and Private Sector Participation.** The rhetoric in the HUDA Strategy is appropriate: "changing the perception of an apartment from a personal asset to a marketable commodity." Much is to be gained from devoting resources to a public education campaign on the current housing policy and tools and options available to both local governments and individuals. Community planning workshops and strategy sessions with gminas, local businesses, banks, housing providers, others in the real estate sector, and nongovernmental organizations (NGOs) could be developed to help define community development problems, strategies, and tools.

6.2 Homeowners' Associations (Wspolnotas), Privatization, and Rehabilitation

The privatization policy of selling communal housing units to sitting tenants was carried out by many local governments beginning even before the transition in 1989. This practice intensified in the early 1990s, resulting in the emergence of many mixed-ownership buildings. Practices and policies vary from city to city but generally, units were sold for well below their market value, usually with no provisions regarding building condition, a renovation plan, or requirements that purchasers be financially capable of maintaining the building. The tendency was to purchase the most desirable units; however, throughout the country, owners with limited means purchased units in buildings requiring considerable capital investment.

The passage of the Law on Housing Unit Ownership formally established the homeowners' association and indicated the responsibilities of owners in maintaining the building common areas. As many owners felt no responsibility for building conditions resulting from decades of neglect, considerable protest resulted over this newly legislated responsibility. Implementation of the Act over the past four years has revealed flaws in the legislation; some have been corrected in earlier amendments, and others are proposed to be corrected in the present HUDA Strategy. In addition to problems of legal status, barriers to successful association development include lack of financial support for rehabilitation, lack of management experience on the part of owners, unrealistic organizational and reporting requirements for privately managed associations, and limited enforcement of laws and regulations that should assist owners in carrying out building management.

Privatization and Rent Reform. In addition, future privatization should be considered in conjunction with rent reform and rehabilitation policies**.** As rents are increased, it is likely that an increasing number of tenants may wish to buy their units. Two factors, drawn from successful practices by the gminas, should be more broadly encouraged:

- To ease building management problems, gminas should give serious consideration to allowing tenants to buy their units only when a majority of tenants in the building agree to do so. By this means, more buildings will be managed by condominiums run by tenants, not gminas.

- Further, whether or not the policy of deep discounts is continued, it may prove unwise to privatize units to households with very limited means. This is, of course, a policy decision to be taken by the gminas, but if there is not a means test imposed for purchasers, gminas should consider their options for financing rehabilitation of buildings that are an integral part of the stock.

HUDA Strategy Report Recommendations. The HUDA Strategy recognizes the barriers to successful association development, noting that legal issues, ownership issues, and cumbersome or costly bureaucratic procedures affect the ability of mixed-ownership condominiums to manage themselves efficiently, organize for building-wide renovation, and access financing. Point II.1.6 of the Strategy suggests remedies, including public education and training campaigns and modifying the Local Government and Budget Laws to allow gminas to provide grants to condominiums for building-wide renovation. Many local governments have created financial incentives for wspolnotas to begin building-wide renovation by providing a variety of financing options, including some that are currently illegal under present law.[32] This modification is necessary to allow for the use of grants, which is often less expensive than subsidizing interest rates.

The HUDA strategy cites the need for correction of legal and regulatory frameworks that would address problems faced by many condominiums: unclear interest in common areas, need to change plot boundaries, improved building code enforcement, and improved owner and minority shareholder protections. Yet, there are no specific recommendations on how these improvements would be made. Also, there is a suggestion to simplify accounting and reporting procedures, which are too cumbersome for condominiums, but again with no specific details (II.1.6 and III.1.3). All of these recommendations would assist the condominiums, and implementation strategies should be sought.

The HUDA Strategy recognizes the frequent inefficiencies of privatization policies of scatter unit privatization to sitting tenants with no income tests or renovation plans. Rationalization of the privatization policies to limit mixed-ownership buildings and sell to those with sufficient income would be ideal for future privatization, but would not correct weaknesses in past privatization policies. While difficult politically, facilitating unit exchanges to create fully privately owned buildings or to provide housing options to owners too poor to participate in building renovation would greatly reduce many problems in condominiums (II.3.4). Many condominiums find that they may be hindered in renovation efforts by one or more low-income owners who cannot participate in increased payments to rehabilitation funds or to pay off loans. Some attention should be given to how to assist these persons to pay their share of costs or to relocate them. Finally, the rhetoric in the Strategy is good on this point of “changing perception of an apartment from a personal asset to marketable commodity.” There is much to be gained from devoting resources to a public education campaign on the current housing policy and tools and options available both to local governments and individuals.

Recommendations. The HUDA Strategy Report has detailed a number of recommendations, some of which need to be made more specific to be implemented, and others require coordinated action across a number of issues. In addition, the team recommends that HUDA take advantage of the efforts being made across Central and Eastern Europe.

CEE Review of Condominium Policies and Rehabilitation Strategies. Many of the other Central European countries are dealing with condominium issues, and it would be useful to provide an opportunity for sharing and comparing existing and proposed strategies. For example, a major program for condominium associations and condominium rehabilitation is being carried out by USAID in Hungary. Further thought is needed as to

[32] As mentioned previously, Sopot and Gdynia have organized loan programs for building-wide renovation; Szczecin and other cities are providing grants upon the completion of renovation.

how best to support the cooperation of residents in condominiums to meet the social and economic challenges of organizing and financing the long-term maintenance and rehabilitation of the buildings.

6.3 Social Housing

The Polish system of welfare benefits and housing allowances is now helping many families and individuals afford their housing units. However, as in every country, some households fall through the safety net of government assistance.

Some of these homeless only need housing. However, many need special support to achieve independence. A large number of Poland's homeless, probably the majority, suffer from alcoholism, mental illness, drug addiction, physical illness, or abuse, or have poor coping skills. Support for these individuals and families should tie housing assistance to these multiple contributory causes that appear to underlie most homelessness.

Recently, the Polish Committee for Social Assistance started a program of assistance to the homeless and called for setting up a National Forum of Assistance for the Homeless, which would join government and nongovernment programs and institutions. The Committee proposes to finance the operations with a fund from a tax on alcohol and to request tax breaks for firms that build cheap social housing and employ the homeless.[33]

Much of the information available on the homeless (and those on the brink of homelessness) is anecdotal. No comprehensive system is in place to assess the scale of the problem at the state, voivodship, or gmina level. The statistics available vary greatly according to the agency or organization providing the information and how the information was collected. Estimates vary from 20,000 to 400,000 homeless individuals in Poland.[34] *In fact, the extremely wide range of these estimates suggests that determination of the number of homeless needs to be addressed before concrete policies can be developed. Developing an approach to understanding the dimensions of homelessness, a problem with which the United States has struggled for decades and is still addressing involves complex problems of both definition and methodology*.

Recommendations. The first recommendation, therefore, is to develop a common set of definitions of homelessness (which in fact necessarily entails a determination of the multiple possible causes) and to adopt a methodology for

[33] From *Prawo I Gospodarke*, No. 168, p. 2, August 19, 1998.

[34] The estimate of 20,000 is the "official" figure listed by the Department of Social Welfare. However, the department official with whom the team spoke suggested that 80,000 was a closer estimate. This figure was corroborated by the homeless program of the Catholic Church and the director of Warsaw's programs for the homeless. The estimate of 400,000 was offered by the Association for the Homeless, a direct aid and lobbying group which carried out a study based on a sample of cities and extended the findings to a nationwide estimate.

measurement (which has proved to be a particular statistical challenge in the United States). The remaining suggestions as to policy development can follow only from this first step.

Understanding the Scale of the Problem: Definitions and Measurement. Because so little is known about the scale of the homelessness problem, HUDA would be well served to keep its strategy open, evolving, and flexible until a formal needs assessment can be performed to guide its long-term internal planning efforts. Because the United States has struggled for many years with the problems of its own homeless population, extensive experience exists in understanding and measuring the problem and proposing modalities of assistance relevant to the different problems involved. Although many of the causes of homelessness in Poland and the United States may not be similar, HUDA might review the *methodologies* developed over many years in the United States for estimating the number of homeless and categorizing the reason for their homelessness. This needs assessment should take into consideration the proposed changes in the housing allowance formula and a toughening up of the housing enforcement regulations (particularly evictions) as both could have significant long-term impacts on the number and type of homeless in need of assistance.

Achieving Maximum Use of Available Housing Stock. Although suggested by HUDA, a change in the building codes to allow the construction of substandard housing for the homeless is not recommended by the UIC team. In addition, as noted above, calls by the Polish Committee for Social Assistance to provide tax breaks for firms building social housing is certainly not recommended. Adding new units for the poorest (or non-functioning) households is not an economically efficient or cost-effective way in which to increase supply**.** Certain types of collective living arrangements, as mentioned in the Strategy Report, may be used by some housing populations with special needs or for temporary or interim housing. Housing stock for the homeless is allocated at the gmina level; HUDA's recommendation of using gmina housing as social housing seems reasonable. It appears from the anecdotal evidence that existing stock is often being underutilized for this purpose either because of a need for renovation or because of a flawed system of distribution in the gminas. *Before building new social housing, it is important to assess the availability and condition of existing housing and the feasibility of turning it into special needs housing if required. Also, maximum use should be made of housing allowance benefits in conjunction with other social benefits to provide coordinated support from existing programs.*

Adopting a Comprehensive Approach. In many, perhaps most, cases, homelessness is a social problem and not necessarily a housing supply problem. HUDA's goal of reducing homelessness can be reached only by ensuring a comprehensive range of services to the homeless to help them on the road to self-sufficiency. To do this, assistance in making up for skill deficits, in overcoming mental and physical disabilities, alcoholism, and drug dependencies, and in strengthening family support must be available in addition to providing adequate temporary or permanent shelter. Without rehabilitative and support services, the social conditions that contributed to homelessness in the first place will continue, making real progress toward breaking the cycle of homelessness almost impossible. *HUDA's primary role may be to coordinate provision of housing allowances with those institutions responsible for other aspects of the problem*.

Planning for the Long Term. HUDA's plans for decreasing homelessness are very ambitious and the deadline they have set for accomplishing their tasks (by the end of 1999) is very tight. Loosening up that time line by extending it for several more years may help HUDA be more successful in the long run. Development of a pilot project in a chosen gmina or voivodship to demonstrate an integrated approach to solving homelessness might also help develop long-term strategies. A sample project could be working with NGOs and halfway houses for the treatment of homeless alcoholics who will eventually be integrated back into the community.

7.0 INCREASING PRIVATE RESOURCES FOR HOUSING LENDING

7.1 Contract Savings Systems

The government has passed laws facilitating the creation and operation of two contract savings schemes. The first, *kasy mieszkaniowe,* is in operation and the second, the *Bausparkassen* system, is slated to begin operations by the end of 1998. These programs aim to create a pool of long-term savings dedicated to housing. A USAID-supported study in March 1998 recommended a number of changes in the *Bausparkassen* Act to facilitate a safe and sound operation at sustainable levels of government budgetary support. The MOF has prepared a number of amendments to the Act (draft of June 8, 1998) that are consistent with the recommendations of the study.

Issues and Options. The proposed amendments go a long way toward improving the safety and soundness of the system. There remains, however, an inconsistency regarding the subsidy. The MOF proposes to leave the premium rate at 30 percent of annual savings but to cap the maximum annual premium at a level equal to the value of 2 square meters of housing (indexed to annual consumer price inflation). The cap will lower the annual budgetary obligation of the government and is consistent with reducing the burden of the program on the state budget. This change will also most likely lower the annual contract savings amount as many individuals will not save more than the amount subject to the premium because of the low savings interest rate. In effect, this will result in greater use of Bauspar contracts and subsidies for renovation and modernization as the funds saved and borrowed will be too small to finance the construction or purchase of a house.

This result is inconsistent with the stated objective to help create conditions for larger savings for new housing. If the desired result is use of Bauspar funds for new construction and purchase, the current cap should be maintained but the subsidy should be reduced to 20 percent. The subsidy rate of 30 percent generates extraordinary returns for savers, though the stated role of the subsidy is to supplement the low savings interest rate up to the market level. For example, the program generates a return equal to 4.2 percentage points over inflation for a seven-year savings period and a return of 7.2 percentage points over inflation for the minimum four-year savings period under current MOF inflation assumptions. Although current real savings rates range between 3 and 6 percent for terms between one month and one year, they are considered to be abnormally high, reflecting the impact of the Asian crisis on the Polish economy. The Polish government should consider whether it wishes to lock in a subsidy program that generates such high real returns over extended periods.

If the desired result is to provide resources for renovation and improvement, then reducing the cap while maintaining the premium rate is appropriate. However, a three-year-minimum savings period may be more appropriate for this purpose. The choice of a minimum savings period is a trade-off between the safety of the system and its attractiveness to participants. A four-year-minimum savings period may reduce the attractiveness of the system to households mainly interested in renovation and improvement. If the subsidy is not overly attractive and, as the MOF recommends, the *Bausparkassen* have the right to impose longer waiting periods, a three-year-minimum period can in most circumstances be safe. It is important that the MOF and the NBP develop a model capable of simulating the performance of the schemes in different macroeconomic environments in order to judge the safety and soundness of various parameters.

The MOF's proposed amendments include a provision to defer payment of the subsidy until the loan is taken out or the savings contract concluded. They reason that it is costly to issue bonds to fund payment of the subsidy to the *Bausparkassen,* which in turn will invest in the bonds as assets during the start-up phase of the program (earning the spread between the Bauspar deposit rate and government bond rate). The deferral has been criticized by HUDA and others as adding an element of political uncertainty because it is not definite that the government will have the funds available when the saver completes the contract, which reduces the attractiveness of program. The MOF amendments propose that the Council of Ministers stipulate "by way of an ordinance, detailed principles of Bonus payments." It is essential that the details of payment be decided as soon as possible, that they be as transparent as possible (for example, by setting up individual bonus accounts in both the institution and HUDA), and that the obligation to fund the bonuses be recognized as a future budgetary obligation.

The *Bausparkassen* have criticized the proposal for a 3 percent technical reserve, stating that such a reserve would adversely affect the profitability of the institutions. These reserves can be invested in government securities, so there does not appear to be any profitability impact on the reserve. Because the performance of the system will be difficult to project in its early years, a larger reserve (such as 10 percent) is preferable to ensure that sufficient funds exist to meet the initial loan demand. This reserve can be adjusted once the system approaches a steady-state performance.

Recommendations. The GOP should decide whether the resources accumulated through the subsidy program are best allocated for renovation and modernization or for new construction and purchase. If the former is desired, then the MOF's proposed amendments to the subsidy (lowering the cap and maintaining the subsidy rate) are appropriate. If the latter is desired, then the current cap should be maintained, but a lower subsidy rate of 20 percent should be adopted. A focus on lower savings rates for renovation and modernization is more consistent with current Polish housing needs, as well as the government's priorities of developing private pensions and the mortgage bond market, given the likely performance of the contracts in an inflationary environment. As noted in the study, inflation reduces the attractiveness of the contracts, and the loans are only a supplementary source of finance in non-inflationary markets in France and Germany.

The amendments proposed by MOF do not suggest any changes in the *kasy mieszkaniowe* system. The level of subsidy in this system should be in line with the subsidy levels in the *Bausparkassen* system. Thus, a reduction in the subsidy rate or maximum for the *Bausparkassen* scheme should be accompanied by a reduction in the subsidy rate or maximum for the *kasy mieszkaniowe* scheme. As pointed out in the study, the presence of two potentially competing contract savings systems can undermine the stability of both. Therefore, strong consideration should be given to the merger of the two systems at a later date.

The government could be supported in the management of the contract savings systems in Poland by the development of a *Bausparkassen* simulation model that can quantify the potential liquidity risk of the institutions and through a study analyzing the issues and alternatives associated with the merger of the two systems. The simulation model can be developed as a variant of the mortgage bank simulation model. The model would construct a balance sheet of a *Bausparkassen* under assumptions about the magnitude of savings and loan demand in different macroeconomic environments (which impact the relative attractiveness of the program). This model can be a tool for use by NBP in analyzing the risk of the system and by the MOF in forecasting future budgetary obligations. Although not much political support for the merger of the two systems exists today, it is almost certainly going to become an issue by the year 2000, when the kasy mieszkaniowe system is likely to need a short-term loan from the NHF to meet expected loan demand. Perhaps this study could be part of a larger study of the funding needs and resources of the NHF.

7.2 The Mortgage Fund

The Mortgage Fund was created to promote mortgage lending using the DIM by providing long-term refinancing for banks making DIM loans. Demand for the Mortgage Fund loans has been and continues to be weak. There are at least three reasons for the weak market acceptance of the Mortgage Fund: weak demand from banks, reflecting their liquid condition and small mortgage portfolios; the relatively high cost of Mortgage Fund loans (relative to retail deposits); and the complexity of the loan and procedures to originate and refinance, affecting both borrower and bank demand. It is doubtful that any new banks will enter the program given the uncertainty over its continuation beyond the end of the year. Only five banks have been active in the program (four currently) and the total volume of lending through 1997 was PLN 53.9 million.

The government would like to privatize the Mortgage Fund host, the Bud Bank. The G-12 bank group has expressed interest in the Mortgage Fund. The International Finance Corporation (IFC) has recommended termination of the Fund and sale of its assets (either separately or as part of the Bud Bank privatization).

Recommendations Presented in the HUDA Strategy Report. HUDA recommends accelerating the privatization of Bud Bank and development of mortgage banks in Poland. Before deciding on Bud Bank privatization, a decision must be made on future operations of the Mortgage Fund. There are several concepts of how it can be made a more helpful instrument to support development of the mortgage loan market and development of housing construction. Such concepts must provide for sufficient control over Mortgage Fund resources left with privatized Bud Bank, or transfer the Fund to another bank (Bank for National Economy—BGK). Specifically, HUDA recommends developing the concept of operating the Mortgage Fund in new conditions and making a decision on its location in the banking system and extension of operation of the NHF and the BGK.

Issues and Options. The retail mortgage market has developed considerably over the past few years. More than 20 banks in Poland are now engaged in mortgage lending. As there is no need for a government-owned bank engaged in retail mortgage lending (construction or permanent), the Bud Bank should be sold as soon as possible. The value of the Bud Bank could be enhanced if the government granted it a mortgage bank charter before its sale/privatization. This action may necessitate an equity injection from the government, depending on the NBP's minimum equity requirements for a mortgage bank. The sale of Bud Bank to a retail banking group engaged in mortgage lending or a resumption of retail mortgage lending by the Bud Bank as a government-owned bank would necessitate a change in the Mortgage Fund.

The IFC has recommended that "any ongoing Government liquidity facility for the housing sector not be connected to the present Mortgage Fund." Their rationale is that the Fund has not proved its viability, and that any liquidity facility would be temporary and provided through a government entity. They are concerned that the Fund would be difficult to discontinue in the future if it were a “formal government program” or a formal financial intermediary.

This recommendation ignores that fact that the Fund has advanced the development of the mortgage market in Poland, even without a large volume of lending, and has developed a set of standardized documents and procedures, training support, and analysis tools for DIM lending. Discontinuing the Fund and re-creating it in the NBP seems unnecessarily wasteful if demand exists for remaining Fund resources. Furthermore, even if the Fund is sold, its current portfolio of assets and liabilities will need to be serviced by some entity.

In the opinion of the team, there is an ongoing demand for DIM loans in the Polish economy. Contrary to the assertion of the IFC that “these mortgages would likely be made to middle- and upper-income borrowers,” in the current situation of high interest rates, DIM loans (with a 1.2 percent first payment ratio) are almost twice as affordable as a classic loan with the same conditions (interest rate 26 percent, maturity 14.5 years), (e.g., PLN 100,000 loan: DIM payment 1,200 PLN/month, classic loan 2,219 PLN/month). USAID analysis of mortgage loans made from the mortgage fund show that a significant proportion benefit below-median-income households.

If macroeconomic conditions improve and nominal interest rates fall, conventional loans will become more affordable to middle-income households, but until that time there is a (transitional) role for a Fund refinancing DIM mortgages. The experience of the Fund suggests that these loans, while complex, can be successfully commercialized if lenders are willing to do so. There is an ongoing demand for Fund resources from the two largest borrowers of the Fund, PBG and Bank Inicjatw Społeczno Ekonomicznych (BISE), both of which stated in interviews that they would cut back their DIM lending if the Fund is discontinued.

We believe that HUDA and the GOP should consider three principal options with the Mortgage Fund: (1) transfer within the government, (2) sale of its assets, and (3) privatization. An in-depth assessment of the options for continuing the Mortgage Fund is currently being conducted by UIC on behalf of USAID:

- **Transfer Within Government**. The Mortgage Fund can be separated from Bud Bank and transferred to another government entity (such as BGK or NBP) that would continue to operate the Fund. The Fund appears to have sufficient liquid assets and incoming cash to meet demand for the next two years at current levels of lending (approximately PLN 20 million annually). This option will maintain a competitive alternative to PKO-BP, offering DIMs in the Polish market. The Fund’s small scale and independent financial status should make transfer relatively easy. This should only be done if the costs (such as system costs) are minimal, and the host is agreeable. Under this scenario, the Mortgage Fund would cease operations in one to two years (when its resources run out) and thus would serve a transitional role in providing long-term resources until a viable mortgage bond market is developed. The government may wish to provide additional resources to the Fund if demand picks up, but such funding should be transitional and used solely for the purpose of refinancing deferred payment mortgages.

- **Sale of Mortgage Fund Assets**. The Fund could be sold to a private entity either as a part of or separate from the Bud Bank privatization. From a commercial standpoint, operation of the Fund within a banking group in Poland is not viable as it is highly unlikely that it could continue a meaningful volume of lending to other banks if it were part of a Polish banking group.

  In this scenario the Fund should be viewed as a government asset and not an ongoing operation. The Fund's assets could be sold to another financial institution that would be required to service the loans until they were fully repaid. Proceeds from sale could be used for other government programs (note that the government is obligated to repay the World Bank and USAID loans, so use of proceeds in this manner mainly affects the timing of programs). Further research is needed regarding the future cash flows of Fund assets and liabilities before any conclusion can be reached about the advisability of sale (of the asset) versus liquidation. The small scale of the Fund, the need to continue servicing the loans, the continued deferral of loan cash flows, and the complexity of the loans suggest that any buyer would significantly discount the assets. Care must be taken to safeguard information possessed by the Mortgage Fund about participating bank customers.[35] We do not think that operation of the Fund as a government-owned entity within a private group (e.g., the G-12 mortgage bank) is advisable. This would give the government an ownership share in a private entity (group).

- **Privatization of Mortgage Fund**. A third option for the Fund is privatization, which could be accomplished through the sale of the equity of the Fund to the private sector. One model of operation as a private entity could be as a liquidity facility, owned by its borrowers. This model has been successful in the United States in Federal Home Loan Banks and in France with the Caisse de Refinancement Hypothécaire (CRH) (see Box 7.1 for a brief description). The viability of the Mortgage Fund as a stand-alone institution will depend on the demand for its funds from mortgage lenders, the cost of such funds if the fund

[35] Concern about access to this information by Bud Bank has been an inhibiting factor to bank participation and would be of even greater concern if Bud Bank were private or part of another banking group.

is truly private, and the ability to change its charter to facilitate privatization and issuance of bonds. Creation of a government-owned centralized liquidity facility is not advisable as it would create a competitor for mortgage banks with preferential funding possibilities.

The Mortgage Fund could not be turned into a mortgage bank without a change in the Mortgage Bank Act. This Act does not allow loans to other banks as collateral for mortgage bonds. Also, the legal status of such loans (loans collateralized by loans, subintabulate) is not clear. The Fund has insufficient equity at present to meet expected NBP requirements.

The equity of the Mortgage Fund could be used as seed capital for a mortgage bank. The Fund equity could be turned into shares owned by a government entity (such as BGK), forming part of the capital base of a mortgage bank. The rationale for this approach is to ensure that at least one mortgage bank focuses on residential mortgage lending (a requirement for contribution).[36] Market participants suggest that most of the initial mortgage bank lending will be in the form of hard currency loans for commercial real estate projects. The government's share should be less than 50 percent, with plans to sell its stake over a medium-term time horizon.[37]

Box 7.1
Liquidity Facilities and the CRH

[36] It is unlikely that mortgage banks created under the new Act will make DIM loans. To do so they would have to be funded primarily from non-mortgage bond sources, as only the amount up to 60 percent of the loan-to-value ratio can be funded with mortgage bonds. The matching requirements may necessitate funding with indexed bonds that would be difficult to sell in the current Polish market.

[37] The government initially owned all of Fannie Mae and the Federal Home Loan Banks, which are now entirely private. There has been minority government ownership in several developing country secondary-market institutions such as in Malaysia, Trinidad, and Jordan. Partial government ownership is often seen as a preference and therefore may be resisted by purely private-sector players. These concerns may be mitigated if the activities of the mortgage bank were restricted to residential and communal (gmina) finance and the government announced that it planned to sell its shares within a certain time period.

In several countries, purely wholesale institutions exist to facilitate the flow of funds to the primary mortgage market. These institutions, referred to as *liquidity, rediscounting,* or *secondary mortgage facilities,* issue general obligation bonds in the capital markets and use the proceeds to refinance the portfolios of primary market lenders. They provide funds to primary market lenders through collateralized loans or recourse purchases. In the United States, the Federal Home Loan Banks have been making collateralized loans to mortgage lenders since the 1930s. In France, the Caisse de Refinancement Hypothécaire (CRH) was formed in 1985 for a similar purpose.

CRH is a collateralized lender and centralized bond issuer for its members. CRH issues bullet bonds to finance the purchase of mortgage-backed bonds created by member lending institutions. It issues bonds that are (over)collateralized by mortgage bonds created by primary market lenders rather than whole loans. CRH is a private institution, owned by most of the major mortgage lending banks in France. Institutions that refinance mortgages through CRH must be shareholders of CRH. The current size of CRH is $9.5 billion. Its growth has slowed in recent years, reflecting a desire of its depository institution members to fund loans with relatively cheap retail funds.

Recommendations. Among the possible recommendations are to grant Bud Bank a mortgage bank license and sell it. The sale will provide additional revenues to the government, enhance the franchise value of the Bank, and get the government out of the retail banking business. The Mortgage Fund could be transferred to BGK or NBP if they are agreeable and the transition costs are minimal. This approach is preferable to terminating Fund lending and contributing the equity to a new private sector mortgage bank because it would keep a flow of funds dedicated to DIM lending in the market. The charter of the Fund should be amended to allow the Fund to purchase mortgage bonds backed by DIMs and other deferred payment mortgages.

As noted above, on behalf of USAID, UIC is currently conducting a study to identify the principal options available to the Polish government regarding the Mortgage Fund. The options for transfer, sale, or liquidation of the Mortgage Fund will be addressed in detail. This study will analyze the current balance sheet and cash flow forecast of the Fund under different assumptions about the demand for loans from participating banks and develop the advantages and disadvantages of the three options (transfer, sale, privatization). This issue is integral to the evolution of private sector housing finance in Poland.

7.3 Mortgage Banking and Mortgage Bonds

The Mortgage Bank Act was passed in 1997 to create institutions that specialize in lending for commercial and residential real estate and to local governments funded through the issuance of mortgage bonds. Since passage of the Act, implementation guidelines governing the regulation and supervision of mortgage banks and mortgage bonds have been developed.[38]

HUDA Recommendations. Despite a European Union (EU) directive recommending a solvency ratio of 50 percent for mortgage loans, the NBP does not consider mortgage bonds to be enhanced-quality securities. Thus NBP assigns a risk weight of 100 percent, which increases the issuer's costs and decreases mortgage bonds' attractiveness for investors. Also, certain investors are not legally allowed to invest in mortgage bonds. As a result, one can anticipate that, given the present circumstances, mortgage bonds will not be popular. HUDA recommends both amending provisions to enable numerous financial market entities to invest in mortgage bonds and lowering the risk weight for mortgage bonds.

[38] See, for example, L. Chiquier, "Regulation of Mortgage Banks and Mortgage Bonds in Poland," USAID, June 1998 and Mortgage Credit Foundation, "Development of Terms and Conditions Concerning Implementation of the Act on Mortgage Bonds and Mortgage Banks," April 1998. Also, as mentioned, a Mortgage Bank Simulation Model has been tailored to the mortgage bank structure proposed for Poland and has been made available to all counterparts in the UIC Housing Finance Project. Further improvements and adaptations are currently being made for NBP.

Issues and Options. Currently, residential mortgage loans carry a 100 percent risk weight owing in part to the weakness of the lien. The loans backing mortgage bonds will be lower-risk, conservatively underwritten loans with a lien that has a higher priority than the statutory lien. The conservative underwriting and priority over the statutory lien suggest that the risk weight of the conservatively underwritten residential loans backing mortgage bonds should be lowered to 50 percent, which is in line with EU solvency requirements for such mortgages.

The credit quality of mortgage bonds will be higher than mortgage loans in general as there will be some overcollateralization and backing by the equity of the issuing bank. Mortgage bonds in the EU generally carry a risk weight of 20 percent, which is in line with EU solvency requirements for interbank debt. The Mortgage Credit Foundation has proposed lowering the risk weight of mortgage bonds in Poland to 10 percent.

The protections inherent in the Mortgage Bank Act suggest that a risk weight comparable to interbank debt is reasonable. Currently, the risk weight for interbank debt in Poland is 30 percent for Polish banks and 20 percent for Organization for Economic Co-operation and Development (OECD) banks. However, a lower risk weight is not justified in Poland given the nascent state of the mortgage and mortgage bond markets. As the market and mortgage banks are not yet in operation, higher risk weight will not disturb the economy.

Currently, mortgage bonds are not legal investments for insurance companies, and their eligibility as legal investments for other institutional investors is unclear. The Mortgage Credit Foundation's Implementation Report (4/8/98) recommends adding mortgage bonds as eligible investments for insurance funds, pension funds, investment funds, cooperative savings and loan institutions, contract savings institutions, and BGK. The design of the bonds and the banks puts great emphasis on their safety. The mortgage bonds therefore should be eligible investments for insurance companies and other official institutional investors.

Recommendations. It is recommended that support be given for a lower risk weight for mortgage bonds (to a minimum of 20 percent) and the inclusion of mortgage bonds as eligible investments for insurance companies and other institutional investors.

Further, support should be given for continued development of the mortgage bank simulation model for use by NBP and the banks. The model's capabilities need to be expanded to include the following: an interface to make it more accessible for new users, development of a module for commercial real estate loans (which are larger and should be handled on a discrete as opposed to pool basis), and expansion of the model's asset and liability classifications so that it can emulate a universal bank. The model can be used to simulate the effects of different mortgage instruments that can be adopted in a lower inflation environment. The fixed-rate module should be expanded to include graduatedpayment mortgages, and both the fixed- and variable-rate mortgages should be expanded to include interest rate buydowns. An expanded model can be used in training and to help policymakers with as yet unresolved questions about the capitalization, risk weighting, and matching requirements of the mortgage banks.

8.0 HOUSING AFFORDABILITY AND SUBSIDY POLICY BY INCOME GROUP: THE ADEQUACY OF POLAND'S SUBSIDY PROGRAMS

8.1 Introduction and Overview

The affordability of housing is a major problem in Poland, as it is in most countries. The following analysis addresses the affordability of housing options available to different income groups by analyzing the interface between an estimate of the household income distribution for employed persons in Poland and a variety of assumptions about rent levels and prices for new housing and purchases on the secondary market. The simulation analysis considers the impact on affordability of the major subsidy programs—the housing allowance and the TBS programs—to see how they affect the rent burden faced by households at different income levels. In addition, the analysis attempts to determine whether major "gaps" exist in addressing household affordability: for example, whether households not eligible for the current housing allowance program can afford housing under various cost assumptions, or could afford to take part in a TBS project.

As discussed at length elsewhere in this report, we very strongly support rent reform. Thus, in addition to examining current rent levels and the resultant rent burdens, we have extended the simulation analysis to a future scenario in which rents have been increased; we then assess the situation of households with reference to the new income eligibility limits proposed by HUDA for the housing allowance program.

Similarly, with regard to the TBS program, the analysis examines the payment burden for households in TBS programs when rents are set at or below the maximum of 4 percent of replacement cost. Finally, households whose income falls above the eligibility limits for TBS may or may not also face severe affordability problems; their options differ from those with more modest incomes and include home purchase as well as private-sector rental housing. In summary, the issues addressed in the simulation include the following:

- **Current Rent Levels and the Current Housing Allowance and TBS Programs**

  — What is the profile of rent burden for households at different points in the income distribution?

— What affordability problems are faced by households not eligible for assistance under the current housing allowance rules?

— What might be the income and rent burden profile of households that might typically participate in a TBS project?

— Is there an affordability gap for households those not eligible for a housing allowance but not able to afford a TBS unit?

- **Rent Reform and a Revised Housing Allowance Program**

— What would the rent burden profiles be for households if rents were increased under rent reform?

— What would be the impact of the new housing allowance eligibility rules on assisting households?

- **Purchasing a New or Existing Unit with a Mortgage Loan**

— Which income groups can afford to purchase new or existing apartments or single-family houses with the assistance of a mortgage loan?

— How is the affordability of home purchase affected by differences in location and the structure of housing costs?

8.1.1 Approach to the Analysis

The analyses described in this section have been addressed through a “simulation” that relates the income distribution for employed households in Poland to various assumptions about rent levels, utility payments, and the cost of new housing. Please refer to Annex I for a detailed description of the preparation of the data used in the simulation. Ideally, an analysis of affordability would examine what Polish households are actually paying for housing. Thus, the analysis would use a database composed of information on individual households—for example, a sample of households selected for interview, with a sampling plan structured to provide nationwide and regional estimates. The interviewed households would be asked to supply information on income, housing costs, utility costs, mortgage loans, and so forth, which would provide figures for the actual payment burden facing each household.

Figure 8.1 The Net Income Distribution for Employed Households and Housing Allowance and TBS Income Limits

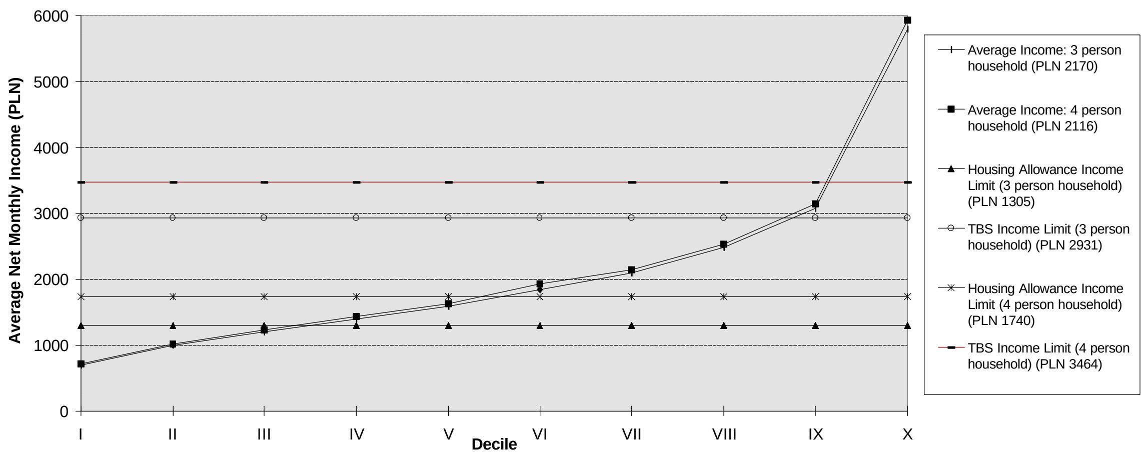

Table 8.1 Average net household income by decile for employed persons (PLN per month)

	I	II	III	IV	V	VI	VII	VIII	IX	X	Average
3 person household	698	995	1206	1397	1587	1841	2095	2476	3068	5798	2116
4 person household	714	1017	1234	1429	1624	1932	2143	2533	3139	5932	2170

Source: Income distribution developed by Cracow Real Estate Institute based on GUS income data for 1997, updated to mid-1998 values.

Because these types of data are not available, either nationally or for gminas, we have prepared data suitable for “simulating” payment burdens for a variety of household income levels. An aggregate data series describing the distribution of net income for employed households in Poland was compared with various “typical” levels of rent, utility costs, and housing costs. The income distribution—average net income for three- and four-person households—is shown in Figure 8.1 and Table 8.1.[39] Note that in Figure 8.1 the income ceilings, expressed in terms of net income for the housing allowance program and for the TBS program, are juxtaposed on the distribution (refer to Annex I for a definition of these income ceilings).

[39]The income distribution is described in terms of the average income in each decile. This approach divides households, in this case all employee households of either three or four persons, into ten equal groups, equal, that is, with regard to the number of households in each group. The ten groups are ordered by level of income; thus, the average income for households in decile one is less than the average for decile two. Similarly, the average for decile two is less than that for decile three and all higher deciles. Average income for the entire group is also calculated.

For the purposes of this simulation, rent is calculated as a percentage of the replacement cost index for each voivodship.[40] This approach to rent is used for a number of reasons. First, there is no adequate data series for "market" rents in different areas of Poland. Second, in housing programs in Poland, including TBS and rent-controlled housing, rents are frequently defined in terms of this voivodship replacement cost index. The cost is then expressed as a monthly amount. Poland's housing programs generally use this approach: the rents for both rent-controlled housing (with a ceiling of 3 percent of replacement cost) and the TBS program (with a ceiling at 4 percent of replacement cost) are both defined using the replacement cost index.

The major outcome parameter of the analysis is rent burden; that is, the proportion of income that households spend on rent and utilities (gross rent burden). The analysis necessarily makes judgments as to whether rent burdens seem "acceptable" or "too high." The proportion of their income that households can—or should—pay for rent and utilities is a complex topic and is further discussed in Section 8.4.1. Under the current housing allowance formula, three- and four-person households contribute 12 percent of income. The discussion here generally assumes that this insert figure 8.1/table 8.1 page payment burden is too low, especially in comparison with other countries. Thus, in our discussion of the simulation results, rent burdens above 20 to 25 percent of income are considered "high" for low income households. At higher income levels, households are generally more able to exercise their preferences as to what proportion of income to spend on housing, as is seen in the TBS program, which is voluntary. Households are known to have widely differing tastes for housing, so declaring a benchmark level of rent burden as "high" for those in the upper-income deciles is not really meaningful; nevertheless, we will assume that a rent burden of 30 percent can represent a benchmark of sorts for higher-income households.

The details of the analysis are presented in Sections 8.2 and 8.3 and a summary of findings and recommendations in Section 8.4. Representative tables are included in this section of the report and in Annex I.

8.2 Analysis of Rent Burden and Poland's Housing Allowance Program

8.2.1 The Current Housing Allowance Program: Summary of Findings

As discussed in Section 4.0, rents in rent-controlled housing are, on average, currently very low in Poland, standing at just over 1 percent of replacement cost. Nevertheless, even at this level, households in approximately the lowest three income deciles would face high rent burdens without the housing allowance program. Furthermore, if rents were increased—to the 3 percent level, for example—roughly half of Poland's

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[40]The voivodship replacement cost index is expressed as a per square meter (sq. m.) cost. Households of three persons are assumed to have a unit of 50 sq. m.; households of four persons have a unit of 60 sq. m.

households would face somewhat high or extremely high payment burdens. The current housing allowance program is structured to assist many of these households. However, even with the type of extended eligibility ceiling that is apparently used in some gminas, the current program would leave a very significant “gap” in coverage if rents were increased to 3 percent. Thus, HUDA’s proposals to increase the income eligibility rules represent an extremely important policy reform. The details of the analysis are presented below; the major findings of the simulation for the current housing allowance program are summarized as follows:

- Without the assistance of the housing allowance program, major segments of the Polish population could not easily afford housing;

- Under the current housing allowance program, ineligible households (those just over an “extended” eligibility limit) face an affordability problem, especially if rents were increased to approach market levels. Rent increases would produce a gap in affordability for households that are above the eligibility level for the housing allowance program but that cannot afford to participate in a TBS program, where rents are generally 3 to 4 percent of replacement cost;

- Very large differences in the affordability problem exist across voivodships because of the large differences in rents. Although we have not “measured” these differences properly for lack of voivodship-level income and actual rent figures, the outcomes for households not eligible for the housing allowance appear to be inequitable; and

- Households of different sizes may not be treated equitably under the current housing allowance formula, basically because the relationship between the income eligibility ceiling and rent appears to be less generous for three-person households than for four. We have tried to adjust somewhat for this discrepancy (by applying differences in square meters and utility costs for the three- and four-person households), but this problem warrants further investigation.

8.2.2 The Simulation Model

The voivodships of Radom and Warsaw have been selected for detailed analysis in the simulation. Radom’s replacement cost index is roughly in the middle of the distribution of these indices nationwide, while Warsaw’s is the highest in Poland. Please refer to Table 8.2 and Annex I - Tables 2, 3, and 4, for a presentation of the rent burden analysis for Radom and Warsaw for three- and four-person households.[41]

[41] Also, Annex I, Tables 1a and 1b, show the replacement cost indices for all voivodships for the second and third quarters of 1998. Annex I, Table 7, presents a summary distribution of rent burdens for 3- and 4-person households in the Warsaw and Radom voivodships for a variety of income levels; rent burdens are calculated for rents of 1 percent, 3 percent, and 4 percent of replacement cost, assuming that the household does not participate in any subsidy program. This table can

As noted above, households currently participating in the Housing Allowance Program are required to pay 12 percent of income toward gross rent (rent plus utilities) regardless of rent level. Just as is done in practice for the current housing allowance program, the simulation model provides a "cushion" whereby households just over the eligibility limit continue to receive an allowance (which decreases as income increases). Thus, households slightly above the eligibility ceiling receive an allowance, but in amounts decreasing as incomes rise. These households are represented in the tables as being "13.5 percent over the ceiling." At a somewhat higher income level, the simulation assumes that households become "not eligible" and thus receive no allowance payment.

The main questions we wish to address are as follows: What happens to households just over the extended income ceiling?[42] What rent burden do they face? What rent burden is faced by households just above the extended housing allowance income ceiling who might wish to participate in a TBS program or find a private unit?

Radom. As shown in Table 8.2, for Radom households at the "13.5 percent over ceiling" point, rent burdens have increased from 12 to 15 percent. For households not eligible to receive any housing allowance, rent burdens are at reasonable levels only when rents are at 1 percent of replacement cost. For households just above eligibility, rent burden would increase to 30 percent if rents were increased to 3 percent. In fact, all households with incomes ranging from the extended income ceiling (PLN 1,740 for four persons) to the average income for decile VII would face high rent burdens if rents were raised to 3 percent.

Thus, to participate in a TBS program with rents at 3 percent of replacement cost, the "not eligible" households would have to pay a rent burden of 30 percent. If rents in TBS projects or private units were to be set at 4 percent of replacement cost, a household not eligible for the housing allowance would face a rent burden of 34 percent if it chose to participate in such a TBS program. Only at the average income for decile VIII does the rent burden drop below 25 percent.

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also be used as a baseline measure.

[42] As discussed in Annex I, the extended income ceilings used in the analysis were based on several factors. The current housing allowance program, in practice, continues to pay households a decreased allowance to at least 13.5 percent above the ceiling. For the revised program, HUDA has suggested that it will pay a decreased allowance at a per capita income PLN 50 above the ceiling, but the subsidy will cease as households reach PLN 100 above the ceiling. To make the comparison of the current program and the proposed revised program consistent, we have used both the "13.5 percent above" rule (which is about PLN 50 above the current limits) and the "PLN 100 rule" for analysis of both programs.

Table 8.2
HOUSING AFFORDABILITY BY INCOME GROUP
Radomskie Voivodship (Q2 1998)
(4 person household, 60 sq. m. flat)

Income Group	Net Income	Rent at 1%	Rent at 3%	Rent at 4%	Total Utilities	Rent Burden (1%)	Rent Burden (3%)	Rent Burden (4%)
Rent Burden for Households Not Eligible for Current Housing Allowance								
Current Income Ceiling								
PLN1388	1388	75	225	300	297	12%	12%	12%
13.5% over ceiling	1575	75	225	300	297	24%	33%	38%
Not eligible	1740	75	225	300	297	21%	30%	34%
Decile VI	1932	75	225	300	297	19%	27%	31%
Decile VII	2143	75	225	300	297	17%	24%	28%
Decile VIII	2533	75	225	300	297	15%	21%	24%
Decile IX	3139	75	225	300	297	12%	17%	19%
Decile X	5932	75	225	300	297	6%	9%	10%
Average Net Income	2170	75	225	300	297	17%	24%	28%
Rent Burden for Households Not Eligible for Revised Housing Allowance								
Income Group	Net Income	Rent at 1%	Rent at 3%	Rent at 4%	Total Utilities	Rent Burden (1%)	Rent Burden (3%)	Rent Burden (4%)
HUDA Revised Income								
Ceiling PLN 2082	2082	75	225	300	297	12%	12%	12%
13.5% over ceiling	2363	75	225	300	297	16%	22%	25%
Not eligible	2434	75	225	300	297	15%	21%	25%
Decile VIII	2533	75	225	300	297	15%	21%	24%
Decile IX	3139	75	225	300	297	12%	17%	19%
Decile X	5932	75	225	300	297	6%	9%	10%
Average Net Income	2170	75	225	300	297	17%	24%	28%

Note: Ineligible households are defined based on the "extended" eligibility formula described in Annex I.
Program eligibility limits are expressed in terms of net income.

The situation for a three-person household is even more difficult (see Annex I, Table 2). For a household at the extended eligibility level, rent burden has increased from 12 percent to 16 percent. However, for one just over the extended income ceiling of the current housing allowance program, participation in a TBS program with rent at 3 percent would require that the household spend 33 percent of disposable income on rent and utilities. If the rent in a TBS project were at 4 percent of replacement cost, this amount would increase to 38 percent. In fact, rent burdens would be quite high for all households with income less than the average for decile VIII.

In summary, rent burdens above some “acceptable” level—for example, 25 to 30 percent of income—extend as far up in the income distribution as the average for decile VIII when rents stand at 3 percent or 4 percent of replacement cost, whether in the private market or in a TBS program. *Thus, the majority of those households “not eligible” for the housing allowance but “eligible” for TBS would find it difficult (or impossible) to participate in a TBS program. They can find more reasonable rent burdens only when rents are less than 3 percent of replacement cost. This is our definition of the program “gap.”*

Warsaw. As would be expected, the results for the Warsaw voivodship—where replacement costs are the highest in Poland—paint a more serious picture (refer to Annex I, Tables 3 and 4). For four-person households whose income is just over the housing allowance extended eligibility limit, rent burden rises to 34 percent (for rents at 3 percent) and 40 percent (for rents at 4 percent). Again, the rent burdens calculated for three-person ineligible households are even higher: the corresponding figures for rent burden are 38 percent and 44 percent.

Thus, if rents reach 3 or 4 percent of replacement cost, as in TBS programs and as we recommend for rent reform, rent burdens still exceed an "acceptable" level for households in Warsaw with incomes as high as decile VIII. The problem in Warsaw may be more pressing than in Radom. *Clearly, then, there is a major program gap; furthermore, the gap appears to vary by geographic area.*[43]

Rent Burdens in Other Voivodships. To present a cross-section of rent levels in Poland, Tables 8.3 and 8.4 summarize the results of similar analyses for several other voivodships. We have selected seven voivodships in addition to Warsaw and Radom, including Chełm, which has one of the lowest replacement costs in Poland (refer to Annex I, Table 1a). The voivodships of Ostrów and Tarnów also have relatively low replacement costs, while Szczecin and Katowice face relatively high costs. Calculations have been made for situations in which rents are at 3, 4, and 6 percent of replacement cost; we included rents at 6 percent of replacement cost because according to some "rules of thumb," this level would be necessary to fully cover all current and capital costs (and to yield a profit in a rental building).

[43] Please refer, however, to the discussions in Section 8.2.4. As noted, we do not have an income distribution for households at the level of the voivodship. The average per capita wage is higher in Warsaw than elsewhere in Poland, which may serve to mitigate the affordability problem.

Table 8.3

Rent Burden Analysis by Varying Replacement Costs (4 person household, 60 sq. m. flat)

Rent Burden Analysis at Rent Set at 3% of Replacement Cost (Q2 1998)

Voivodship	Replacement cost	Rent (3%)	Total Utilities	Total Rent + Utilities	Income level at which rent burden =.25	Rent burden if ineligible for current housing allowance	Rent burden if ineligible for revised housing allowance	Rent burden if ineligible for TBS
Warsaw	1994	299	297	596	2384	34%	24%	17%
Szczecin	1837	276	297	573	2290	33%	24%	17%
Katowice	1763	264	297	561	2246	32%	23%	16%
Gdansk	1665	250	297	547	2187	31%	22%	16%
Radomskie	1502	225	297	522	2089	30%	21%	15%
Bielskie	1420	213	297	510	2040	29%	21%	15%
Tarnow	1351	203	297	500	1999	29%	21%	14%
Ostrow	1230	185	297	482	1926	28%	20%	14%
Chelm	1190	179	297	476	1902	27%	20%	14%

Rent Burden Analysis at Rent Set at 4% of Replacement Cost (Q2 1998)

Voivodship	Replacement cost	Rent (4%)	Total Utilities	Total Rent + Utilities	Income level at which rent burden =.25	Rent burden if ineligible for current housing allowance	Rent burden if ineligible for revised housing allowance	Rent burden if ineligible for TBS
Warsaw	1994	399	297	696	2783	40%	29%	20%
Szczecin	1837	367	297	664	2658	38%	27%	19%
Katowice	1763	353	297	650	2598	37%	27%	19%
Gdansk	1665	333	297	630	2520	36%	26%	18%
Radomskie	1503	300	297	597	2388	34%	25%	17%
Bielskie	1420	284	297	581	2324	33%	24%	17%
Tarnow	1351	270	297	567	2269	33%	23%	16%
Ostrow	1230	246	297	543	2172	31%	22%	16%
Chelm	1190	238	297	535	2140	31%	22%	15%

Rent Burden Analysis at Rent Set at 6% of Replacement Cost (Q2 1998)

Voivodship	Replacement cost	Rent (6%)	Total Utilities	Total Rent + Utilities	Income level at which rent burden =.25	Rent burden if ineligible for current housing allowance	Rent burden if ineligible for revised housing allowance	Rent burden if ineligible for TBS
Warsaw	1994	598	297	895	3581	51%	37%	26%
Szczecin	1837	551	297	848	3392	49%	35%	24%
Katowice	1763	529	297	826	3304	47%	34%	24%
Gdansk	1665	500	297	797	3186	46%	33%	23%
Radomskie	1503	451	297	748	2992	43%	31%	22%
Bielskie	1420	426	297	723	2892	42%	30%	21%
Tarnow	1351	405	297	702	2809	40%	29%	20%
Ostrow	1230	369	297	666	2664	38%	27%	19%
Chelm	1190	357	297	654	2616	38%	27%	19%

Note: Ineligible households are defined based on the "extended" eligibility formula described in Annex I.
Program eligibility limits are expressed in terms of net income.
(PLN 1740 at current limit; PLN 2434 at revised limit; PLN 3464 at TBS limit).

Table 8.4

Rent Burden Analysis by Varying Replacement Costs (3 person household, 50 sq. m. flat)

Rent Burden Analysis at Rent Set at 3% of Replacement Cost (Q2 1998)

Voivodship	Replacement cost	Rent (3%)	Total Utilities	Total Rent + Utilities	Income Level at which rent burden =.25	Rent burden if ineligible for current housing allowance	Rent burden if ineligible for revised housing allowance	Rent burden if ineligible for TBS
Warsaw	1994	249	248	497	1989	38%	27%	17%
Szczecin	1837	230	248	478	1911	37%	26%	16%
Katowice	1763	220	248	468	1874	36%	26%	16%
Gdansk	1665	208	248	456	1825	35%	25%	16%
Radomskie	1502	188	248	436	1743	33%	24%	15%
Bielskie	1420	178	248	426	1702	33%	23%	15%
Tarnow	1351	169	248	417	1668	32%	23%	14%
Ostrow	1230	154	248	402	1607	31%	22%	14%
Chelm	1190	149	248	397	1587		22%	14%

Rent Burden Analysis at Rent Set at 4% of Replacement Cost (Q2 1998)

Voivodship	Replacement cost	Rent (4%)	Total Utilities	Total Rent + Utilities	Income Level at which rent burden =.25	Rent burden if ineligible for current housing allowance	Rent burden if ineligible for revised housing allowance	Rent burden if ineligible for TBS
Warsaw	1994	332	248	580	2321	44%	32%	20%
Szczecin	1837	306	248	554	2217	42%	30%	19%
Katowice	1763	294	248	542	2167	42%	30%	18%
Gdansk	1665	278	248	526	2102	40%	29%	18%
Radomskie	1503	251	248	499	1994	38%	27%	17%
Bielskie	1420	237	248	485	1939	37%	27%	17%
Tarnow	1351	225	248	473	1893	36%	26%	16%
Ostrow	1230	205	248	453	1812	35%	25%	15%
Chelm	1190	198	248	446	1785	34%	24%	15%

Rent Burden Analysis at Rent Set at 6% of Replacement Cost (Q2 1998)

Voivodship	Replacement cost	Rent (6%)	Total Utilities	Total Rent + Utilities	Income level at which rent burden =.25	Rent burden if ineligible for current housing allowance	Rent burden if ineligible for revised housing allowance	Rent burden if ineligible for TBS
Warsaw	1994	499	248	747	2986	57%	41%	25%
Szczecin	1837	459	248	707	2829	54%	39%	24%
Katowice	1763	441	248	689	2755	53%	38%	23%
Gdansk	1665	416	248	664	2657	51%	36%	23%
Radomskie	1503	376	248	624	2495	48%	34%	21%
Bielskie	1420	355	248	603	2412	46%	33%	21%
Tarnow	1351	338	248	586	2343	45%	32%	20%
Ostrow	1230	308	248	556	2222	43%	30%	19%
Chelm	1190	298	248	546	2182	42%	30%	19%

Note: Ineligible households are defined based on the "extended" eligibility formula described in Annex I.
Program eligibility limits are expressed in terms of net income.
(PLN 1305 at current limit; PLN 1825 at revised limit; PLN 2931 at TBS limit).

The results are fairly striking. Under the eligibility rules of the current housing allowance program, rent burdens are very high in every voivodship for those just over the extended eligibility limit. For example, for households of four persons not eligible for the current housing allowance program, rent burdens extend from 34 percent in Warsaw to 27 percent in Chełm for rents at 3 percent of replacement cost. Midpoints in this distribution include Gdańsk at 31 percent and Bielski at 29 percent. If rents reached 4 percent of replacement cost, such as under a TBS program or in private units, the rent burden would range from 31 percent in Chełm to 40 percent in Warsaw. Finally, at 6 percent of replacement cost, rent burdens increase to 51 percent in Warsaw, 46 percent in Gdańsk, 40 percent in Tarnów, and 38 percent in Chełm. Once again, the results for three-person households are similar but even more pronounced.

8.2.3 The Housing Allowance/TBS "Gap" and Proposed Revisions to the Housing Allowance Eligibility Formula.

The team has stressed that rent reform may be the single most important step in HUDA's policy reform agenda. Sooner rather than later, rents should be increased at least to 3 percent of replacement cost, and the implications of this increase for housing allowance program eligibility must be made clear. Ultimately, as noted above, we assume that rents must be at market levels above 3 percent of replacement cost—and perhaps more suitably at 5 to 6 percent—to cover the full costs of both maintenance and capital repairs. Thus, on the basis of our analysis of nine representative voivodships, if rents for rent-controlled housing in some gminas, or rents in private units, were to reach 3, 4, or even 6 percent, the rent burdens implied for households just over the extended eligibility threshold for the current housing allowance would generally be infeasible. In summary, the findings of the simulation with regard to this situation include the following:

- Under almost any rent reform scenario, the current housing allowance program is inadequate to provide many households with assistance toward affordable housing;

- Most households whose income is just above the current housing allowance (extended) ceiling probably cannot afford to pay rent at levels that might be typical of TBS programs;

- The affordability problem is vastly improved with the new income ceilings proposed by HUDA for the housing allowance program. Thus, the revised housing allowance program is absolutely crucial to supporting rent reform; and

- Households whose income falls between the revised housing allowance ceiling (again, extended to provide a cushion of eligibility) and the current TBS income ceiling can generally afford to pay rent at levels that might be typical of the TBS program or the private market.

8.2.4 Simulation of the Revised Housing Allowance Program

HUDA has proposed increasing the eligibility limits to 150 percent of the minimum pension, up from 100 percent (which is the limit that applies in multiperson households). This revision would certainly be a major step in the right direction. (See the discussion in Section 8.4, however; the UIC team recommends an alternative housing allowance formula that would be more efficient and equitable.) Under HUDA's proposal, many of the serious affordability problems would disappear.[44] Put another way, the revised housing allowance program is crucial to supporting rent reform. Refer again to Tables 8.2 through 8.4 and to Annex I, Tables 2 through 4, for the results of the simulation model calculations for households eligible and not eligible for the revised housing allowance program. The rules for the gradual decrease in subsidy remain the same.

Radom. At the new income limits, for households that are not eligible and whose incomes are just over the eligibility ceiling, rent burdens are relatively low when rents are at 3 percent of replacement cost in Radom. At 4 percent of replacement cost, rent burdens reach 25 percent for households just over the extended ceiling and 24 percent for those at the average for decile VIII. In decile VI, for three-person households, rent burdens stand at 27 percent for those not eligible and 24 percent for those at the average income of the decile. Households in the highest income deciles, however, appear to be able to easily afford rents at a level common to TBS programs.

Warsaw. As expected, the picture is similar in Warsaw, although rent burdens are somewhat higher. Four-person households with incomes just above the revised eligibility limits face rent burdens of 24 percent (at 3 percent of replacement cost) and 29 percent (at 4 percent of replacement cost). Incomes must reach the level of the average for decile IX before rent burdens are much lower. For three-person households, the comparable rent burden figures are 27 percent and 32 percent. Again, incomes must exceed the average for decile VIII to achieve somewhat more acceptable levels.

Other Voivodships. The findings presented in Tables 8.3 and 8.4 indicate that when the housing allowance formula is liberalized—and thus we are dealing with higher-income households with regard to ineligibility for an allowance—the resulting rent burdens are quite reasonable for rents at 3 percent for all the voivodships. However, for rents at 4 percent, only Bielsk, Tarnów, Ostrów, and Chełm have rent burdens below 25 percent for four-person households. For three-person households, only Chełm has rent burdens below 25 percent. If rents were to stand at 6 percent of replacement cost, the range would jump accordingly, and rent burdens would generally be quite high in all the voivodships; thus,

[44] Annex I, Table 7, presents rent burdens for a variety of income levels assuming that there are no subsidy programs (or that households do not participate). The table reemphasizes the results discussed above: without a housing allowance, and without revisions to it, rent burdens are onerous for some even at low levels of rent, and would become infeasible under rent reform.

households would need to seek less expensive options, such as TBS programs or private units with a lower market price. Finally, at an income just above the TBS eligibility level, most households could find affordable housing with rents at just above 4 percent; at 6 percent, rent burdens also seem acceptable for this income group.

In summary, the affordability gap has shrunk very considerably with the introduction of the revised housing allowance formula. Only in certain high-cost areas would households not receiving a housing allowance face difficulties with rents at typical TBS levels. At rent levels above the TBS limits of 4 percent, however, affordability is more limited; this situation points to the need for TBS-type programs as rents shift toward market levels.

8.3 Purchasing a Home with a DIM Loan

This section discusses the affordability issues posed with regard to purchasing a new or existing home or apartment in any of 15 urban areas of Poland today. On the basis of various assumptions about a household's own resources and a DIM (dual index mortgage) loan, we have simulated the cost of purchasing various types of new or existing housing in Warsaw, Szczecin, Poznań, Bydgoszcz, Płock, Olsztyn, Łódż, Białystock, Lublin, Kraków, Kielce, Rzeszów, Częstochowa, Katowice, and Wrocław (refer to Annex I, Tables 10 through 15).

At present, there are no systematic data indicating free market house and apartment sales prices, either nationally or in major urban areas.[45] We have therefore used some "typical" options for new and existing apartment and house prices.[46] We have focused on moderate- and upper-income households, basically the top half of the income distribution for employed households. The loan-to-value ratio is a key variable in the analysis. This is the ratio of the amount of the bank's mortgage loan to the price paid for the house or apartment. The difference between the loan and the price is the value of the household's cash downpayment. The assumptions of the analysis are as follows:

- The mortgage loan used by the would-be purchaser is a DIM typical of Polish lenders. Under most assumptions, the DIM loan is more "affordable" than other options in the market;[47] and

[45] UIC is currently working with the Polish Banks Association on a report on appraisal and valuation information systems that examines information systems in the United States and provides recommendations for Poland. We feel that it is important that both public agencies and private companies begin a process that would make such data widely available. See Mark Bates, David Dale-Johnson, and W.J. Brzeski, "Property Evaluation and Appraisal: U.S. Information Systems and Recommendations for Poland," Urban Institute Consortium for USAID/Warsaw, forthcoming in 1999.

[46] The data were prepared by the Kraków Real Estate Institute, based primarily on information published in newspapers and the personal knowledge of market experts. See also Malwina Buszko. "An Expensive Small Apartment," *Gazeta Wyborcża*, October 6, 1998.

[47] The terms for the DIM are as follows: the maximum credit available is 25 times monthly income, the monthly payment begins at 1.2 percent of the loan amount, and together these terms yield a payment burden of 30 percent of income. This DIM formula is currently the requirement of the Mortgage Fund. Other DIM loans may be available in the market

- We have assumed three levels of loan-to-value (LTV) ratios: 50 percent, 60 percent, and 75 percent. At an LTV of 50 percent, the prospective purchasers would have contributed an amount of own funds equal to the DIM loan. At an LTV of 75 percent, the total available for home purchase is less, because the DIM credit represents three-fourths of the funds, rather than one-half.

8.3.1 Summary of Findings

The major policy question to be addressed is whether, and under what circumstances, affordable housing exists for higher-moderate income households, that is, those who might wish to purchase a modest unit. The highest income households in Poland are assumed to have a reasonably wide variety of options under most circumstances. The more pressing issue is whether housing could be made affordable to households of moderate (e.g., deciles V and VI) and higher-moderate (deciles VII and VIII) income. The findings suggest that in some cities housing is more affordable to a wider income group than may generally be assumed. However, this conclusion is predicated on three assumptions: (1) that the households have a large cash down payment, (2) that they qualify for a mortgage loan, and (3) that they opt for a 30 percent payment-to-income ratio. Our findings include the following:

- The prices of new and existing apartments and new single-family dwellings vary dramatically from city to city. In our sample of cities, Łódż, Bydgoszcz, and Olsztyn have the lowest prices while Warsaw, Poznań, and Kraków generally have the highest. As would be expected, new apartments are generally more expensive than existing dwellings;[48]

- Moderate-income households (and those just exceeding the extended eligibility for the current housing allowance program) cannot afford to purchase a new or existing apartment except at the lower cost level and with a down payment of 50 percent. Because these same households cannot afford rents at typical TBS levels, *the program gap and the necessity of expanding the housing allowance program must be reemphasized as important issues*;

- However, if supported by an ample down payment of 25 to 50 percent and financed with a DIM loan, housing is perhaps more affordable to higher-moderate income households than generally recognized. In many of the cities,

at slightly lower monthly payment rates. However, UIC's analysis of the risks inherent in DIM loans suggests that 1.2 percent is a preferred level. Thus, we have used this more conservative parameter. See Loïc Chiquier, "Dual Index Mortgages (DIMs): Conditions of Sustainable Development in Poland," Urban Institute Consortium for USAID/Warsaw, February 1998.

[48] However, note that in the data series cited for new and existing homes in 15 cities, prices in Warsaw and Bydgoszcz for existing apartments exceed that for new units. We do not assume that our data are a statistically valid distribution of prices; however, there is nothing incorrect about such an inverse relationship at a particular point in time, especially if existing units exhibit quality or locational characteristics that make them especially desirable.

new or existing modest apartments appear to be affordable to these households. Thus, if the housing allowance program were revised, those households not eligible at the revised, higher income limits, could often afford to purchase a small (50 to 60 sq. m.) apartment in the lower-cost areas in Poland;

- Nevertheless, many households will not be able to provide such a large down payment. At the less generous LTV of 75 percent, only households in the higher income brackets (deciles VIII to X) can generally afford to purchase an existing apartment, and only those in deciles IX and X can purchase new apartments throughout the urban areas of Poland; and

- As noted, DIM loans are the most affordable mortgage products on the market in Poland today. Payment rates for other loan types are roughly twice as high; thus, it is important to note that our affordability findings would be greatly altered for other loan types.[49]

8.3.2 Purchase of New and Existing Apartments in 15 Cities in Poland

Annex I, Tables 10 through 13, present detailed findings regarding purchase of new or secondary market apartments (of 50 sq. m. and 60 sq. m. for households of three and four persons, respectively) under LTV assumptions of 50 percent and 75 percent. All households in decile X can afford new or existing units in all the cities cited. Households in decile IX can generally purchase an apartment with an LTV of 50 percent; even with an LTV of 75 percent, these households can purchase an apartment in most cities.[50]

However, the results for households with incomes in decile VIII and below become more sporadic and much more dependent on the LTV ratio and the cost profile of specific cities. For example (see Table 10), with just a few exceptions, households with income in decile VIII and an LTV of 50 percent can afford a new unit; however, households in decile VII can afford new apartments in only one-third of the cities. If the LTV reaches 75 percent, even households in decile VIII cannot generally purchase new units.

With regard to existing units, however, the picture is much improved, as even decile VI households with a 50 percent LTV can buy a unit in the secondary market in half the cities in our example (and three-person households purchasing 50 sq. m. generally fare better than four-person households, which, we assume, purchase 60 sq. m.). With an LTV of 50 percent, only in Warsaw is housing too expensive for those in decile VIII. In lower-cost cities, such as Płock, Kielce, and Łódż, existing housing is affordable for a wide group

[49] The payment rate (ratio of first month's payment to income) used for the DIM is 1.2 percent. Comparable payment rates are 2.8 for a variable rate loan and 2.2 for a fixed (annuity formula) payment (which usually begins lower than the full debt payment service of the variable rate loan). As noted, the DIM formula comes from the current requirements of the Mortgage Fund; the others derive from commercial bank products currently on the market.

of income levels if they have a large down payment. Without a large down payment, however, only the two higher-income groups can generally purchase existing units in most cities.[50]

Finally, we pose a similar question: How do higher-moderate income households fare in the market for new or existing apartments? We develop the answer using the following framework: how many square meters could be purchased under various cost assumptions about PLN per square meter? Two cost levels typical of prices for modest units are analyzed: PLN 1,300 per sq. m., a modest cost level, and PLN 1,800 per sq. m., a somewhat higher building quality standard. Again, the household obtains a DIM loan with the same assumptions about LTV and so forth (see Annex I, Table 14).

The results highlight the affordability problem in a very concrete manner. Subject to two very important assumptions—that modest units are available at the lower price of PLN 1,300 per sq. m. and that households can provide large down payments—modest-sized units could be affordable to households with incomes as low as those in deciles V and VI. Thus, in areas where apartments are available at a modest cost, moderate-income households can purchase a unit of 50 to 60 sq. m. with a down payment of 25 to 40 percent of the cost.

In areas where somewhat higher market prices prevail (that is, PLN 1,800 per sq. m.), a decile VI household needs a down payment of 50 percent to obtain a 54 sq. m. unit. With a 25 percent down payment, only households with income somewhat above decile VIII can purchase a 50 sq. m. unit.

In summary, it is important to note that many of the households represented in Annex I, Table 14, can, in fact, purchase a modest apartment in cities where moderate building costs prevail. However, higher-cost cities such as Warsaw, Poznań, and Kraków may be barred to the majority of households who lack substantial funds for a down payment. Several suggestions are noted below for subsidy policies that would assist moderate income households to purchase modest apartments.

8.3.4 Purchase of New or Existing Modest Apartments with a First-time Buyer Subsidy

The UIC team has previously recommended a grant approach to assist qualifying buyers—those who are purchasing a home with a mortgage loan—with their down payment; this approach to subsidy policy can be well targeted, efficient, and reasonably progressive.[51] The government has recently developed a proposal whereby a "First

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[50] We could increase the payment burden above 30 percent for the highest income households. Some banks may choose to do so, but we have modeled the more conventional practice of 30 percent.

[51] See the discussions in Sections 2.0 and 8.4 of this report.

Apartment" program would replace the house construction tax break.[52] The plan would provide a subsidy of PLN 6,900 for households who do not already own a dwelling, who have not taken advantage of a previous construction tax break, who do not benefit from tax breaks in a contract savings program, and who will take out a bank loan to help finance their home.

To illustrate the potential of such a program, we have examined the impact of this subsidy on the ability to purchase a modest apartment, using the range of prices from the analyses discussed above. In Annex I, Table 15, we have replicated the analysis in Annex I, Table 14, and added the PLN 6,900 subsidy calculation to the total available funds. The subsidy could help either by increasing the size of the unit that could be purchased or by reducing the amount of down payment required. At a housing cost of PLN 1,300 per sq. m., the "First Apartment" subsidy essentially finances 5.3 additional sq. m. of space. This is a significant addition—more than 10 percent—for apartments of 50 sq. m. At the moderate price level of PLN 1,800, the subsidy would add 3.8 sq. m., and at PLN 2,200, it would add 3.14 sq. m.

When housing costs PLN 1,300, the subsidy helps even households in decile V to purchase a small unit; only the lower-cost option is feasible for decile V households, but the subsidy can assist households to obtain a larger unit or to meet the LTV ratio. Households in decile VI can manage at the lower cost with an LTV of 75 percent. Finally, by decile VII, the subsidy helps would-be buyers purchase a unit at the higher cost (PLN 1,800) with a down payment reduced from 50 to 40 percent.

8.3.5 Purchase of New Single-Family Homes

Finally, we look at a range of prices for new single-family houses in four urban areas, ranging from a high-cost, high-quality dwelling in the Mokotow area of Warsaw to a more modest dwelling and lot in Łódż (refer to Annex I, Tables 16 and 17). Because of the wide variations that tend to exist in the quality, size, and locational amenities of single-family homes, it is even more difficult to reach firm conclusions on affordability for such homes than for apartments. The examples used in the simulation attempt to cover a wide range of possibilities, but we have no data to tell us where these prices fall in the actual distribution of new home prices in Poland. The examples are as follows:

— Łódż:	PLN 111,250
— Poznań:	PLN 175,000
— Warsaw, Bielany:	PLN 275,000
— Warsaw, Mokotow:	PLN 375,000

[52] *Polish News Bulletin*. October 7, 1998, 190–98.

In Poznań, for example, a household with the average income of the decile X has more than enough funds to purchase the PLN 175,000 dwelling under all three LTV assumptions. However, the other income groups cannot make the purchase even with an LTV of 50 percent. For example, with the average income of the decile IX and an LTV of 60 percent, the household could purchase only 75 percent of this specific single-family home.

In Łódż, in contrast, households in both deciles IX and X could purchase the PLN 111,250 dwelling at nearly all the assumptions for LTV. A household in decile VIII can purchase the home if it can provide a down payment of 40 to 50 percent.

The results for Warsaw are illustrative of the city's growing pains. Warsaw is a high-cost area, presumably with some supply shortages despite the high level of construction in evidence. Representative data collected on house and lot prices have two characteristics that are particularly evident in Warsaw: (1) immense variation across various districts and suburbs and (2) immense variation in the apparent quality and price of the houses and lots.

In any event, in Warsaw, not even the highest-income households in our analysis can purchase the very high cost home in Mokotow. The best that a household with the average income of the highest decile can manage is 79 percent of the purchase price, even at an LTV of 50 percent. In Bielany, such a household could purchase the PLN 275,000 home with a down payment of 50 percent. Similarly, given that prices of some existing apartments in Warsaw are reputed to be PLN 3,000 per sq. m. (see Annex I, Table 10), an apartment of 60 sq. m. would cost PLN 180,000, which is within reach only of the highest income category.

8.4 Summary of Findings from the Simulation Model and Policy Recommendations

8.4.1 Summary of Findings

The simulation analysis has concentrated primarily on two types of households: those who are (or will be) dependent on the housing allowance, especially if rents begin to increase, and higher-income households considering other options in the housing market, such as participating in a TBS project or purchasing a new or existing home. The key findings may be summarized as follows:

- **The Housing Allowance Program and Rent Reform.** Depending on the circumstances of the key variables in the simulation—household income, the program eligibility limits, the level of rent, and the level of utility payments—the simulation has clearly shown that for households caught in the program gap between the current housing allowance program and most other options for renting or purchase, rent burdens can range from somewhat difficult to clearly infeasible as an element of a household's budget, especially under rent reform. The proposed revisions to the housing allowance would be of great assistance.

- **Home Purchase and TBS**. Depending on income, LTV, the cost of new construction, and the geographic location, households of more moderate income as well as those of higher income may be able to purchase modest existing or new apartments with a DIM loan. This assumption is predicated, however, on the household being able to assemble a large cash down payment and qualify for a DIM loan. Households that cannot provide a sufficient down payment and, in addition, are above the eligibility limits for a TBS-type program may face difficulties finding affordable housing. This is another type of program gap wherein new types of subsidy intervention could be defined to help encourage an increase in housing supply.

8.4.2 Recommendations

On the basis of the simulation analysis, we have been able to strengthen and clarify a number of the recommendations presented in previous sections of the report. Our recommendations include the following:

- The housing allowance program should be expanded as soon as possible according to HUDA's plan to allow rent reform to proceed in Poland. Every attempt should be made to show to gminas that a revised housing allowance will indeed provide an adequate social safety net;

- Ultimately, the formula used for the housing allowance should be altered in two major ways:

  — The level of household contribution should be increased, and

  — The concept of "fair market rent" should be introduced to achieve equity in treatment under different rent and income profiles;

- New subsidy programs, such as mortgage insurance and grants to first-time home buyers, could assist moderate-income households that have assembled some resources but whose down payments are still insufficient to purchase modest units. The GOP's "First Apartment" proposal is an example of this approach; and

- To encourage home purchase and develop a stronger supply response, every effort should be made to reduce interest rates—both the nominal rate and the real rate—by reducing the rate of inflation and by ameliorating the impact of factors that cause real rates to be high, such as the legal and administrative barriers outlined by HUDA, some of which are discussed in this report. *It is likely that reducing lending rates by a significant amount would have more impact on housing than any of the subsidy programs.*

8.4.3 Revisions to the Housing Allowance Program

The housing allowance program should become Poland's "flagship" subsidy program. It can be equitable, well targeted, and, combined with rent reform, will lead Poland on a more dynamic path toward market-based solutions to housing supply. However, the housing allowance program must be made more generous if rents are to be raised. Without greatly improved coverage, rent burdens would become intolerable for many households, a situation that would continue to block rent reform.

HUDA's proposed revisions to the housing allowance formula are a good starting point. However, we recommend two revisions to the formula, both of which could be implemented gradually. First, the level of household contribution to gross rent should be increased. Second, ultimately, eligibility for the program should be tied to a "fair market rent level" rather than to specific income limits.[53] These concepts are briefly described below.

Household Contribution Level. The selection of a contribution rate for the household's share of gross rent payments in the housing allowance program is a complex issue, but one that certainly demands further analysis.

As indicated above, the team considers the current level of 12 percent too low. In order to determine what level might be appropriate, three issues should be addressed:

— What proportion of their income are households now paying for rent and utilities?

— What levels of contribution are in effect in housing subsidy programs elsewhere in the region, in Europe, and in the United States?

— Should the contribution rate differ by level of income and/or household size?

Few or no data are available to provide a detailed look at what households in Poland are actually paying for rent and utilities. The data used in the simulation analysis

[53] Refer to the forthcoming UIC report by Sally Merrill, Harry Garnett, Rebecca Lawrence, Wanda Urbanska, Edward Kozłowski, and Jacek Łaszek, "Local Government Rent Policy and Best Practice in Poland: The Need for Rent Reform and an Improved Housing Allowance Program," prepared by Urban Institute Consortium for USAID/Warsaw. The recommended changes to the formulas are discussed at greater length in this new report.

can provide a first step, however. Thus, assuming that rents in Poland are, on average, at about 1 percent of replacement cost, households not eligible for an allowance are paying at least 21 to 25 percent of net income. This range would probably be much broader if we had data on income at local levels. Similarly, for households that have chosen to participate in TBS programs, the minimum contribution levels (that is, at the income ceiling for TBS eligibility) would be between 14 and 17 percent if rents were at 3 percent of replacement costs. If rents were at 4 percent, contribution levels would be about 15 to 20 percent at the maximum income. And finally, because many households participating in TBS have incomes less than the ceiling amount, the contribution levels, on average, must be higher than this amount. To use one of the simulation parameters, for households just over the eligibility levels for the proposed revised housing allowance, contribution levels would range from 22 to 27 percent for rents at 3 percent and from 24 to 32 percent for rents at 4 percent. *Clearly, most rent burdens in Poland exceed 12 percent; furthermore, many households in Poland have freely chosen to accept higher contribution levels to obtain preferred housing*.

Programs similar to Poland's housing allowance are in place in many countries. Direct comparisons must be done carefully because of differences in the program definitions for income (gross or net) and rent (with or without various utilities). In any event, the comparisons indicate that the contribution rates in developed countries are much higher than in Poland; in the NIS region, the contribution rates are somewhat higher.

In the United States, the housing voucher program is formulated so that households must pay 30 percent of adjusted income (somewhat similar to net income in Poland) for gross rent. In Germany, households pay up to 28 percent of income on rent, but excluding utilities. Thus, gross rent burden in Germany is presumably higher than 28 percent. Russia's housing allowance program built in a gradual increase in the contribution rate, which began at 10 percent in 1994 and increased to 20 percent in 1998. In Szolnok, Hungary, the city set the maximum contribution at 35 percent for rent and utilities. The housing allowance program designed for Slovakia, which has not yet been implemented, planned for a contribution rate of 20 percent.

The housing allowance program in Estonia varies the contribution rate by both the number of household members and the level of income. The household contribution rates range from 15 to 30 percent for one-person households, from 14 to 30 percent for two persons, from 12 to 30 percent for three persons, and from 10 to 28 percent for four persons.[54] Thus, the formula in Estonia addresses the third question above—should the contribution level vary by level of income and household size? Given the relatively low

[54]Data on programs in the region are drawn from two Urban Institute publications: Raymond Struyk, ed., 1996, *Economic Restructuring of the Former Soviet Union: The Case of Housing*, Washington, DC: Urban Institute Press, and Maris Mikelsons, "Other Country Experience with a Consumer-Based Housing Subsidy," Annex A of "Housing Allowance Design: An Evaluation for Slovakia," Urban Institute report prepared for USAID, December 1996.

income levels in Poland, it is likely that the answer might be yes, because low-income households may require a lesser contribution to ensure that the remaining necessities in their household budgets are affordable.

Revising the Formula to Reflect Fair Market Rent. In Poland, inequities having to do with differences in rent and income arise from the income-based eligibility formula. The formulation is entirely centrally derived, whereas rent and income—and the relationship between them—vary greatly in urban and rural areas and in different regions. Worldwide, the preferred design for housing allowance programs is now based on some concept of “fair” or “socially acceptable” rent. In the United States, this parameter is known as fair market rent (FMR); in Germany, it is called socially acceptable rent; in Estonia, Hungary, and Slovakia, it is called the maximum social rent. The common theme is that this rent level reflects the cost of modest standard housing. In the United States, this concept is rigorously defined, and detailed data are assembled to compute the FMR for small geographic areas.[55] The formula is a so-called gap formula, whereby the housing allowance is computed as follows:

— Housing Allowance = FMR—@ × Income where
— FMR = gross rent (rent + utilities) defined for small geographic areas (to capture variations in rent levels), and
— @ = the household contribution rate
— Income = adjusted household income.

This type of formula would treat households equitably with regard to their rent burden in the face of geographic variation in rent. In other words, currently in Poland, in very high rent areas versus low rent areas, households that are not eligible for an allowance face a very different degree of affordability. Under HUDA’s revised proposal, this situation would not be corrected. Under an FMR approach, the allowance becomes zero not when an income ceiling is reached, but rather when the cost of modest standard dwellings equals the household’s contribution.

The problem with this formula for Poland in the immediate future is that the requisite data are not available to compute a rent level equivalent to an FMR. It may be possible, however, to gradually adjust the formula using the replacement cost index until more data on market rents are available.

8.4.4 Subsidy Programs for Home Buyers

For households in approximately the deciles VI through VIII or IX, becoming a homeowner is feasible under a variety of cost profiles. However, the analysis has shown

[55]The FMR in the United States reflects the median gross rent charged for standard units (decent, safe, and sanitary according to a prescribed set of characteristics) in the applicable country or standard metropolitan statistical area.

that the down payment requirements can be extremely high. This group of households also includes those ineligible for TBS programs but facing difficulties purchasing even modest units.

The GOP, as discussed above, has already proposed an alternative subsidy program—the “First Apartment” Program—designed to replace subsidies based on tax benefits. The program proposes to set a level of PLN 6,900, subject to a variety of eligibility requirements. It does not take into account the level of housing prices.

Another possible approach to subsidizing qualifying would-be home buyers is government-sponsored mortgage insurance such as that developed in the United States (e.g., the Ginnie Mae program) or in Canada, where mortgage insurance is a very important aspect of home buyers’ calculation of affordability.[56] In these types of insurance programs, the government shares the risk of underwriting a mortgage loan with the originating bank; it does so by guaranteeing a “band” of the LTV ratio such that the LTV can be higher than the bank would wish to offer a particular moderate-income home buyer. In other words, this program enables the prospective home buyer to obtain a larger loan and provide less cash down payment. If both the government and the bank are reasonably sure that this borrower can service the larger loan, the program can greatly facilitate home purchase for those with adequate income but lacking large down payments.

In conclusion, the team supports the types of subsidy programs represented by well-targeted grants and shared public/private guarantees. Designed for relatively higher income levels, such interventions could be extremely useful additions to Poland’s housing allowance and TBS programs and perhaps less costly than the proposed tax benefit program. Both can improve affordability. Both have the potential to be efficient: recall the discussion in Section 2.0, where efficient is defined as more “bang for the buck” in increasing housing supply. In other words, such subsidies are directed at households that require only a marginal additional input in order to be able to afford to purchase a unit with a mortgage loan.

[56] See the recent UIC study by Roger Blood, “The Prospective Role of Mortgage Insurance in Support of Housing Finance in Poland.”

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ANNEX I: APPROACH TO THE SIMULATION ANALYSIS AND ADDITIONAL TABLES AND DATA USED IN THE SIMULATION ANALYSIS

As discussed in Section 8.0, we have prepared data suitable for "simulating" rent burden for at different levels of household income under a variety of housing cost scenarios. An aggregate data series describing the income distribution for employed households in Poland was compared with various levels of rent, utility costs, and housing costs. The simulation analysis requires data for household income, rents per square meter (sq. m.), utility costs per sq. m., a typical range of prices for new and existing apartments and single-family houses, the income eligibility criteria for the current housing allowance and TBS programs, and HUDA's proposed criteria for a revised housing allowance program. The data series represent a variety of time periods for 1997 and 1998. We have attempted to make all data consistent for a time frame of mid-1998; thus, the indices used to update several of the series are also noted below.

National Income Data. Income data as currently collected in Poland do not readily lend themselves to analyses of this type. The data are generally available for "social groups" (employees, farmers, self-employed, pensioners, and so forth) rather than as a national distribution and are typically derived per person rather than per household.

The household income distribution was developed by the Cracow Real Estate Institute based on 1997 GUS data for employees' "average net income" (income after taxes) by decile; the per capita data have been transformed into household-level income for households of three and four persons and updated to values representing mid-1998. The data are presented in Table 8.1 in the main text. The data describe average net income overall and for each decile for employees households of three and four persons.[57] The data, which represent the average monthly values for 1997, have been adjusted to reflect mid-1998 via an income index specific to employees from a GUS index series.[58]

The adjustment to create household-level data by decile (from per capital income data) has been done for employees only; as noted, the only other group for which this type of adjustment would have been possible was the "retired and pensioners" group. However, as shown in the table below, the average per capita figures for these groups were nearly identical; also, we wished to concentrate on younger, mid-sized households, which are perhaps most likely to be seeking alternative rental or homeowner accommodations. It is

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[57] Source: "Households—selected elements of living conditions of the population in 1997," Information and Statistical Papers, GUS, Warsaw, 1998, Table 4. GUS provided the structure of income distribution by deciles in percent for only two groups of households—employees and retired persons and pensioners.

[58] "Statistical Bulletin," GUS, Warsaw, August 1998, Table 56:

	Jan. - June 1997	Jan. - June 1998	Increase
Total	412.69	500.07	121.2
Employees	436.39	527.16	120.8

also clear, however, that our analysis will not be fully applicable to self-employed households, whose incomes are much higher, nor to rural households, whose income structure and housing options both differ from those of the employee group.

Average Monthly Per Capita Disposable Income by Socioeconomic Group

Socioeconomic Group	1996 (in PLN per month)	1997 (in PLN per month)
Total	383.33	473.79
Employees	401.33	486.41
Employees—Farmers	326.82	397.74
Farmers	343.19	439.28
Self-employed	487.69	618.39
Retired and Pensioners	402.46	494.64
Unearned Sources	192.17	232.52

Source: "Households: Selected Elements of Living Conditions of the Population in 1997," Information and Statistical Papers, GUS, 1998.

Income Eligibility for the Housing Allowance and TBS Programs. The key parameters for comparison with selected points on the income distribution are the income eligibility ceilings for the current housing allowance program, the proposed revised housing allowance program, and the TBS. As noted, the income data in the simulation represent "net" income — that is, after income tax and several other more minor adjustments. Gross income data would have been preferable, especially to facilitate comparison with the program eligibility limits for the housing allowance and TBS programs; however, gross income data were not available for the decile structure that we wished to use. Therefore, an adjustment must be made to the program eligibility ceilings used in the analysis to make them more "comparable" to the income data. The ceilings are used in the actual programs are pre-tax; we have adjusted them downward as discussed below.

Eligibility for the housing allowance program is determined from the value of the minimum pension, which is calculated as 39 percent of the average salary. This value (39 percent of the average monthly salary) was PLN 394.3 for the period March—August 1998, and this is the figure used in the simulation to determine eligibility (for three- and four-person households, the average pension is simply multiplied by 3 or 4). However, for this figure to be compared with the income distribution, it must be transformed into a value more consistent with net income. A study undertaken by the Ministry of Finance indicates that the average difference between gross and net income for the lowest tax bracket (the one relevant here) was 12 percent in 1996.[59]

[59] Ministry of Finance, Treasury Bulletin, No. 6, 1997.

HUDA has proposed increasing the Housing Allowance eligibility ceiling to 150 percent of the lowest pension for multiple-person households. The calculation remains the same in other respects. This revised figure was also reduced by 12 percent to make it more comparable to net income.

The other adjustment made to the housing allowance ceiling was to increase it to reflect the “cushion” in receiving a reduced allowance before being declared ineligible. As discussed in Section 8, the current housing allowance program continues to pay households an allowance when they are slightly above the ceiling. The excess amount of income over the income ceiling is deducted from what the housing allowance would have been at the ceiling to yield the reduced subsidy amount.

In the proposed revisions for the housing allowance, this cushion approach will apparently be continued. HUDA indicated in conversations with the UIC team that at PLN 50 above the ceiling, a household would continue to receive an allowance, but at PLN 100 above, the allowance would cease. We have adopted this rule in our calculations to create an income level that receives less than the full subsidy. The PLN 50 excess mentioned by HUDA is roughly 13.5 percent above the present ceiling. Thus, we have used an income level of “13.5 percent above the ceiling” in the simulation to represent the gradual decrease in allowance payments. At PLN 100 over the ceiling, we have assumed the household receives no subsidy. The same approach was employed for both the current program and the (proposed) revised program.

The TBS eligibility limit is based on the average wage in Poland; for purposes of calculating eligibility for TBS, GUS announces this figure in the first and third quarters of each year and does not update it for inflation between the announcements. Thus, we used the average wage for the first quarter of 1998; in addition, we used the average for Poland, not for each voivodship, as is done in practice. (The eligibility formula is 1.3 times the average wage, plus 20 percent extra for a single person household and 80 percent for a two person household.) However, just as for the housing allowance ceiling, the TBS eligibility ceiling must be adjusted to represent net income, so as to better reflect a net value rather than a gross value. Since the TBS ceiling is at a somewhat higher income level than the housing allowance ceiling, though it is still in the same tax bracket, and since there is a positive correlation between household income and the relative size of tax deductions, we adjusted the ceiling (somewhat arbitrarily) downward by 15 percent rather than 12 percent.

Voivodship-Level Income Data. From an analytical viewpoint, voivodship-level income data would be most desirable, since both income and rent vary greatly by voivodship. Comparing national data with voivodship rent data is likely to introduce unknown distortions into the analysis of rent burden. Section 8 briefly describes the only recent voivodship data available—monthly per capita wages for public administration employees (for the first quarter of 1998, the most recent available). These data are not compatible with the employee data we have used nor with our household-level data; we have therefore not used them in the analysis. Just to illustrate the problem, however, we cite here some of the large differences seen across voivodships (Poland overall PLN 1,206, Warsaw 1,616, Kraków 1,172, Radom 977, Tarnów 1,026, Toruń 989, and Katowice

1,373). We recommend that HUDA obtain from GUS a more representative data series, if possible, and extend the analysis here to the voivodship level.

Rent Data. There is no adequate data series for "market" rents or house prices in different cities or rural areas of Poland. Lacking this information, we used the index of replacement costs (expressed per square meter) to estimate rent. This series has the advantage of being available by voivodship and of being updated every quarter. For the purposes of the simulation, households of three persons are assumed to have a unit of 50 sq. m. and households of four persons to have a unit of 60 sq. m. The data used here, presented in Annex Table 1a, are for the second quarter 1998. In some voivodships, data for the third quarter are also available (Table 1b). We used these data only to illustrate various shifts in the index; however, the second quarter data are considered a closer match to our other data series.

Rents in Poland are frequently expressed in terms of replacement cost. Poland's housing programs use this index; the rent ceilings for both rent-controlled housing (at 3 percent of replacement cost) and the TBS rent ceiling (at 4 percent of replacement cost) are both defined using the index. In terms of our analysis, however, the replacement cost data have the serious disadvantage of representing "construction cost" rather than "market rent." As Poland continues its shift to a market economy, actual rents and construction costs will relate to each other differently in areas with different demand and supply parameters. Thus, although it is of unknown magnitude, the bias introduced by using cost data must be taken into consideration.

Utility Data. Calculation of utility costs was based on data regularly collected by the Housing Research Institute. In 1997, the average utility costs per sq. m. in Poland were PLN 2 for heat and PLN 2.11 for the other utilities. These figures were updated to mid-1998 using a GUS price index for utilities. The index for June 1997 was compared with the index for June 1998. Thus, heat was increased by 25.6 percent and the remaining utilities by 15.5 percent, which is the average change for electricity (at 14 percent) and gas (at 17 percent). As described in Section 8, we have also presented an example of rent burden using current utility charges from communal housing in Warsaw Centrum.

The Impact on Rent Burden of Alternative Estimates of Utility Cost, Income, and Rent. A simulation analysis is obviously sensitive to the choices made for selecting the key variables in the analysis. A number of issues are involved, including comparable time frames, comparable geographic areas, the level of detail by geographic area, and urban/rural differences. For example, although rents vary by voivodship, we do not have comparable variation in our data for utility costs or income. Furthermore, replacement cost is not necessarily a good proxy for market rent, but we have used it because it is a consistent variable for all voivodships and is updated every quarter. Also, although we have attempted to align all variables to represent approximately the middle of 1998, it is not always easy to find ideal or comparable inflation indices. The discussion below tests a variety of these assumptions with alternative data on utilities, income, and rent in order to provide a very limited type of sensitivity analysis of the model's assumptions.

- **Utility Costs**

  After having increased in recent years, as noted in Section 4.0, utility costs are now a significant portion of total housing expenditure for many Polish households. On the basis of estimates made by the Housing Research Institute, average utility costs for a modern unit were PLN 4.11 per sq. m. in 1997.[60] These figures were updated to mid-1998 by using an inflation index for utility costs and the simulation model has relied on this figure for all the findings discussed thus far. However, because there is considerable variation in utility costs for different housing types—cooperative, private, non-full-standard units, and so forth—and also in different geographic areas of Poland—we have also used a second estimate of utility costs to illustrate the impact on rent burdens of charges that are higher than the national average. This estimate was obtained from the Warsaw Centrum Housing Department for communal housing.

  The results of this analysis are presented in Annex I, Tables 5 and 6. These tables present results for the utility costs of communal housing in Warsaw Centrum; they are otherwise identical to Annex I, Tables 3 and 4.

  In general, for households not eligible for the current housing allowance program, rent burdens have increased by 3 to 4 percentage points. Comparing Tables 3 and 5, for example, shows that the rent burden for four-person households for rents at 3 percent has risen from 34 to 38 percent. For households just over the eligibility for the revised housing allowance, the comparable increase is from 24 to 27 percent. These increases would have a fairly substantial impact on a household's budget; furthermore, when such increases occur at the lower income levels, they could push rent burdens to clearly infeasible levels.

- **Geographic Variations in Income Level**

  The analysis is also flawed by lack of income data at the level of the voivodship. Because rents are varied at this geographic level, comparisons with voivodship income would provide a much more accurate picture of affordability. Ideally, we would also be able to separate urban and rural areas within voivodships. However, we lack an appropriate data series on household income by voivodship; we have used a GUS data series on the average per capita wage rates of public administration employees by voivodship just to illustrate the point. These data can at least emphasize how important geographic differences in income are. For example, the public administration wage rate is PLN 1,616 in the Warsaw voivodship, but only PLN 977 in Radom and PLN 964 in Chełm. However, the data are not broadly representative of employed persons and cannot be transformed into household level income. Thus, they are not

[60] See the forthcoming UIC report on rent policy in Poland by Sally Merrill, Harry Garnett, Rebecca Lawrence, Wanda Urbanska, Edward Kozłowski, and Jacek Łaszek, "Local Government Rent Policy and Best Practice in Poland: The Need for Rent Reform and an Improved Housing Allowance Program," Urban Institute Consortium for USAID/Warsaw.

comparable to the income data used in the simulation, and for these reasons, we have not presented rent burden statistics based on the voivodship data because they would be quite misleading.

Nevertheless, illustrative comparisons can be made internal to the data series, which does change somewhat the picture of affordability presented elsewhere. If these income data are compared with voivodship replacement cost data, some of the higher-cost areas are seen to be relatively more affordable than implied by our simulation. Thus, rents relative to these wage data suggest that Warsaw, Katowice, and Bielsk are slightly more affordable than the remaining six voivodships used in the simulation, leading to a reordering of the voivodships as listed in Tables 8.3 and 8.4. Although this finding will not alter our conclusions, it does serve as a reminder of the sensitivity of housing demand and affordability analyses to the data employed. In addition, it supports our recommendations for a transformation of the housing allowance formula to one that treats geographic differences in rent and income on a more equitable basis with regard to household rent burden (this revision is discussed in Section 8.4).

- **Alternative Rent Statistics**

The replacement cost data used in the simulation are for the second quarter of 1998 (see Annex I, Table 1a). The income and utility data represent mid-1998. Replacement cost data are now available for some voivodships for the third quarter of 1998. In theory, it would have been possible to average the two replacement cost indices and reach the midpoint of 1998. Given that some of the data for quarter 3 are missing, it seems preferable to use the second quarter data. Thus, we made a comparison of the two quarters. An analysis using the replacement cost data for the third quarter, shown in Annex I, Table 1b, is presented in Annex I, Tables 8 and 9, which replicate Annex I, Tables 8.3 and 8.4 (for those voivodships with data).

The results vary rather widely across the voivodships. Replacement costs rose very sharply in Radom, resulting in a dramatic increase in rent burden for households not eligible for the current allowance program: rent burden rose by 5 percentage points for four-person households and by 6 percentage points for three-person households. Lesser, but still significant, increases are seen for the higher-income groups in our comparisons. Similarly, in the Warsaw and Katowice voivodships, the increases in replacement costs resulted in increases in rent burdens of 1 and 2 percentage points for the lower-income households. As these rent burdens were already among the highest, the difficulties are magnified. In contrast, there was little or no increase in costs in the Szczecin, Tarnów, Ostrów, or Chełm voivodships in this period.

ANNEX II: STATEMENT OF WORK

HOUSING AND URBAN DEVELOPMENT ASSISTANCE IN CENTRAL AND EASTERN EUROPE CONTRACT No. EPE-C-00-95-00110-00 (formerly EPE-0034-C-00-5110-00) RFS No. 648

A PRELIMINARY ASSESSMENT OF POLICIES AND STRATEGIES FOR PUBLIC SECTOR HOUSING FINANCE

BACKGROUND

USAID has been providing Poland with ongoing assistance in a wide variety of topics in municipal government, urban development, infrastructure, and housing. USAID's Housing Finance Project, managed by the Urban Institute Consortium, is among these programs and is currently providing support in areas of private and public housing finance to a variety of governmental institutions and private sector associations. This RFS seeks to provide a conceptual framework for technical assistance to support the restructuring of governmental assistance in housing finance.

A number of reports have shaped the nature of the technical assistance proposed in this RFS.

Recently, a major review of public sector housing finance policies was completed by the Housing and Urban Development Authority, resulting in a comprehensive document entitled "Town and Country Planning, Real Estate, and Housing Construction: Medium-Term Strategy for the Industry," Warsaw, April 1998 (hereafter referred to as the HUDA Strategy Paper). This compendium reviews a wide variety of housing, infrastructure, and utility policies, including tax and legal issues, from the perspective of central government policy reform actions and support to gmina policies.

In addition, in November 1996, USAID initiated a broad-based review of housing finance activities in Poland. The resultant report—"Building on Progress: the Future of Housing Finance in Poland"—has been widely distributed in Polish and English (hereafter referred to as the Assessment Report). The Report's topics, which include both private and public sector housing finance, were discussed at a conference in May 1997.

Finally, USAID's Housing Finance Project is currently working on, or has recently undertaken, a number of studies with a direct bearing on the topics to be addressed in this RFS. These include analyses of Poland's Bauspar system, the statutory lien, rent-setting practices, and information systems for real estate appraisal.

This RFS will provide advice to USAID, on the type of technical assistance which might assist with the formulation and/or implementation of selected medium- and long-term public housing finance policy goals, consistent with USAID's own goal of developing (a) a competitive, market-oriented private financial sector, and (b) effective, responsive, and accountable local government. The work will take guidance from HUDA's Strategy Paper and will also build on some of the types of analyses of public sector housing finance policies in USAID's Assessment Report.

GOALS

Overview. The purpose of this RFS is to provide USAID with an overall review of the central government's public sector housing finance policies. The review will incorporate a response to the HUDA Strategy paper, in particular, to those parts that deal with the housing finance policies now being pursued by the government of Poland or being proposed for review and/or restructuring by HUDA. The review will concentrate on housing finance policies which, in conjunction with the evolution of private sector housing finance, will most effectively and efficiently support housing demand and stimulate supply and rehabilitation. The review will address the public sector housing finance policies in the context of the overall national housing finance system now evolving in Poland, and in particular with the broad goals that will best address the needs of the entire sector. There will be two closely-related areas of investigation: (1) a review of selected public sector housing finance issues raised in HUDA's Strategy Paper, particularly broad subsidy strategies; and (2) a review of initiatives in housing finance that are largely aimed at development of the private housing finance sector (or require its participation to carry out).

Specific Goals of the Review. In the context of the broad goals noted above, specific goals of the RFS include the following:

1. To provide USAID and its Polish counterparts with a conceptual framework for assessing the medium- and long-term goals of overall housing finance strategies including HUDA's proposed strategies. The discussions will include a commentary on desirable results, additional strategies which might be employed, and/or the role of the central government in attaining these goals. The analysis will attempt to assess the following:

(a) how different elements of the population are served by public and private housing finance;

(b) what groups are not being served and how this might be addressed;

(c) what might be an optimal set of subsidy policies in both the short- and longer-term; and

(d) the implications of the proposed universe of policies for the housing stock (for example, with regard to demand, supply, privatization, renovation, rationalization of rent policy, and so forth).

2. To provide USAID and its Polish counterparts with a review of public sector housing finance policies in Poland, with a particular focus on those with central government support. The review will provide a constructive overview of a subset of the proposals addressed in the HUDA Strategy Paper and will include an assessment of the role of public housing finance policies which bear on overall housing finance in the economy—both private and public—and the interactions among public and public/private initiatives.

3. To provide the government of Poland and USAID with advice on the types of technical assistance which might assist HUDA formulate and carry out its strategies.

4. Based on the tasks above, the review will provide USAID and its Polish counterparts with an update of the public sector housing finance chapter of USAID's 1997 Assessment Report. In addition, the review of the public housing finance policies will be integrated with summaries of recent and ongoing UIC work in the areas of statutory lien, rent policies, Bausparkassen, appraisal information systems (and others as relevant) to provide a convenient overall summary.

REPORTS

UIC will provide USAID and its Polish counterparts with two reports: (1) a Rapid Assessment Summary and (2) a Final Report. The Rapid Assessment Summary will be a brief summary report finalized within 3 weeks of the consultant team's exit from Poland; this will allow USAID, HUDA, and others to quickly assess some of the more important options with regard to donor technical assistance for policy planning and implementation, as well as the team's comments with regard to the key housing finance elements of the government's overall strategy. The Final Report will be completed following the Summary Assessment, and will take into consideration comments on the Rapid Assessment Report.

Public Housing Finance Topics to be Addressed in the Review. A broad array of topics dealing with public sector housing finance and various public/private housing finance endeavors will be addressed. These include topics based on commentary in the HUDA Strategy Paper as well as topics in public/private housing finance initiatives which USAID has been addressing under the current Housing Finance Project or in USAID projects initiated in previous years.

Topics drawn directly from the HUDA Strategy Paper are found primarily under two of the main headings: II. Establishment of Conditions for Effective and Safe Investments in Real Estate in a Market Economy, and III. Creation of a Stable and Clear System of Supporting Housing and Housing Construction. The topics in the HUDAs strategy paper relevant to the overall framework are illustratively presented below by type of policy and/or subsidy initiative (and specific examples of HUDAs commentaries are noted):

1. Overall Policy Framework, including, for example:

   III.1.1 Selection of Housing Policy focused on chosen Groups of Citizens

III.1.2 Rationalization of Assistance for New Construction
III.2.3 Implementation of Instruments Ensuring Compatibility of Housing Finance Provided by Gminas and the State

2. Rent Policy and Housing Allowances and Social Housing Rent and Housing Allowance Policy including, for example:

II.3.1 Long-term Rent Setting
II.3.2 Cushioning Program for Adjustment of Rents in Private Buildings to Market Level
II.3.7 Increase the Importance of Housing Allowances as the Basic Form of Tenant Social Protection
III.4.2 Social Housing Program

3. Rehabilitation/ Renovation/ Modernization Renovation Policies, including, for example:

II.3.12 Definition of Scope and Legal Framework of Supporting Rehabilitation and Modernization of Residential Stock

4. TBS:

III.4.1 TBS

5. Institutional Development and Institutional Roles, Housing Finance Sector Liquidity, and Secondary Market Development Issues Policy issues include:

II.5.1 The Act on Mortgage Banks and Mortgage Bonds
III.3.4 Correction of System of State Assistance Provided through Mortgage Fund and National Housing Fund, Definition of the Role of the Bank for National Economy; and Issues surrounding the future of the Mortgage Fund, the possibility of a central mortgage bank or facility, the role of the IFC, “the Group of 12,” and other selected topics in private sector housing finance

6. State-supported Savings Systems:

III.3.5 Correction of Support by the State Savings system for Housing Purposes

7. Legal Framework Legal issues, including, for example:

II.2.1 Removal of Statutory Lien
II.2.4 Increased Accountability of Developers

TEAM MEMBERS

A UIC team of Polish and expatriate members will carry out this assignment beginning June 10, 1998. The expatriate team members will join local team members in Poland between June 22 and July 2, 1998. Sally Merrill will direct the activity overall. The team will be divided into two basic groups: (1) one addressing primarily public sector initiatives in policy reform and subsidies; and (2) one focusing on housing finance policies which are largely in support the of the development of private sector institutions. Thus, the team is constituted as follows:

S. Merrill: team leader
J. Brzeski: policy advisor

Private Sector Team	Public Sector Team
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J. Brzeski	E. Kozłowski
M. Koziarek	K. Aukward
	M. Sickles
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