

# HFA

A Housing Finance Agency  
for Central Eastern and  
South Eastern Europe

Feasibility Study  
Executive Summary

August 2006

## EXECUTIVE SUMMARY

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1. All CEE/SEE countries urgently need an **increase in housing construction**, particularly for lower and middle income groups. The focus until now on owner-occupation has not yielded satisfactory results for either of these groups in terms of housing affordability. Although housing policy and the housing sector are making progress, there are only a few persuasive strategies in evidence for increasing the extremely low share of rental housing (shown in Graph 1) and facilitating housing management and refurbishment. Given the fact that, within the decade to come, around 5 million dwellings have to be created in CEE/SEE and considering that a very large part of the housing stock of some 40 million dwellings is in urgent need of refurbishment, the **need for action** is evident.
2. After 15 years of transition, **conditions seem favourable for change**. Economic growth is considerable and stable, capital market financing instruments are evolving, housing policy is becoming more sustainable and targeted and housing promotion schemes are emerging. Meanwhile, International Financing Institutions (IFIs) are showing a growing willingness to invest in housing for low and middle income groups in CEE/SEE. The EU Structural Funds have also been opened up for housing measures in the new Member States and applicant countries.
3. This feasibility study shows that a **multilateral instrument for housing finance** may respond to existing deficiencies by utilising current opportunities. The idea of a HFA – Housing Finance Agency – for CEE/SEE has been initiated by the Stability Pact for South Eastern Europe and is supported by a group of commercial banks and financing institutions active in CEE/SEE, political players and researchers. Its raison d'être is and will be the facilitation of housing construction and refurbishment for low and middle income groups in CEE and SEE countries. HFA will assist national governments, municipalities, housing management institutions and IFIs in establishing financing schemes for housing and providing financial resources.
4. Starting with an analysis of the housing situation in the region, existing housing finance instruments and the institutional framework, the study describes possible Public Private Partnerships (**PPP**) for affordable housing, both in terms of financing and organisation. A business plan for a Housing Finance Agency is then drafted.
5. The difficult situation of housing finance in CEE/SEE may be tackled by learning from best practice PPP models in Western countries and by utilising all possibilities of funding and increases in efficiency. For the financing models calculated it is shown that, for the whole period of financing (calculated in real terms at present value), they may work with a **public contribution of, at most, 30% of total costs**. Public participation must be higher in an environment of generally low wage levels, high construction costs and high interest rates, and may be lower in well-developed economic surroundings. HFA is targeted on lowest possible subsidies according to national priorities. Due to the potential volume of housing finance, it may contribute considerably to the economic development of a region.
6. HFA shall be installed as a non-profit limited liability company, governed by Austrian law. It shall be funded, owned and controlled by international institutions, commercial banks and other stakeholders that are supportive of IFIs, international policy makers and recipient countries. The European Housing Ministers have positively recognized this initiative (Prague Conference, March 2005).
7. The next steps to put HFA into operation are the conditional capital commitment of future owners, a commitment of IFIs regarding their willingness to make use of HFA by placing investments for housing construction and refurbishment in CEE/SEE, and the commitment of target countries to

allow implementation of HFA, including a capital commitment to contribute to a structured financing by public funds or guarantees.

## NEED FOR ACTION

8. The question needs to be raised of whether middle income groups are able to access affordable and decent housing without public support. Low income groups currently are served within social welfare programmes and there is sufficient housing supply for top income groups. Yet there is a **big “in-between”** of households that are not properly supplied by the mainly upscale stock of owner-occupied flats. Taking any Western country in a similar state of development as an example, the answer is evident that middle income households cannot cope without state support. In all developed countries, some sort of housing support was (and mostly still is) set-up for middle income groups to be able to afford rental or owner-occupied housing and refurbishment respectively. The **target group** of HFA activities are, therefore, in a first phase, middle income households. Furthermore, PPP models need a minimum solvency of the clients to work properly and middle income households can provide this. In the medium term, the proposed PPP models shall be applicable for lower income households as well.

## HOUSING AND HOUSING FINANCE IN CEE/SEE COUNTRIES

9. The years of transition brought **progress** in the following housing-related aspects:
  - construction of owner-occupied flats,
  - privatisation of the banking sector,
  - retail mortgage financing (for higher income groups),
  - introduction of housing promotion schemes.

**Insufficient results** have been achieved in:

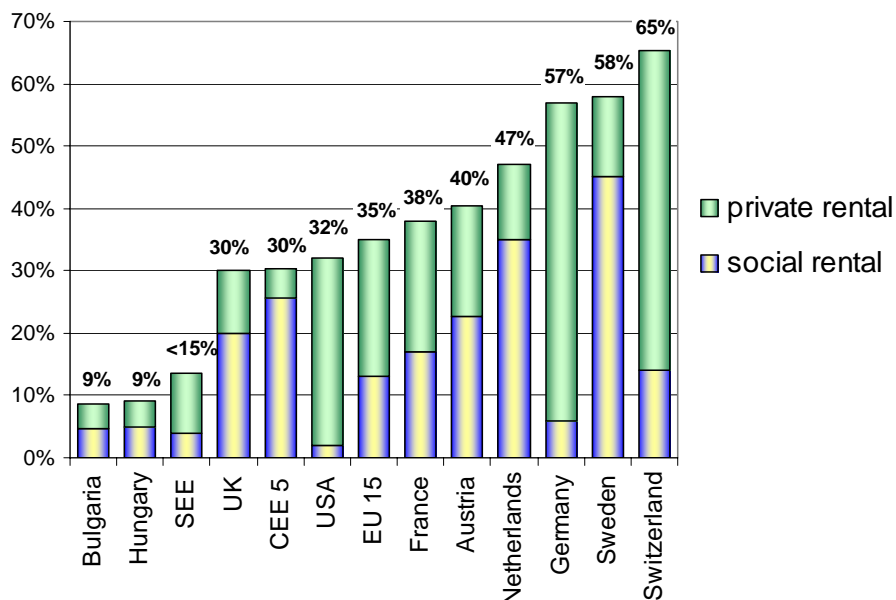
- construction of affordable housing, in particular, rental housing,
  - management and refurbishment of the housing stock,
  - replacement of buildings at the end of their life-cycle,
  - housing provision for lower and middle income groups, young households and domestic migrants,
  - curbing housing expenditure: disproportionate energy and maintenance costs have led to high housing costs. The rapid growth of mortgage financing of owner-occupied flats will inevitably lead to a further increase in the housing expenditure rate.
10. CEE countries spend, on average, **2% of the state budget on housing** (i.e. approx. 1% of GDP). The share ranges from 1% in Slovenia and Poland up to 4% in the Czech Republic. In SEE countries, the expenditure for housing is generally below 1% of the state budget. In comparison, the average state expenditure for housing in the EU15 is 3.3% of state budgets. The difference is even more striking when the much higher GDP per capita and a housing stock in decent condition in EU15 are considered. Given the considerable economic spin-offs of housing investment, the case for additional funding is persuasive.

## SIGNIFICANCE OF RENTAL HOUSING

11. Comparing the situation with EU15 and other Western countries, it has proven that trying to accommodate people solely by means of owner-occupation is economically unwise. A sizeable **rental sector has important functions for a national economy** far beyond mere social policy goals. Rental housing offers low entry prices, it facilitates mobility of the workforce and it is of major

importance for young households and domestic migrants, who do not yet dispose of capital and lack access to financial markets. In the long run, establishing a rental market offers substantial institutional investment opportunities.

Graph 1: Rental housing stock in selected countries, 2003



Source: PRC Bouwcentrum (2005), Czischke (2005), CH Bundesamt für Statistik

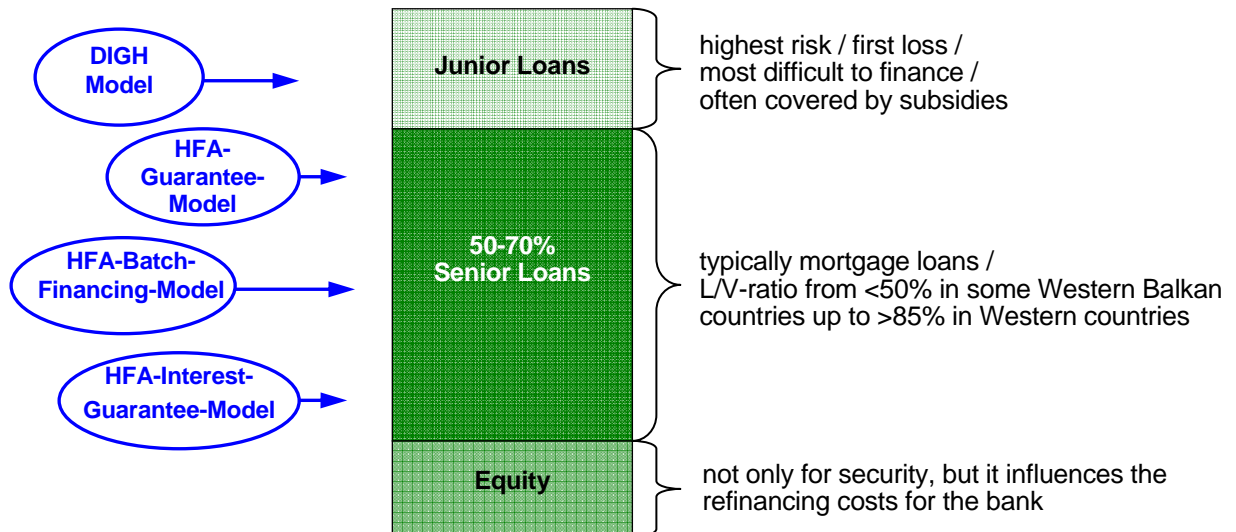
## PPP MODELS

12. The analysis of housing promotion schemes in other countries proves the **efficiency of PPP models**, particularly when facing the needs and possibilities of middle income groups. Combining commercial financing with public funding and backing allows for affordable costs for both tenants and owners with moderate public expenditure. PPP models are especially reasonable in two areas:
- Organisation of affordable housing: The most successful models (more often limited-profit than non-profit) combine the following functions: housing development, long term investment in the housing stock, housing management and maintenance.
  - Housing finance: PPP models combine the strength of the markets with the backing of the state, e.g. by guarantee models and subsidies, which work as incentives to market oriented behaviour.

## FINANCING MODELS

13. Several models of **structured financing** are examined:
- DIGH model: The project partner “Dutch International Guarantee for Housing” is experienced with financing models where the risk of first loss is covered.
  - HFA-Guarantee-Model: The project partner “Kommunalkredit” has designed an efficient model that is structured primarily by guarantees.
  - HFA-Batch-Financing-Model: Following the Austrian model of housing finance, a combination of several “layers” of financing and support is designed.
  - German interest guarantee model: Following a subsidy scheme from Rhineland-Palatinate, the interest rate differential above a certain limit is covered by subsidies.

Graph 2: Principle financing components



Source: IIBW

14. The HFA financing models will result in a form of public support. Thus it has to be in line with **EU legislation on Competition and State Aid**. Analysing current jurisdiction, a set of rules is identifiable: clear definition of services of general economic interest in the field of social housing (target groups), limitation of subsidies to additional costs of these services and transparent and separate accounting principles. These requirements may be met by specific non-profit or limited-profit housing laws. Yet a commercial framework may also be applicable, as long as the individual housing projects are in line with the described rules. A respective model to comply with EU legislation on contractual basis has been designed.
15. **Calculations** have been made to assess the described financing models. Both for CEE and SEE countries, different scenarios have been assumed with the following results:
- Financing affordable housing by PPP models is still very difficult, as construction costs and land prices are high compared to household incomes. Even in some CEE countries, long term interest rates are well above EU15 levels.
  - Facing energy costs on a Western European level, **housing expenditure** rates become rather high, even with annuities of not more than, for instance, 20% of average household incomes (privately financed rental flats usually cost three times as much). With this degree of solvency, the options for financing are limited; either public spending becomes rather high or the maturity of loans becomes extremely stretched. In any case, the financing of affordable rental flats will take 25 to 40 years. The institutional structure of housing investors has to meet this requirement.
  - The total costs (construction plus financing costs, calculated for the whole period of financing in real terms at present value) and the contributions of the public and tenants respectively, vary strongly according to changes in the economic environment, particularly interest rates. Altogether, PPP models may have lower total costs than privately financed or municipal housing, considering an institutional performance such as that of the limited-profit housing sectors in the Netherlands or Austria.
  - PPP models with public loans are more efficient in an economic environment with high long term interest rates. Models with annuity grants are preferable in times with lower long term interest rates. Housing promotion schemes achieve lower public expenditure by the improvement of the economic environment.
  - It is shown that, for the whole period of financing, PPP models of HFA may work with a **public contribution of 20-30% of total costs**.

## FINANCING SOURCES

16. HFA will be successful only if it manages to acquire funding of various kinds as well as the potential to **increase effectiveness** of procedures:

- National housing funds: loans, grants, guarantees.
- National VAT legislation: most CEE/SEE countries levy the full tax rate on construction costs and apply non-taxable rents. Thus input VAT cannot be balanced with output VAT. A recent decision of the European Council allows lower VAT rates for housing or social housing. A reduced VAT rate would reduce overall building costs substantially.
- Municipalities should contribute to affordable housing by providing cheap building land. In return, they might assume responsibility for housing allocation.
- International sources: HFA might work as a intermediary for European Institutions, such as Development Banks, Structural Funds or single donors. They ought to provide loans, grants or guarantees.
- Capital market: HFA aspires for more efficient financing tools from the capital market following international best practice, e.g. Austria, The Netherlands, Switzerland.
- Equity of developers: The example of limited-profit housing associations in Austria or the Netherlands show the potential of a sector strong in equity. A social housing sector will accumulate assets and thus equity. This is not only an important part of general financing, but also makes capital market financing cheaper.
- A requirement for equity from tenants may enable targeting of the support at middle income households.

The benefit for any source is that by **combining the funds**, its effectiveness might increase considerably.

## BUSINESS PLAN

17. The core part of the feasibility study in hand is a Business Plan for HFA:

- Legal form: non-profit limited liability company under Austrian law.
- Owners: European Institutions, DIGH, commercial banks, IIBW.
- Supervisory Board: appointed by the owners, European Institutions, independent experts.
- Advisory Board: appointed by the financing partners, commercial banks, national funds, national policy makers, representatives of municipalities.
- **Mandate:** The objective of HFA is the establishment of efficient financing instruments for rental and owner-occupied housing construction, as well as refurbishment of multi-storey buildings in CEE/SEE. HFA does not act as a bank. The business procedures of HFA are characterised by efficiency and international orientation.
- Capital endowment: 3 million Euros.

18. HFA acts as an intermediary for housing projects. It covers the following **services**:

- Accreditation of developers to be integrated into the programme,
- Project selection according to specific requirements, following a due diligence process,
- Acquisition of guarantees and capital, to be forwarded to project developers and/or commercial banks on site,
- Recommendation for financing,
- Support of the financing partners in execution of the financing process,
- Supervision: Application of a system of steering and control,
- Standardisation of products (financing models) and procedures (assessment of project partners and development projects),
- Consultancy for national authorities, commercial banks and international institutions.

## SPECIFIC ISSUES FOR EU POLICY MAKERS

19. HFA is designed as an instrument to **execute EU positions on housing** (explicit and implicit) for CEE and SEE countries. It is particularly applicable as an intermediary to bridge the gap between investment supply of EU Structural Funds or IFIs on the one hand and financing demand of single housing projects in CEE/SEE on the other hand. The HFA financing models are in line with EU legislation on Competition and State Aid. Furthermore, HFA activities may result in an increase of competition in the construction and financing sector. In general, improvements in housing provision contribute to prosperous economic and social development in the region.

## SPECIFIC ISSUES FOR RECIPIENT COUNTRIES

20. HFA is regarded as intermediary, which may contribute considerably to the **improvement of housing provision** for low and middle income groups as well as to the establishment of a rental housing sector in CEE and SEE countries. National and local authorities are core partners for HFA. The described objectives are only attainable by mutual trust and cooperation. A financial commitment is indispensable.

## SPECIFIC ISSUES FOR DEVELOPMENT BANKS

21. HFA is designed as an efficient intermediary for the **investment interests** of IFIs. They are expected to play a supportive role for HFA. In return, HFA will be most useful in identifying feasible housing projects, structuring financing, supervising the development process and even sharing risks. Even though HFA is not intended to act as a bank, it may work as a pass-through of capital from IFIs. IFIs are expected to provide loans and guarantees.

## SPECIFIC ISSUES FOR COMMERCIAL BANKS

22. HFA is initiated by, amongst others, several Austrian based commercial banks. Nevertheless, it is open to other commercial financing partners if they meet the defined requirements. The financing models of HFA are designed to increase the efficiency of commercial financing (from the point of view of consumers and the public). It is expected that financing products for affordable housing will create **lower margins, but larger volumes** than previous business activities in CEE/SEE. In some Western countries, commercial banks have become owners of limited-profit housing associations.

## PARTNERS

23. Project partners and **possible stakeholders** of HFA are: DIGH - Dutch International Guarantees for Housing, Bank Austria Creditanstalt AG (Unicredit), Kommunalkredit Austria AG, Raiffeisen International. **Pilot countries** for the feasibility study are Slovakia, Romania, Kosovo and Montenegro. HFA is open to all CEE and SEE countries.

Possible **supportive partners** are: EIB - European Investment Bank, other Development Banks, Stability Pact for South Eastern Europe, Austrian Federal Ministry for Economy and Labour, Vienna Municipality, Austrian Association of Cities and Towns.

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