Chapter 8
Housing Finance and New Housing Provision

In the 1990s countries in the region underwent structural reforms associated with privatisation of their centrally planned economies, and specifically with institutional, banking and financial reforms. This adjustment considerably affected the macroeconomic characteristics of emerging housing markets. Declining output, collapsing state industries, tight monetary policies and high inflation indicated a difficult process of macroeconomic transition from planning to markets. Further detailed discussion on the relationships between macroeconomic developments and the housing sector is beyond the scope of this research. Nevertheless, and despite the complexity of those interlinkages, several statements relevant to the study can be made. The housing sector is particularly sensitive to pressures created by economic recession and high inflation. In addition, austere fiscal policies contributed to decreasing levels of state and private investment in housing. Not surprisingly, housebuilding in South East Europe collapsed. Housing demand also contracted as a result of high interest rates, unemployment and slow wage adjustment. More importantly, the economic crisis in the region considerably affected the performance of mortgage markets and made housing finance reforms much more difficult. This chapter explores the transformation in two critical and most dynamic sectors of the housing system – housing finance and the provision of new housing. The comparative evaluation addresses two important questions: First, did the reforms establish a well developed system of housing finance? Second, is the market-based provision system for new housing more efficient in economic and social terms?

8.1 Bridging the Gap: Developments in Housing Finance

Housing finance systems are in the early stages of development in the countries of South East Europe. Governments identify the lack of housing finance as a main constraint for efficient operation of the housing market and access to affordable housing. There are different types of housing finance systems in Europe with a combination of basic models of housing finance – contractual system, commercial bank model, mortgage bank model, and the secondary mortgage bank model. These differences in individual countries are due to historical development, tradition,

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institutional settings and last but not least, government regulations. It is too early to predict the development path of housing finance in different countries, however, recent trends suggest a move towards private commercial lending with limited mortgage banking access to capital markets and experiments with the subsidised *bausparkasse* (contract saving model) model (Hegedüs, 2001).

8.1.1 Overview

Banking sector reform and regulatory and supervisory policies are areas in which countries in South East Europe recently have achieved considerable progress. Consumer lending is growing, including mortgages and housing-related consumer loans. The highlights of the achievements include the following:

- Collateralised mortgage lending for the purchase or renovation of housing has grown rapidly in the region; in addition, many consumer loans are being utilised for housing purposes.
- Mortgage lending is dominated by large commercial banks, often with foreign ownership, bringing international underwriting and servicing skills. Lenders are competing for consumer lending, particularly in Croatia, Bulgaria and Romania, which ultimately is of great assistance in providing more affordable housing finance.

However, there are significant constraints:

- The growth of mortgage lending is limited by the legal and administrative problems, especially those plaguing foreclosure and registration. Banks have conservative underwriting criteria due to legal uncertainties and incomplete property registration systems.
- Underreported income in the region, and the substantial amount of informal income, limit both the number of qualifying clients and the size of the loan.

8.1.2 Banking Reforms

The economic crisis in South East Europe also engulfed the banking system. Currency Boards were introduced in Bulgaria and Bosnia and Herzegovina in 1997 and in several countries the sector collapsed. Eighteen banks were closed in Bulgaria, amounting to about one-third of the banking sector. Half of the banks in Serbia and Bosnia and Herzegovina went bankrupt due to a large number of bad loans, poor internal controls, insider lending, and inadequate risk management (Rabenhorst, 1997). In Albania, the collapse of the 1996–1997 pyramid schemes brought a general distrust in financial institutions. An estimated 33% of the country's total money supply remained outside the banking system. These problems were no doubt related to macroeconomic difficulties, but also institutional weaknesses including inadequate capitalisation, and poorly developed regulation and supervision.

Recent studies indicate that the banking system across the region has recovered (Butler et al., 2004; Merrill et al., 2003; Registra, Analystas and Imantra [RAI], 2005b). Although privatisation occurred more slowly than planned, much of the controlling interest in the commercial banks of Bulgaria, Croatia and Romania was sold to straegic investors. In Bosnia and Herzegovina today 76.7% of banks' capital is foreign-owned, while in Kosovo/UNMIK the ratio is 60%, in Albania and Former Yugoslav Republic of Macedonia 47% and in Serbia 38%. By comparison, state ownership of capital in the region has been reduced dramatically to less than 15% on average. Not only is the banking system dominated by private and in a number of cases foreign ownership, it has experienced large scale restructuring and consolidation (see Table 8.1) Bulgaria has the largest rate of bank consolidation, while Croatia and Serbia still tend to have a disproportionately high ratio of banks per capita.

Commercial banks are licensed, regulated and supervised by the central banks.[1] The central banks use traditional supervisory tools to carry out their prudential responsibilities, including risk-based capital adequacy requirements, periodic on-site examinations, financial reporting and disclosure requirements, and off-site monitoring. Most countries also are taking actions to bring their regulations and standards into compliance with European Union directives (Falcetti et al., 2003).

Access to finance is a critical determinant of private sector development in all economies, as it affects both market entry and subsequent growth. After more than a decade of transition in South East Europe, the banking sector has generally been cautious in expanding its services to the private sector (Council of Europe Development Bank and World Bank, 2004). The level of banking sector intermediation to the domestic economy measured by the ratio of domestic credit (both to the whole economy and to the private sector) to GDP in the region is still very low

Table 8.1 Banks and mortgage lenders in the region, 2004

Country	Number of banks	Banks active in housing finance	Foreign-owned share of total (%)
Albania	20	7	47.0
Bosnia and Herzegovina	27	4	76.7
Bulgaria	37	20	80.0
Croatia	45	8[a]	25.4
FYR Macedonia	21	2	47.0
Romania	31	7[a]	80.0
Serbia	46	4	38.0
Montenegro	7	2	80.0
Kosovo/UNMIK	5	1	60.0

Source: Tsenkova (2005), Council of Europe Development Bank Regional Housing Survey

[a]Includes housing savings institutions

[1] The Central Bank of BiH was among the first institutions to begin consolidating and centralising operations across all entities.

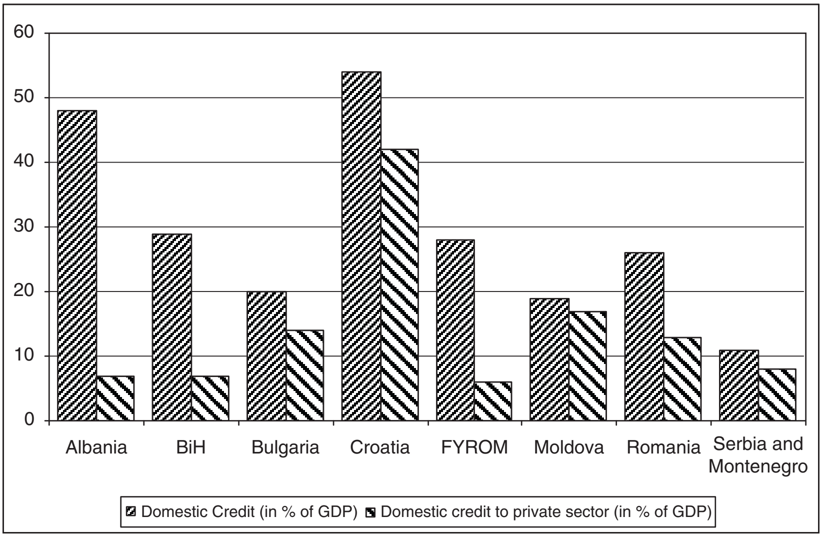

Fig. 8.1 Domestic credit as a ratio of GDP in the region, 2001. *Source:* Falcetti et al. (2003)

(see Fig. 8.1). For the region as a whole, the ratio of total domestic credit to annual GDP was 27% (weighted average), ranging between 11.6% in Romania to 69.1% in Croatia.[2] The private sector credit-to-GDP ratio was particularly low in some countries (less than 10% in Albania, Bosnia and Herzegovina, Former Yugoslav Republic of Macedonia, and Serbia and Montenegro).

8.1.3 The Primary Mortgage Market

The Croatian mortgage market at present, although still far from European Union standards, is extremely more developed than any other in the Western Balkans. In fact, out of the €2.5 billion mortgage loans outstanding in the region, €2.2 billion correspond to Croatia, accounting for close to 12% of the country's GDP and 9.4% of the banking sector's total assets. The total amount of Croatian mortgages outstanding represents 20 times the amount in Bosnia and Herzegovina and over 60 times the amount in Former Yugoslav Republic of Macedonia or Serbia. Croatia not only heads the region in size of the mortgage market in absolute values, but also as a percentage of both total assets and GDP (Registra, Analystas and Imantra [RAI], 2005b).

In most of the other countries in the region, credit activity in general, and household lending in particular, seems to have increased substantially during the past 2 years.

[2] While this level is higher than the intermediation in the CIS region (22.6%), it is much lower compared to the EU average of 108.8%).

Reportedly, despite current low level by EU standards, the mortgage markets in Former Yugoslav Republic of Macedonia, Bulgaria and Bosnia and Herzegovina are expanding at a rate of 20–40% annually. Banks have started to offer much more competitive financial terms – particularly longer maturities and lower interest rates – and apply less restrictive underwriting criteria. In Romania, for example, concerns over rapid private sector lending compelled the National Bank of Romania to establish a maximum payment-to-net income ratio of 35% for mortgage credit and to introduce a maximum loan-to-value ratio of 75%[3] (Merrill et al., 2003; Registra, Analystas and Imantra [RAI], 2005a).

However, in other countries in the region mortgage lending is in its initial stages of development, particularly in Serbia and Moldova. Former Yugoslav Republic of Macedonia has a relatively new mortgage lending system established in mid-2002. Its size is estimated to be 40 million euros, amounting to barely 1.1% of GDP, with an ~3,000–3,500 mortgage loans outstanding in November 2004 (Registra, Analystas and Imantra [RAI], 2005a). In Bosnia and Herzegovina several banks have initiated mortgage-backed (and guarantor-backed) lending for housing at 15-year maturities. This development has been stimulated by the European Union supported (€25 million), KfW implemented *Housing Construction Loan Program of the European Fund* for Bosnia-Herzegovina, which has kick-started a commercially oriented housing finance system through local banks (Butler et al., 2004).

8.1.3.1 Mortgage Lenders

The mortgage market in the region is dominated by commercial banks. Recent overview of the mortgage market in a number of countries suggests that mortgage lending is offered by a small number of institutions, often the largest commercial lenders with some degree of foreign ownership.

In Croatia the mortgage market is dominated by the biggest six banks. Zagrebacka Banka is the current leader of the mortgage market, followed closely by Privredna Banka. These two institutions account for more than 50% of the market in 2004 (more than €1,100 million; 50,000 operations) (Registra, Analystas and Imantra [RAI], 2005b). In Bosnia and Herzegovina mortgages or housing loans are offered by the largest banks – Raiffeisen, Zagrebacka, and Hypo Alpe-Adria. Volksbank has also entered the competition but is still considerably smaller. In Former Yugoslav Republic of Macedonia the mortgage market is dominated by the country's two largest banks: Stopanska and Komercijalna, jointly accounting for 75–80% of mortgage lending. The third main player is Tutunska Bank while the Export and Credit Bank has also increased its mortgage lending activity, but its market share is less than 5% (Butler et al., 2004; Registra, Analystas and Imantra [RAI], 2005a).

[3] Since much of the mortgage lending in Romania is in foreign currency – US dollars or euros – the National Bank of Romania increased the mandatory reserve requirement or banks' foreign exchange liabilities from 25% to 30%.

The principal exception in the region is the monopoly over mortgage lending in Bulgaria by the State Savings Bank (DSK), privatisation of which has experienced major delays and barriers. Historically, all mortgage lending was undertaken by DSK, which recently is losing share to over a half dozen competitors. The overall mortgage portfolio was roughly US $100 million in the fall of 2002, of which over one-half is held by the DSK. Other banks lending for housing include UBB, Post, Bulbank, BACB, First Investment Bank, Express Bank, and Raiffeisen (Merrill et al., 2003).

8.1.3.2 Housing Saving Banks

While mortgage lending is clearly dominated by the largest commercial banks, Housing Saving Banks account for a very small share in Croatia and Romania. In Romania, two non-bank mortgage finance companies – Domenia Credit and Eno Credit – are required to register and report to the National Bank of Romania (NBR). There is also a specialised housing savings bank – Raiffeisen Bank Bausparkasse Romania.

Housing Savings Banks (*Bausspаrkasse*) in Croatia account for less than 1% of mortgage lending. Their activity is strongly regulated and supervised by the Central Bank. *Baussparkase* generate interest income, which together with a government premium on savers' deposits results in favourable home loans funded exclusively through customer deposits. Although the minimum saving term required to qualify for building societies' home loan is 2 years, most of the agreements are concluded for a term exceeding 5 years.

Mortgage Insurance is a new instrument launched in Serbia. *Nacionalna korporacija za osiguranje stambenih kredita* (NKOSK) was established in 2004 to improve the situation on the mortgage market. It is a public enterprise with an implicit state guaranty. The original capital is €10 million from the state budget. The supervision is provided by the Ministry of Finance, with the obligation to report annually to the government and correspondingly to Parliament. The NKOSK will insure mortgage credits given by banks up to an amount of 80% of the value of the real estate. The premium for the insurance will be 1–4.5% depending on loan amount, borrower, real estate and credit terms. The banks will be obliged to lower the interest rate for the credit by at least 1%(Box 8.1). It seems to be problematic, that the NKOSK will be active in the financial market without supervision by the National Bank, without a license and without fulfilling the capital requirements obligatory for other market participants. In addition, this form of state support for housing appears to be poorly targeted (ECE, 2005).

8.1.3.3 Sources of Funding

The principal sources of funds for commercial banks, and thus for mortgages, in the region are demand and time deposits and, to a much lesser extent, loans, lines of credit, and equity from parent foreign banks. In some cases, international lending institutions like the EBRD and the IFC also provide funds. Credit activity at present

Box 8.1 Declining Significance of *Bausparcasse* Financing in Croatia

Housing Savings Banks have complete independence to establish the criteria to be applied in determining savers' creditworthiness. While a saver is entitled to a mortgage loan after the expiry of the saving term, the loan is not granted automatically, but is subject to the fulfilment of lending criteria (loan requirements and financial terms) that vary according to the saving term completed. Currently, housing loans are provided at a fixed interest rate – below mortgage market rates – that cannot exceed 3% of the premium of deposits. Although this financing system was quite popular when it first began in the late nineties, its attractiveness has decreased over the years, particularly since the effects of this program have been very modest and interest rates charged on mortgage loans have decreased significantly. Until now, housing saving banks have been providing relatively small volumes of housing loans (which, judging from the size of the loans and the amount needed to buy a house in Croatia at the moment, is not enough for home purchase).
Source: Registra, Analystas and Imantra [RAI], (2005a)

is mainly funded through deposits (70% of total assets). Since mortgage loans are being granted at increasingly longer terms, this situation leads to a significant assets and liabilities maturity mismatch that so far has been partially solved by international credit lines and banking loans from headquarters. The secondary mortgage market for now does not exist and the main limitations to its development are the little interest of the banking sector, the limited depth of financial markets and the lack of institutional investors.

Bulgaria is a notable exception in the region – it has introduced legislation and institutional infrastructure to mobilise long term finance. During the period July 2001 to September 2004, seven Bulgarian banks financed mortgages by issuing €63 million in mortgage bonds. The bonds, denominated in either EUR or BGN, had maturities of 2, 3 or 5 years, and interest rates ranging from 6.1% to 8.00% (Merrill et al., 2003).

Romania is in the process of amending its laws to facilitate mortgage bonds and securitisation. However, the likely investors for such bonds – pension funds, insurance companies, and mutual funds – are not as well positioned in Romania as they are in Bulgaria.

8.2 Mortgage Lending

The *underwriting criteria* that mortgage lenders use to select the borrowers are in line with European Union practices and include:

- Maximum loan-to-value (LTV) ratios and related appraisal requirements.
- Maximum payment-to-net income (PTI) ratios and related documentation.

- Borrowers' credit and employment histories and credit scores.
- Requirements for insurance and credit enhancements, including requirements for property and life insurance, mortgage insurance.
- Collateral or third-party financial guarantees.

Mortgage lending practices are becoming gradually more standardised, as a result of increasing competition in the banking sector. In theory, there are no major differences among underwriting criteria applied by lending institutions in different countries. In practice, mortgage lending in Bosnia and Herzegovina and Former Yugoslav Republic of Macedonia is dominated by banks in the capital cities and lenders are much more conservative. The level of standardisation in Croatia is the highest for South East Europe (Registra, Analystas and Imantra [RAI], 2004a, 2005b).

Table 8.2 presents the terms of mortgage lending in a comparative perspective using 2004 data. In Croatia the maximum loan size generally offered by banks may be as high as €100,000, although, on average, loans granted do not exceed €50,000. In the other countries this varies with Former Yugoslav Republic of Macedonia and Swwerbia usually lending short term with a maximum amount of €10–12,000. In Moldova, mortgage lending is very limited, reportedly housing loans are used for business purposes. Banks offer maturities that range from 10 to 25 years, frequently within the 15–20 years range. Lending interest rates offered by banks vary widely, ranging from a low of 5.5% to a high of 9.5% depending on the prime rate in each country and a number of factors such as (1) the currency of denomination (2) the client's credit risk profile, (3) the personal relationship between the bank and the customer, (4) the number of guarantors and (5) the down payment made. Interestingly, in Bulgaria loan terms vary according to construction type and building materials, the rationale being that these factors have a major impact on the expected life of the building. Thus, for example, loan terms for panel construction are less liberal than for brick (Merrill et al., 2003; Bothwell and Merrill, 2005). Bank competition in Bulgaria has led to product innovation. Recently banks have introduced 'bridge financing' to allow the purchase of new dwelling for clients still waiting to sell their existing home and secondary mortgages for renovation. The State Savings bank) offers credits without review of labour/income contracts with interest rate of 13% for 15 years (Dimitrov, 2004).

Meanwhile the banks in Bosnia and Herzegovina and Serbia have generally adopted an over-collateralisation approach to lending, and focus their marketing on upper income groups and favoured corporate customers. Mortgage loans are offered only to clients with multiple guarantors and often require other collateral as well, including compensating balances, bills of exchange, and other real estate. Employment must generally be in the formal sector, and in some cases, employment at bank-financed corporations. Loan-to-value (LTV) ratios generally range from 50% to 70%, terms from 10 to 15 years, and interest rates are currently around 10–12% (Butler et al., 2004; Merrill et al., 2004).

Table 8.2 Terms of mortgage lending in the region, 2004

Underwriting criteria	Serbia	BiH	Croatia	Bulgaria	FYR Macedonia	Albania
Amount (max) EUR	10,000	10–30,000	50–100,000	50,000[a]	10–12,000	10–15,000
Loan-to-value (LTV)	70–100%	50%	70–85%	70–80%	50%	50–70%
Monthly salary to pay the loan (PTI)	Up to 50%	Up to 50%	33%	33%	33%	33–40%
Interest rate	8.5–10.5% floating	9–11%	6.75–8%	9–12%	8.7–10%	11.5–14%[b]
Maturity	Up to 20 years	10–15 years	15–25 years	15–20 years	10–15 years	5–20 years
Guarantors	0–2	2–3	Up to 3	2	3	Up to 2
Property insurance	Yes	Yes	Yes	Yes	Yes	Yes
Life insurance	No	No	Yes	No	No	No
Currency clause	Yes	Yes	Yes	Yes	Yes	Yes
Registration of the real estate	Not in all banks	Yes	Yes	Yes	Yes	Yes
Admin. fees	Up to 2% of loan amount	Up to 2% of loan amount	1–2% of loan	–	Up to 2% of loan amount	–
Collateral	First ranking mortgage	Yes	Yes	Yes	Yes	Yes

Source: Serbia, BiH, Former Yugoslav Republic of Macedonia – Interview data, November 2004 and March 2005; Bulgaria and Romania – Merrill et al. (2003); Croatia – Registra, Analystas and Imantra (RAI), (2005b)

[a]In Bulgaria, Croatia and Romania loans are denominated in the local currency with interest rates indexed to foreign currency

[b]Loans in foreign currency min LIBOR + 4–9%

In most cases payment instalments (PTI) cannot exceed 33% of household (regular and formal) income. Regular income and employment stability is compulsory. In cases where informal income represents a high amount of total income, lenders usually require collateral for the mortgage as well as one to three guarantors. Guarantors must meet the same eligibility criteria as the borrower to counteract instability in income and employment. However, given that there is no central registry of guarantors in any of the countries, it is impossible to verify whether or not one individual is acting as a guarantor for multiple loans.

Life insurance is not always compulsory, but property insurance usually is. Insurance costs, however, are low and do not seem to represent a significant extra cost for the borrower. There are nearly always additional up-front fees pushing costs higher. The banks have devised numerous schemes for 'risk-based' pricing, varying the interest rate with the size of the loan and the size of the compensating balance. Upfront fees, usually in the range of 1–3% vary according to loan size or whether the borrower is a bank customer.

8.3 Constraints for Mortgage Lending

8.3.1 Interest Rate Spread

Annual inflation in South East Europe has declined steadily in the last few years, leading to more manageable interest rates. However, the interest rate spread between loans and deposits in local and foreign currency is still considerably high. The available data presented in Fig. 8.2 indicate that the interest rate spread in the region is two to three times higher compared to the average in Hungary and Slovakia. There are several reasons – both systemic and non-systemic – to explain the current high spreads. Banks have less experience with credit risk assessment than banks in the more advanced reformers in Central Europe; there are still numerous gaps in the primary mortgage market – uncertainty of borrower's income, high credit risk profiles, registry and foreclosure inefficiencies.

8.3.2 Conservative Approach to Lending

The experience in developing mortgage finance systems in transition and emerging markets indicates that banks remain very risk averse and tend to adopt an over-collateralised approach to lending. These may include multiple guarantors, low LTV ratio and other collateral. In addition, although foreclosure might be legally possible, social and cultural barriers make lenders less reluctant to enforce it, so there has been a very limited experience with foreclosures in the region (Merrill et al, 2003; Registra, Analystas and Imantra [RAI], 2004b).

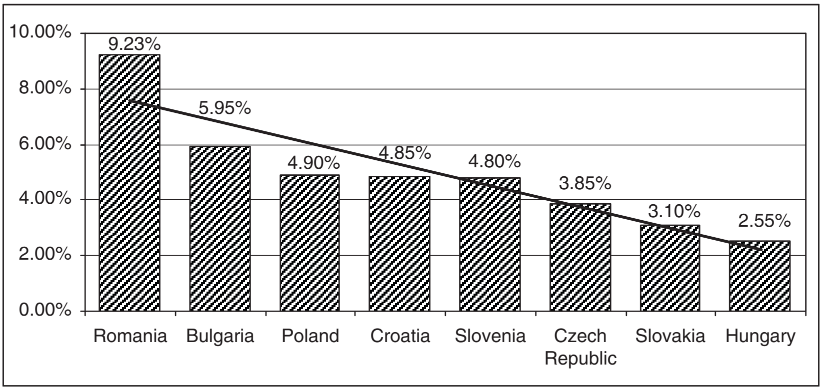

Fig. 8.2 Interest spread in transition countries, 2004. *Source:* Registra, Analystas and Imantra (RAI), (2005b)

8.3.3 Affordability Constraints

As a result of high interest rates and interest rate spreads, but also perceived risks in mortgage lending, banks have focused their marketing on the upper income groups and favoured corporate customers. Households with ability to borrow and repay their mortgage tend to be in the higher income quintile. A recent assessment of mortgage markets in Croatia, Serbia and Former Yugoslav Republic of Macedonia concluded that average price-to-income ratios tend to be high compared to the ones in mature and well established housing markets – close to 12 in Former Yugoslav Republic of Macedonia and Croatia and 16 in Serbia (Registra, Analystas and Imantra [RAI], 2004b, 2005b). While these estimates are no doubt very crude given the lack of systematic data on income and prices of housing, they suggest that in the case of Croatia less than 10% of the households can qualify for a mortgage. Data are presented in Fig. 8.3 with an indication of average values for price-to-income ratios in each income decile. Households are grouped from the poorest to the richest income deciles. At the bottom of the income spectrum price-to-value ratio is as high as 45. What is particularly interesting is that given the more competitive mortgage terms with similar price-to-income ratio, up to 14% of Croatian households might be able to borrow, while in Former Yugoslav Republic of Macedonia this share is 3%.[4]

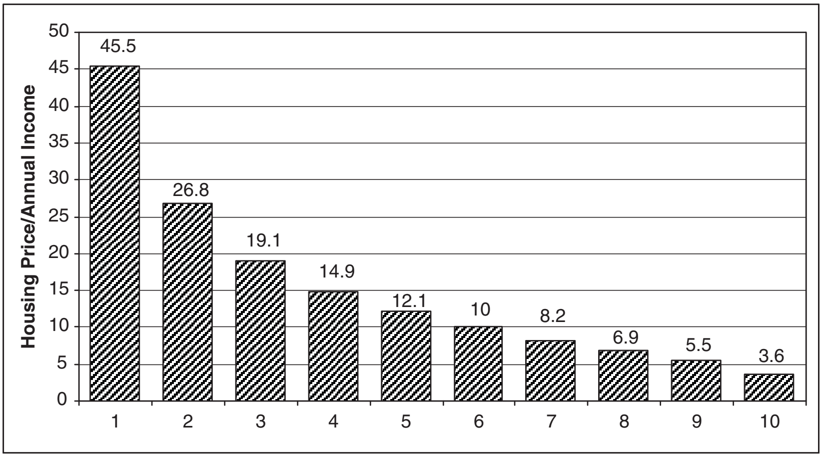

Fig. 8.3 Price-to-income ratios in Croatia, 2004. Note: Households are grouped from the poorest to the richest income deciles. *Source:* Registra, Analystas and Imantra (RAI), (2005b)

[4] Under the most advantageous conditions offered by Croatian banks – 80% LTV, 25 year maturity and 6.5% interest rate, PTI 33% – 14–16% of the households can qualify. In the case of a renovation loan – 20% LTV, 5 year maturity, 8.5% interest rate, PTI 33% – close to one third of the households can qualify.

8.3.4 Lack of Construction Lending

Many banks do not engage in construction lending due to uncertainty about titling and ownership of un-built land. This is a significant constraint for new housing construction, particularly in the case of multi-apartment housing. The lack of mortgage support institutions further constrains the development of a well functioning system of housing finance. Primary market support functions are especially important in emerging market mortgage lending. This implies an effective legal infrastructure, including foreclosure and repossession; an appraisal process based on international standards; credit information bureaus; and mortgage-related insurance products (Bothwell and Merrill, 2005). The development of effective appraisal methodology in the emerging housing markets of South East Europe faces numerous challenges. For example, broad-based databases generally do not exist, making it difficult to utilise a comparable appraisal methodology. Also, actual sales prices are often not recorded in order to reduce sales taxes. Most of the countries lack professionally licensed real estate agents and property appraisers. Credit bureaus are established in BiH and Kosovo/UNMIK and are under consideration in Bulgaria and Romania.

8.4 The Housing Industry in Transition

8.4.1 Privatisation of Construction Enterprises

Privatisation of the construction industry was undertaken in all South East Europe countries although at varying paces and in different ways. It has, however, primarily been regarded as an industrial rather than a housing measure. Models of privatisation have been based on those employed in other industrial sectors, such as employee buy-outs, sale of enterprises to foreign investors, and the establishment of state shareholding funds (World Bank, 2002). The privatisation of large-scale, vertically integrated, state owned construction enterprises – *kombinats* – has been a slow process in Bulgaria, Moldova and Romania. In Bulgaria, 12 out of the 30 *kombinats* – producers of 3,000 panel housing units per month in the early 1980s – survived till the mid-1990s, and in Romania a large number were left to complete some of the large scale housing projects (Tsenkova, 2000). Parallel to privatisation, a restructuring of the state construction industry has proceeded decisively with new firms emerging from the original vertically integrated organisations. In Serbia, construction enterprises have been caught in the general postponement of industrial privatisation. Despite various problems, former state enterprises recast as private entities have achieved considerably greater production flexibility and management efficiency through production restructuring and downsizing. Struyk (1996) argues that the structural change has been accompanied by efforts to offer housing products with different characteristics compared to the old concrete panel design.

8.4.2 Private Housebuilders

The housing industry in the region is in a process of restructuring. A wide range of different organisations, varying by size, ownership, and expertise, has emerged. Indeed, within a decade the shift to private housebuilding has become almost universal in all countries in the region with further restructuring driven by demand in the homeownership market. In the general absence of national/local data on the housebuilding industry, information on the construction firms in region can be used to highlight major outcomes of the transformation process. Several characteristic features emerge. First, the share of private construction firms in 2000 has increased to 80% in Albania, Bulgaria, Croatia and Romania. Second, employment in the construction sector has contracted in the 1990s in all countries with some notable increases since 2000 due to infrastructure and non-residential investment (Euroconstruct, 1995; ECE, 2004). Third, there has been a phenomenal growth in the number of firms, particularly those with less than 20 employees. The process has had a dramatic impact in Romania, Bulgaria and Croatia as shown in Table 8.3, where available data on construction firms grouped according to number of employees are presented. Time-series indicate that a fragmented industry has emerged in a short period of time. Small firms with less than 20 employees account for two thirds of all firms in most countries with the exception of Former Yugoslav Republic of Macedonia and Moldova. In the latter group, large firms of up to 1,000 employees account for 33% and 74%.

Table 8.3 Construction firms by number of employees in the region

Country	Year	Total number of firms	Percentage of firms in the following employee categories			
			Up to 19	20–99	100–999	1,000+
Albania	1995	1,457	86.6	9.7	3.6	–
	1996	1,789	88.8	8.2	3.0	–
Bulgaria	1991	923	4.3	35.2	58.0	2.5
	1992	4,576	75.3	13.1	11.3	0.3
Croatia	1990	953	60.8	13.3	24.2	1.7
	1996	2,144	78.0	16.0	5.6	0.3
FYR Macedonia	1994	251	33.9	30.3	35.1	0.8
	1995	238	33.6	32.4	33.2	0.8
Republic of Moldova	1994	27	3.7	7.4	85.2	3.7
	1996	27	3.7	18.5	74.1	3.7
Romania	1990	203	4.9	1.5	25.1	68.5
	1996	7,046	68.1	20.2	11.1	0.7
Yugoslavia	1992	2,631	76.1	8.5	14.1	1.3

Source: Economic Commission for Europe (1996, 1998)

Private housebuilders have become the new agents in the homeownership market with a strategic role in the provision of new housing. They manage the entire development process from identification of the site, through planning negotiations, land provision, supply of building materials and equipment, labour contracts, marketing, financing and the final sale of dwellings. It is important to distinguish between the private housebuilder (developer) and the builder or contractor. A variety of firms currently operate as housebuilders, performing the function of both a developer and a contractor (ECE, 2001, 2002).[5] The existence of a large number of small firms in the housebuilding sector reflects the ease of entry into the industry, the fragmented nature of the development process, the demand for small traditionally built housing, and the lack of economies of scale. In general, the industry is characterised by a large number of small firms building up to 25–30 houses and/or apartments per year and only a handful of larger firms building more than 100 housing units per year. Large builders play a more prominent role in selected large urban markets, including Bucharest, Sofia, and Belgrade (Colliers International, 2007a, b, 2008c). Those companies use their own resources for construction finance, and in some cases have established investment and development subsidiaries. Some housebuilding firms have started by spinning off from state construction enterprises, others – as a new business venture driven by market demand. Private housebuilding has established a considerable market presence in Bulgaria, Croatia and Montenegro with speculative housebuilders targeting the elite market. Notwithstanding progress, market–based housing provision in the region remains limited both in terms of volume (with rates below 1 dwelling per 1,000) and tenure choices (exclusively for owner-occupation).

8.5 The Transition in New Housing Provision

The radical change of relationships between the state and the market during the transition period has modified the forms of new housing provision and has set a new framework for the operation of key actors and institutions (Adams, 1987). The following analysis applies the concept of structures of housing provision to explore these dynamic changes in a comparative perspective (Ball et al., 1988). The concept is important in comparative research since the nature of the building industry and the diversity of promotion/production are vital to understanding the varying nature of output between countries (Ball et al., 1988, 1996; Barlow and Duncan, 1994).

[5] The statistical information does not distinguish the housebuilding sector from all other construction activities. Most of the firms are involved in residential as well as non-residential activities depending on local demand.

8.5.1 *Forms of New Housing Provision*

There is a wide variety of private and mixed forms of new housing provision, mostly for owner-occupation in South East European countries. Their evolution depends largely on the relationship between the state and the market within a particular housing policy framework. Some can be regarded as successful and adaptable to the new political and economic reality, others will fade along with the transition period. On the basis of processes and institutions related to the promotion, production, allocation, and consumption of housing, the following major forms of new housing provision can be identified: public/private cooperation, speculative housebuilding, self-help and informal housing. Forms also determine the level of participation of key public and/or private sector actors and institutions, as they were identified in Chapter 4, Fig. 4.6. Considering the dynamics and adaptability to the market environment, these forms have a different potential in specific local markets. With respect to national experiences and specific arrangements the 'labels' might conceal significant variations within each form.

8.5.1.1 Public/Private Cooperation

In the public/private cooperation local or national housing agencies initiate the majority of the housing schemes. Other developers are enterprises, governmental agencies and public organisations. Land is often owned by municipalities or other public institutions. The construction process is carried out on a contract basis by state and/or private construction firms under regulated costs. Funding is provided proportionally by all the parties in the project using different sources: loans, personal savings, mortgages, enterprise funds, etc. Private investors, usually individual households, finance a significant share of the development. Often those shared participation schemes have evolved as a strategy to overcome shortage of construction finance in new or uncompleted projects (Council of Europe, 2001, 2004; Kaganova, 1995). Allocation of housing to each partner is according to its share of development costs financed (Council of Europe, 2003b; Kaganova, 1995). Municipalities and other public institutions as landowners often receive up to 20–25% of the units. In Moldova and Romania, some public institutions, have implemented this model through auctions of land, or uncompleted projects (Tsenkova and Dogotaru, 2006).

In Bulgaria, Croatia and Albania similar arrangements are used to provide owner-occupied housing to 'target groups'. There are significant variations in the quality, structure and type of these public/private projects but in most of the cases this is modest housing with standardised apartments as shown in Fig. 8.4. Some are built using traditional construction methods with greater involvement on behalf of future homeowners financing the construction; others are developed by public construction enterprises in high-rise structures. More recently, the model has been implemented in several countries – Romania, Macedonia, Bosnia and Herzegovina and Albania – to provide public rental housing, often with state guaranteed loans.

Fig. 8.4 New housing through public/private cooperation in Shkodra, Albania

8.5.1.2 Speculative Housebuilding

Speculative housebuilding is usually a small scale undertaking which operates by linking investors with capital, land, building materials, equipment or labour. To organise the whole process from the promotion to the completion of the project requires enormous efforts. In the case of condominiums, landowners acquire a share of the built units, though larger firms are in a position to buy the land. Equity financing is the dominant source of funding both for multi-family and single-family housing. An amazing variety of schemes exists trying to compensate for the lack of adequate construction finance ranging from advance payment to shared participation (Struyk, 1996; Tsenkova, 1997). The importance of the informal economy for this form of housing provision is significant attracting funds from unreported activities.

Condominiums have become a significant part of the new housing market in urban areas. Costs are lowered through collective ownership over the land, common elements and shared maintenance. Purchasers of condominiums obtain the benefits of ownership in attractive locations where the cost of land is usually much higher. The scale of some developments, however, creates difficulties in management of the production process and coordination of financial contributions (Tsenkova, 2000). While there is a growing preference on behalf of speculative housebuilders to initiate single family housing in attractive suburban areas, the lack of serviced land is a major problem (Hegedüs and Tosics, 1996; Colliers International, 2007a, 2008b). Market prices are high; housing is built with the expectation of being sold during or shortly after completion. The small scale of development provides an opportunity to control and even reduce the investment risk through appropriate management of the construction process. Private firms use traditional construction methods; quality and space standards are higher than those in self-help and self-built housing.

8.5.1.3 Self-Help Housing

Self-help housing is a small scale housing development initiated by one or two households on privately owned land. This form of housing provision has a long tradition in small towns and villages across the region (Koleva and Dandolova, 1992; Kos, 1992). Future homeowners often control the promotion, financing and production process. Construction tends to be labour intensive, and is carried out by a contractor with the help of the extended family for 4–5 years. Access to land is critical and in some countries (Albania, Croatia and Romania) municipalities facilitate this through expansion of development boundaries in the new master plans. In general, housing construction costs are lower and the quality varies. Recently, self-help in rural communities within commuting distance to large urban centres, coastal areas and recreational zones in Croatia, Bulgaria and Romania has gained popularity and has become more commercialised, attracting even international investors.

8.5.1.4 Informal Housing

Informal housing has grown rapidly in the region since the transition. In fact, authorities in former Yugoslavia had a higher tolerance towards informal house-building both in rural and urban areas. However, the scale of these developments today is much more challenging and varied – from slums to luxury residences, from centrally located areas to suburbs, and from several small units to large settlements. Studies indicate that most of the new housing is illegally constructed in Serbia, Montenegro and Albania (ECE, 2002, 2005). This includes illegal construction on both regulated and non-urbanised land. Households mostly build single-family homes with the construction process heavily dependent on availability of funds and labour. Remittances reportedly play a very important role as well as personal savings. Land is often unserviced, without a clear title, but the construction is solid with concrete frame and bricks or block infill. As both building and planning control is limited, the quality of construction varies and materials can be of poor quality. Some of the significant disadvantages are associated with the lack of infrastructure services – piped water, sewer and transport. Households admittedly often pay bribes to state and municipal companies to get access to services. Similar strategies to informal housing construction may be used by private builders and individuals acting as developers of their own housing. Although quality and standards are higher, housing is legalised after its completion.

The preceding analysis has identified a typology of owner-occupied housing provision within South East European countries. Different forms – public/private cooperation, speculative housebuilding, self-help and informal housing – are defined by the relations between those who initiate and control the production process and the other institutions involved – landowners, financial institutions, municipal planning agencies and housing consumers. Table 8.4 summarises the key characteristics of the housing provision forms discussed above and highlights their differences with respect to entry costs, control over the development process and access to land and construction profits. Owner-occupation through public/private cooperation is an intermediate alternative where land profits are eliminated through public ownership of the land, and construction costs are regulated. Alternatively, the impact over entry costs is favourable and the risk is reduced. Speculative housebuilding offers the best choices to consumers, but at the expense of high costs and risk. Land and construction profits are also high, which certainly affects the sales price. Self-help and informal housing provide opportunities for homeowners to be involved in the promotion and land development stage, as well as in the actual production of housing. Entry costs are lower however choices of location and dwelling type/quality are much more limited. Households, and in some cases private construction firms, act as producers of housing, land profits are internalised and development risk is minimised.

Table 8.4 Forms of new housing provision in South East Europe

Selected characteristics	Owner-occupation and/or public rental through public/private cooperation	Speculative owner-occupation	Self-help owner-occupation	Informal housing for owner-occupation
Entry costs	Medium	High	Medium	Low
Access form	Queue/market	Market	Queue/market	Non-market
Choice of location and dwelling type	Low	High	Medium	Low
Land supply	Non-market	Market	Market/non-market	Non-market
Producer of housing	Private/public firms	Speculative housebuilders	Households	Households/private firms
Access to land profit	Non-existent	Speculative housebuilders	Households	Households
Property ownership	Mixed	Owner-occupied	Owner-occupied	Owner-occupied
Construction profit	Low	High	Non-existent	Non-existent/medium
Risk	Low	High	Low	Low/medium

8.5.2 Quality and Costs in New Housing Provision

The opening up of housing markets to private construction activity and the reorganisation of the industry have resulted in significant changes in the *size, quality and type* of new housing. Aggregate data indicate that in 2002 the average size of newly built housing has increased in all South East European countries. Increases in size are particularly significant in Moldova and Romania where the average size nearly doubled compared to levels in 1990, while in the Former Yugoslav Republic of Macedonia, growth has been modest (see Table 8.5). The elimination of state/publicly funded housing construction programmes and the shift in construction methods is reflected in a growing share of single-family houses in Bulgaria (98%), Moldova (58.3%) and Romania (57.7%). In Croatia, this share has declined compared to 1990 due to government sponsored construction programmes providing apartments for refugees and IDPs. Finally, urban areas account for a higher share of new construction in most countries due to pent-up demand in cities. Romania is a notable exception with a complete reversal of its socialist policies of urban-driven housing provision; the share of housing in rural areas in 1998 is as high as 65%.

Large scale panel construction, through which 50–70% of the urban housing stock has been built, has been eliminated. Private housebuilders employ largely traditional methods. Brick and concrete construction are increasingly popular in the region. On-site construction is labour intensive and time consuming, so housing takes an average 18–24 months to complete. However, those methods have improved dramatically the diversity of the product which is reflected in the design and variety of dwellings offered on the market. Private housebuilding has been very quick to adjust to the marketplace and to broaden consumer choices with respect to size, type of units and architectural styles. Though systematic comparative information on other quality indicators is not available, the national statistics report on significant improvement in the level of infrastructure services, at least in the formal housing market.

Table 8.5 New housing provision: Selected indicators

Country	Average size of newly built housing (m^2)			Share of new housing in urban areas (%)	Share of single-family housing in total new housing (%)	
Year	1990	1995	2002	1998	1990	1998
Bulgaria	71.7	86.1	91.3	86.0	94.6	98.2
Croatia	80.4	84.8	88.0	49.0	74.2	42.0
FYR Macedonia	71.6	71.9	79.4	59.4	–	12.2[a]
Moldova	68.0	76.7	111.8	60.0[a]	54.0	58.3
Romania	64.5	72.9	104.9	35.0	7.3	57.7
Yugoslavia	74.0	78.5	–	54.7[a]	23.1	19.2[a]

Source: Economic Commission for Europe (1996, 1998)
[a]Data refer to 1996

While the market-based provision system has delivered better results with respect to size, quality and diversity of housing types, *land and construction costs have increased dramatically*. The first comparative assessment of housing reforms and their impact on new housing production in transition countries carried out by the Metropolitan Research Institute (MRI) (1996) documented the widening differences in land and construction costs in South Eastern Europe at the start of the transition. These differences appear to have been sustained, although some convergence in land costs is observed. Land costs vary widely according to the size of the city and location. Average land costs defined as a percentage of the total house price in typical new housing development are lower in Bulgaria and Moldova (see Table 8.6). These costs can be as high as 25–28% in Croatia, Romania and Serbia. The data indicate that land cost have declined since the mid-1990s which might be attributed to better functioning of land markets. Generally, difficulties in converting agricultural land into residential uses create land shortages. In addition, jurisdictional and titling problems are driving land prices upwards. Legal uncertainties about restitution claims, property titles, and inadequate land register systems further contribute to land shortages and the fragmented nature of land supply.

Construction costs are difficult to forecast and estimates do not remain valid for long due to high levels of inflation and uncertainty about the availability and cost of building materials. Reported costs in 1990 range from US $37/m^2 in Albania to US $1,500 in Croatia. As time series data in Table 8.6 indicate, there has been a considerable increase in construction costs in the last 15 years, particularly in Albania and Romania. Those changes no doubt reflect inflationary processes, increases in the prices of building materials, energy and transportation costs, but may, in part, be due to the use of outdated construction technology and the lack of economies of scale. In the context of general economic instability in the region, most of the firms have adopted a US dollar pricing strategy since 1994, and switched to EUR in 2003. It is interesting to note that

Table 8.6 Land and construction costs in new housing, 1994–2004

	Land costs[a]		Construction costs[b]		
Country	1994	2004	1990	1994	2004
Albania	–	20.0	37	150	210
Bulgaria	17.0	15.0	120	176	450
Croatia	35.0	28.0	1,500	1,000	1,136
Romania	32.0	25.0	320	336	760
Moldova	–	18.0	–	156	390
Serbia	20–25	25.0	1,055	859	450

Source: Metropolitan Research Institute (1996); Tsenkova (2005) (data for 2004 and Moldova)

[a]Defined as a percentage of the total house price (including land price) for typical newly constructed units

[b]Defined as the present replacement cost (labour, materials, on site infrastructure, management and contractor profits) in US $/m^2 of a median priced dwelling unit

construction costs in Croatia have remained relatively stable, while in Serbia the decline might be due to sluggish demand and economic difficulties.

8.6 Economic and Social Efficiency of Private Housebuilding

Addressing the question of economic and social efficiency requires analyses of first, key characteristics related to the economic performance of housebuilders and second, the responsiveness of housing supply to consumer preferences. Economic efficiency can be measured in terms of the ratio between development costs – land, on site infrastructure, construction costs, and development profits – and the sales price. These ratios are very difficult to capture empirically given the heterogeneity of supply and significant fluctuations in construction and land costs, so the analysis here will focus on business strategies to minimise risk and increase profitability. The social efficiency of a housing system (Dickens et al., 1985) refers to its ability to achieve an appropriate supply of housing with respect to location, quality, size, and access costs. Since the chaotic behaviour of prices in the region makes comparative research on homeownership markets extremely difficult, the following sections will explore responses through marketing, product diversification and pricing strategies. The analysis is based on qualitative interview data in several capital cities in South East Europe during 2002–2005.

8.6.1 Economic Efficiency

8.6.1.1 Land Strategies

The way in which firms structure their development activities primarily depends on the nature of the two markets they have to operate in – the homeownership market and the land market (Ball, 1987). Land is a major resource and one of the biggest problems in private housebuilding. The literature highlights the advantages of land strategies such as banking to maximise development gains in housebuilding (Ball, 1996; Barlow and King, 1992; Bramley et al., 1995). In transition countries in general, and in the region, land banking is virtually non-existent. Landowners rarely sell land even to big institutional investors. Land acquisition strategies include a joint ownership with the landlord and/or purchase of the building rights for a period up to 5 years. Within that arrangement developer's profit from land is not as significant, rather profits could be achieved through margins between production costs and the sale price of the dwellings. Although housebuilders emphasise the importance of land dealings, they are much more attracted to areas with high demand and prestigious sites where marketability of units is higher and sales prices are correspondingly higher.

The selection and identification of the site is the first step in reducing the development risk. Larger developers prefer a wider selection of sites in their land portfolio to minimise the risks, however smaller firms tend to be specialised in niche markets, such as gated communities illustrated in Fig. 8.5. Though housebuilders express a preference to build on green field sites, in reality most of their operations are clustered on infill sites in the central areas.[6] Green field development is practically possible for the very few volume housebuilders who can justify the expenditure for off-site infrastructure with the size of the development and also compensate these costs through economies of scale.

8.6.1.2 Production Cycle and Efficiency

The organisation of housing production involves the purchase and assembly of non-land inputs, the management of labour and control over the building process at the different stages of the production cycle. Efficiency and higher profits can be achieved through greater flexibility in the organisation of the production process, and in the management of labour and technological capacity. In general, firms attempt to maintain a steady flow of units in order to utilise their existing technological and

Fig. 8.5 Private housing in Chisinau, Moldova

[6] For example, a shortage of land for residential development in Zagreb has contributed to rapid increases in prices. In the past few years house prices increased to € 2,039 per square meter for apartments and € 1,562/m^2 for houses due to demand outstripping supply. Larger developers are looking for land to locate large-scale residential projects (Colliers International, 2008a, b).

labour capacity. Having a set of projects at different stages of the construction process enables them to streamline the supply of materials and to increase production efficiency. Multi-family housing is built in phases: site clearance, ground work, site servicing, construction of slab and bearing walls, finishing works. Figure 8.6 illustrates these processes in the largest housing development in Chisinau constructed by MAGIC, the largest housebuilder in Moldova. MAGIC owns building material enterprises, several construction companies, and design firms thus controlling all phases of the development process and internalising profits. Traditional methods of housing construction require semi-skilled labour, so most of the small and medium size firms contract *brigadi* for bricklaying and slab erection.

Fig. 8.6 The largest housing development in Chisinau, Moldova, built by MAGIC

Specialised, skilled labour is needed mostly for the finishing works. Most housebuilders, regardless of their size, contract out specific tasks – groundwork and insulation are a good example – to private or public construction firms. Those tasks apparently require heavy technological equipment which is in most cases state owned. Though it is common with firms to purchase lifts, operational mechanisation, fork lift trucks to transport palletised bricks around the site, etc., only the volume housebuilders and several of the medium size firms indicated a serious commitment to developing a technical capacity sufficient to meet their needs. Given the increases in the prices of building materials and inflationary pressures, not surprisingly housebuilders have a strong incentive to reduce construction costs by rationalising the supply of materials.

8.6.1.3 Strategies for Finance and Risk

Success and efficiency are closely related to the mobilisation of funds. Housebuilders try to be independent from borrowing, and as discussed earlier, commercial banks in the region are reluctant to lend for new construction. Most firms provide up to 30–40% internal financing. Through *land barter* (building rights in exchange for a share of the newly built housing) payment for the land is deferred, but builders need to cover the costs of project development, legal fees and marketing upfront. The bulk f the capital is provided by prospective homebuyers (Fig. 8.7). Currently, sources of funding for new housing construction are obscure at best. Needless to say housing absorbs a great deal of profits from the shadow economy, hard currency earning and remittances. *Equity financing* has given a lot more power to consumers in terms of influence over the design, size and quality of dwellings, but has also created a number of problems. If investors pay 90–100% of the price in advance, there is little to no guarantee for the developer against inflation. More importantly, in larger projects the process is much more difficult to manage, often shares of buyers unable to keep up with the payments need to be resold. Ultimately under such conditions investment is considered risky. The implications for the organisation of the production process are several: (1) a shift towards small-scale, tradition-built housing, (2) low tech solutions (cheaper labour and local materials), and (3) a longer construction period so that buyers can mobilise funds. Under the unstable macroeconomic conditions longer construction periods paradoxically shelter the housebuilders from higher risk, since both sales and prices can be adjusted to surges in costs and exchange rates.

8.6.2 Social Efficiency of Private Housebuilding

8.6.2.1 Product Diversity and Marketing Strategies

Successful operation in the housing market implies correct anticipation of demand and consumer requirements and is based on attempts to forecast the future size of the local housing market. Though in reality housebuilders are not involved in a comprehensive assessment of housing demand, firms do attempt to identify local housing market preferences for a particular type of housing, physical layout and

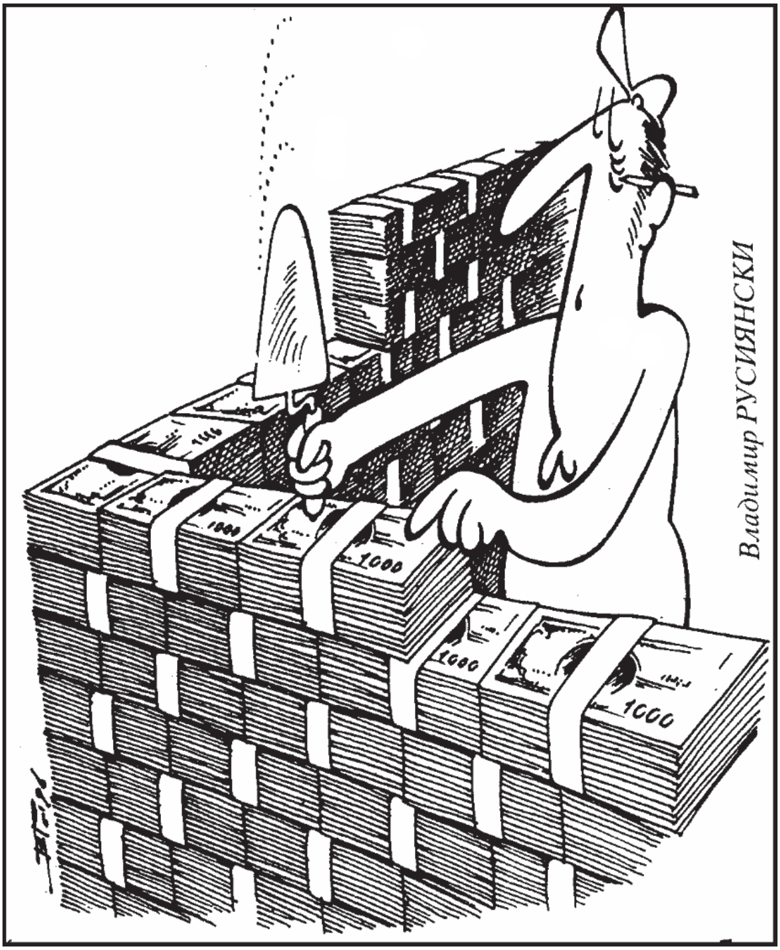

Fig. 8.7 Cash payments have become the basis for financing of new housing

design. Evidence from other studies of new housing construction in the region indicate that output in cities mostly consists of medium density housing in five- to six-storey apartment buildings (Colliers International, 2007a, 2008a, c). Apparently 80 square meter apartments with two bedrooms are most popular on the market. More recent trends in Bulgaria and Romania indicate a shift to larger, high end dwellings, some being part of a new resort apartment market.[7] The physical change can be

[7] There is considerable growth in the resort apartment market in Bulgaria. For the first half of 2007 alone, there were 23,000 new apartment units built in both coastal and mountain resorts (Colliers International, 2007b). This relatively new market has been growing since mid–2005 at a very fast pace. The absorption rate for existing development was 75% in early 2007, with international buyers like British and Irish citizens accounting for much of the demand. The price range for high standard development is around € 1,700–2,000/m^2.

Fig. 8.8 Typical medium density housing development in Bourgas, Bulgaria

illustrated in the improved design characteristics of newly built housing compared to the mass produced dwellings in the housing estates as shown in Fig. 8.8. Housebuilding has made a remarkable progress towards better quality and diversity of the final product. The standard four Ps of a marketing strategy – product, price, place, and promotion – are essential for private housebuilders (Tsenkova, 2000).

In the demand-driven housing provision system, consumer preferences and choices are a powerful influence over new housebuilding. These preferences show a growing focus on inner city living and neighbourhood quality, which in turn affects the location of new housing. Private housebuilders prove to be more efficient than state construction enterprises and can deliver better products compared to the state controlled system. The kombinats were notoriously famous for production delays, poor management of the construction process and unfinished projects. The buildings themselves were costly to maintain and had very low energy efficiency. Though housing in the deregulated markets has become more expensive, medium-density, traditionally built housing as opposed to the uniform, system built units in high-rise estates has become the norm.

A detailed knowledge of local housing markets, prices, and potential sites is obviously very important. A variety of marketing tactics have been adopted to provide a more sensitive response to the housing market and to increase revenue from sites. First, a mix of apartment types is provided in the first phase to see which sells best and adjust the rest of the scheme on the basis of that experience. Second, house-builders gear the rate of completion towards the rate of sales. Third, the uncertainty in the housing market influences the policy over sales prices, and different packages of finishing works. Volume builders often negotiate contracts with fixed final prices, while most medium and small size firms adjust the sales prices with inflation and the construction cost index. Generally firms will provide up to 5–10% discount to purchasers paying the total price in advance. The standard schemes include cash payment on an instalment basis (70–20–10 or 50–30–20). Given the prices of the dwellings, the social composition is skewed towards higher income groups, notably professional and managerial categories. These educated consumers are more demanding, so the industry encourages quality design, improvements in layout, and emphasises flexibility.

8.6.2.2 Affordability and the Myth of Consumer Choice

Theoretically, a market-oriented system for new housing supply should provide a greater variety of housing for owner-occupation. However, consumer sovereignty in a demand-driven housing provision system is in accordance with the ability to pay (Bramley et al., 1995; Renaud, 1996). Given the fact that wages have failed to keep up with inflation, and living standards have declined across the region, the scope for consumer sovereignty is marginal for most households. It has become clear that housing markets are not a universal solution to existing housing problems and will not automatically lead to a better housing situation, particularly for households excluded from access to homeownership. Studies consistently point out that the low purchasing power of consumers, uncertain income prospects and the lack of mortgage instruments suitable for an inflationary environment reduce the pull of potential buyers (Registra, Analystas and Imantra [RAI], 2004a, 2005b; Renaud, 1996; Ravicz, 1992). It is important to mention that there are big regional differences in the housing markets of large urban centres and apparent regional variations in housing prices and affordability. Exploration of those issues is beyond the scope of this work, but studies document recent fluctuations and growth in house prices in the urban markets of Bulgaria, Croatia and Romania with widening differences with the countryside (Colliers International, 2007a, 2008a, c). Bulgaria and Romania, which already joined the European Union, have seen double digit growth in their house prices (Ball, 2007), exceeding rates of growth in most Western European countries.

What affects house prices and makes housing expensive compared to average incomes? Increasing construction costs, though relatively low compared to Western European standards, coupled with land production costs have pushed house prices up considerably. Certainly the elimination of subsidies, inflation, escalating building materials and energy costs, high land costs, planning and legal delays, all have pushed up the prices of newly built housing. In addition, state policies and regulation have been hostile to the sector, imposing prohibitive infrastructure and development costs. For example, the 18–20% value added tax increased significantly the prices of new housing; and often prices for similar projects vary by 20–30% depending on the infrastructure premium. A high ratio between house prices and average earnings limits access to the homeownership market and the opportunities for private housebuilders. Not surprisingly, despite a strong preference for homeownership, but given the affordability constraints, few households can afford entry into the market.

The tenure structure also limits the range of housing opportunities and fuels demand for new owner-occupied housing. Informal discussions with homebuyers indicate that most end up ‘trapped in home ownership’ paying unbearable costs.

To summarise, the transition from a centrally planned to a market-based housing system has created a very different environment for the provision of housing in the region and has increased the role and involvement of private institutions. A large number of private housebuilders produce new housing. These new actors compete in the market place to deliver better products and services. Equally important to the emergence of private developers and housebuilders has been the increase in self-help and informal housing provision, partly as a response to high prices in homeownership markets. In particular, the absence of a well-developed system for housing finance is a major constraint for the efficient operation of actors and institutions in the marketplace. In examining the economic efficiency of private housebuilding, it was argued that the system can deliver financial return and profits, but is extremely vulnerable during recession and inflation. Success in housebuilding depends on land deals, on more conservative organisation of production and on equity financing. It was argued that market-led housing development has a potential for greater social efficiency with respect to consumer choices, quality and product diversity. However, the housebuilders service mainly the upper end of the housing market and little capability is being developed to deliver affordable housing, which seriously questions the social efficiency of the housing system.