

**THE PROSPECTS FOR
HOUSING FINANCE IN
ROMANIA**

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EXECUTIVE SUMMARY

This report updates selected information from a USAID-sponsored housing sector study conducted in late 1994. Although the main focus of the earlier study was not housing finance, it did conclude that the prospects for market-based housing finance were not good at that time. The present study identifies key developments in the sector with respect to housing demand and affordability, especially those that have occurred during the last five years, and discusses their importance for the future development of housing finance. In addition, it assesses the readiness of the banking sector and associated institutions to focus on housing finance and provides suggestions for development of a safe, sound and more active market.

THE HOUSING MARKET

The Development of the Market

The housing market in Romania has continued to develop rapidly during the past five years. The extensive privatization of the housing stock has contributed to the development of a fluid real estate market that offers a wide range of prices and amenities to households seeking to improve or adjust their housing situation. The number of residential sales transactions went from about 39,000 in 1990 to a peak of about 226,000 in 1993, before dropping to an annual rate of less than 180,000 by the mid-1990s. Most transactions involved transfer of units through privatization, not newly constructed units. For example, only about 36,000 new units were built in 1995, yet there were approximately 170,000 transactions during that year (a figure representing about two percent of the total stock). The fact that there has been little new construction recently is not a reason for ignoring the role that housing finance can play in facilitating the market.

The economic downturn of the past few years has slowed the overall demand for housing. While this has hit the construction industry hard, it has helped to keep prices in line with incomes, which have not grown in real terms. The price difference between existing and newly constructed units has made newly constructed units unattractive to buyers. This is illustrated by the fact that nearly all of the 11,000 beneficiaries of a recent government-subsidized loan program chose to purchase existing units rather than new units. The decline in new housing construction has contributed to heavy job losses in the construction industry; the number of construction workers as of July 1999 (342,600) is only half of what it was a decade earlier.

Prices and Affordability

The price of housing is not likely to be a factor that hinders the development of housing finance. Conservative estimates of the ratio of the price of existing housing to income appear to fall within the range of a number of other industrialized countries,

which range from 2.4 to 6.6. While the price of existing housing does not appear to be particularly high with respect to incomes, the price of new construction is prohibitive for most households. The price of a new minimum standard, two-room flat is about \$18,000 to \$21,000. This is well above the approximately \$12,000 the newly-created National Housing Agency plans to charge for a comparable unit—a price that excludes charges for land, infrastructure, profit, taxes, and financing costs. In contrast, existing unit prices cater to a wide range of household budgets. A household can purchase an existing two-room flat in Bucharest for as little as \$7,000 or as much as \$60,000. In Oradea, the price of an existing two-room flat ranges from \$4,500 to \$17,000; in Slobozia, the price ranges from just \$3,000 to \$4,200. There is no general rule of thumb for the price of a single-family home (known locally as a villa). In urban areas, a relatively small number of villas have been built recently, and many of these were built by high income households. While prices for high-end units can easily exceed \$100,000, it is nevertheless possible to obtain a modest villa with services on the edge of Bucharest for around \$25,000 to \$30,000.

The concept of housing affordability takes on a different meaning in a country with widespread free-and-clear ownership (over 94 percent of the stock is privately owned). In principle, any owner could trade his or her present home for another one of at least similar value, provided he or she could cover the transaction costs. Thus, there is a very high degree of affordability and potential effective demand among homeowners. For many, the issue of affordability revolves around the problem of being able to afford an incremental expenditure that would allow them to increase their consumption of housing services.

Housing Needs

Housing needs are not being driven by population growth and overcrowding. The population has not been growing, even in Bucharest, and migrants from rural areas have not applied pressure on urban areas. Average household size has been falling and space consumption has increased throughout the decade. The average household size fell from 3.1 persons in 1992 to about 3.0 persons in 1998, and per capita living space went from 11.5 square meters in 1992 to 11.8 square meters in 1997. While it is true that many young adults experience difficulty acquiring housing outside of their parents' homes, this has not necessarily led to physical overcrowding. About 11 percent of households have at least one child between the ages of 25 to 35, and about half of these households contain a married child. The young adults have been the primary target of most recent government housing programs, and would be strong candidates for utilizing private sector housing finance.

Housing needs are driven more by the need to replace and upgrade existing units than they are by demographic factors. Homes in rural areas are more likely to suffer from a lack of access to basic services, while homes in urban areas are more likely to require physical upgrading of existing services and structures. Over 90 percent



of the urban housing stock is made up of flats. Much of this multifamily construction was of poor quality initially and has suffered subsequently from poor maintenance. Deterioration of the multifamily stock is likely to continue as most resident owners still lack an effective means to maintain and improve their units and the common areas of the buildings. Major opportunities exist for financing rehabilitation work in the privatized stock.

THE DEVELOPMENT OF THE HOUSING FINANCE SECTOR

Housing Finance Under Current Macroeconomic Conditions

Under the current macroeconomic circumstances, demand for housing finance will be very constrained: economic growth is negative, growth in real wages is essentially zero, and unemployment has risen annually since 1996. Interest rates are not only high, but—equally damaging—they have been volatile. Very high levels of uncertainty further disrupt economic activity, especially for credit. In general, but especially in the case of housing finance, even if banks are somewhat protected from interest rate risk through variable rate products, borrower ability to pay suffers in the face of abrupt changes in scheduled amounts due.

Also, there is an extremely large gap between bank lending rates and deposit rates, which can signify a number of problems, including, of course, inefficiencies in bank operations. However, the excessive risk inherent in very volatile conditions is disruptive. Finally, although a new mortgage law is now under discussion in Parliament, at present banks apparently cannot use the property being purchased as collateral, and must rely on other assets, particularly other properties owned by the would-be borrower. Clearly, this limits an already small potential market.

The Changing Situation

On the other hand, there is better news on the horizon. The positive features of the emerging economic and legal situation include the following:

- **Improved Macroeconomic Environment.** Inflation is again falling and is expected to continue to fall. Growth in real GDP is expected to become positive during the year 2000 (or at least by 2001). The Central Bank is well aware of the necessity to decrease the volatility of the inflation rate as well as the level.
- **Restructuring the Banking Sector.** The process of privatization, consolidation, mergers, and foreign investment in the banking sector is well

advanced. The restructuring process is now nearly complete for the banks that currently have an interest in housing finance.

- **Lending for Housing Finance.** There are at least five major banks that already have a small portfolio of market-based housing loans. These include the Romanian Commercial Bank, the Romanian Bank for Development, BancPost, Transylvania Bank, and the Savings Bank (CEC). Each of these has stated aggressive plans to expand consumer lending in the near future, including housing finance. In addition, the Ian Tiriac Commercial Bank plans to introduce housing finance in 2000. The financial position of most of these banks is adequate or good. This will have a very positive impact on the ability of mortgage lending to go forward in the next stage of development in a competitive environment.
- **The Mortgage Law.** The new mortgage law, although it certainly needs additions and clarifications, is a positive step forward in the legal structure for housing finance. Real estate transactions—new purchase, trading-up, and rehabilitation—will be greatly facilitated by effective mortgage and collateral laws. Similarly, building an effective market will be greatly facilitated by a foreclosure process which is readily implementable and is actually implemented when necessary.
- **The Home as an Asset for Romanian Households.** Finally, as noted above, the very high homeownership rate in Romania provides numerous households with a valuable asset that can be used as collateral for purchasing an alternative unit as well as for consumer or business loans.

Affordability and Effective Demand in the Medium Term

There is an immense diversity of circumstances in Romania with regard to ability to purchase a home. While Romania's situation is not unique among the transition nations, it offers a different profile from the housing situations in the U.S. and much of Europe. The rental sector is much smaller than in most nations. Many of the poorer households would be renters if they were living outside Romania. Even among transition countries, Romania's housing privatization was both massive in scale and accomplished very rapidly.

This situation offers both advantages and disadvantages. On one hand, most homeowners now hold a valuable asset that can be used as collateral for a loan for rehabilitation or in order to move and purchase an alternative unit. On the other hand, some owners are too poor to afford even a modest rehabilitation loan. Also, many of those who do not own are likely to be "liquidity constrained" (lack an adequate downpayment) and/or would not be able to service a large loan.



Illustrative calculations are presented in the charts below regarding the proportion of households that can afford housing finance loans under different circumstances. The charts indicate relative magnitudes of affordability for existing units, new construction, and rehabilitation loans in Bucharest and other areas of the country. Calculations are based on income distribution and house prices discussed in Section 2.0; the loan assumptions (a dual index mortgage product, or DIM, is utilized to assist affordability for purchase loans, while a conventional mortgage product is used for rehabilitation loans) are found in Section 3.0, which provides the full analysis of affordability. In summary:

- Households with equivalent incomes face very different affordability circumstances depending on two key factors: (1) location and (2) whether or not they are currently homeowners.

- Many of those who currently own units hold a valuable asset and in many cases could easily “trade-up.” Thus, the affordability analysis distinguishes four groups of households¹:
 - Those who do not own a flat, but could provide a 10 percent downpayment;
 - Those who may or may not own a flat, but could provide a 25 percent downpayment;
 - Those who already own a flat and are assumed to have a 50 percent downpayment;
 - Those who already own a relatively highly valued unit, and can thus provide a 75 percent downpayment for another unit.

- Existing units are generally far more affordable than new units.

As noted, prices in Bucharest generally exceed those in smaller cities such as Slobozia and Oradea. In terms of affordability, households are far more able to move out of Bucharest than to move into it from elsewhere. Households currently owning a unit in Bucharest generally would be able to purchase larger and/or higher quality units outside Bucharest. Conversely, for those selling units located outside Bucharest in order to move into the city, the affordability scenario is less rosy.

¹ Please note that the analysis is illustrative only. The data on the income distribution and house prices are based on surveys and interview information respectively; however, the assumptions about downpayment, and the value of the unit are simply meant to be representative of probable situations.

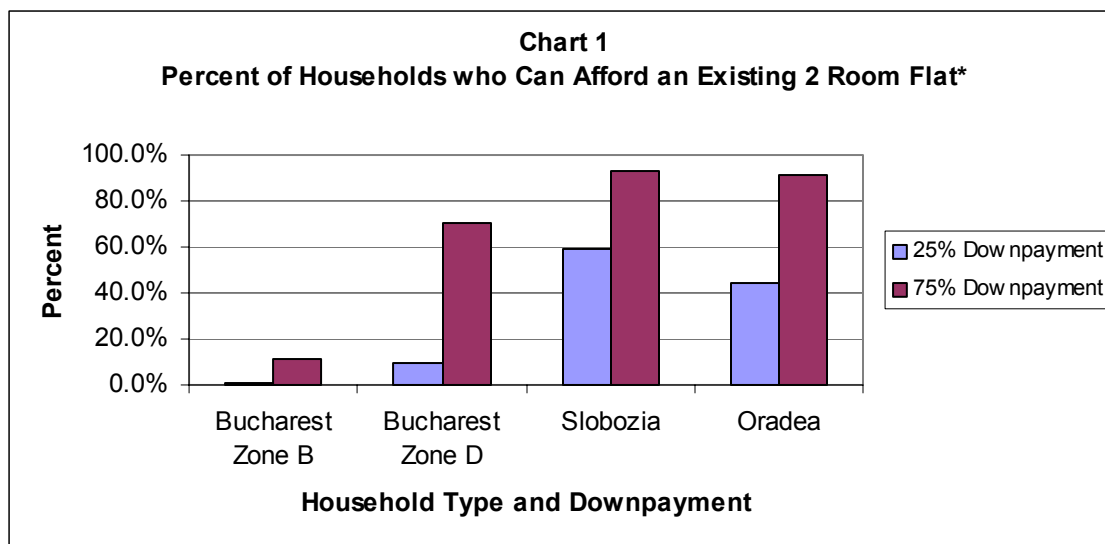
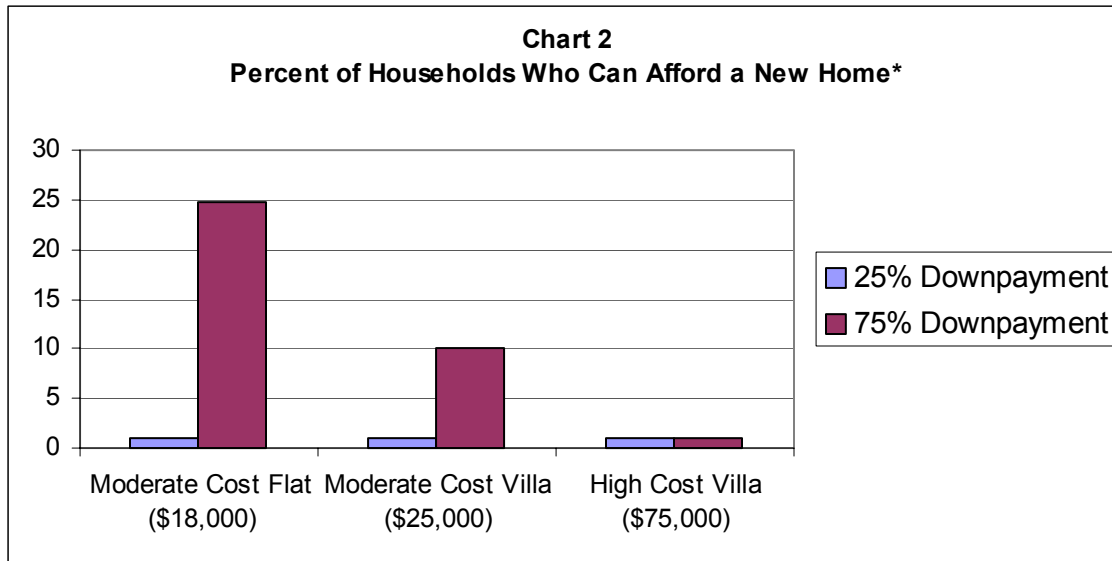
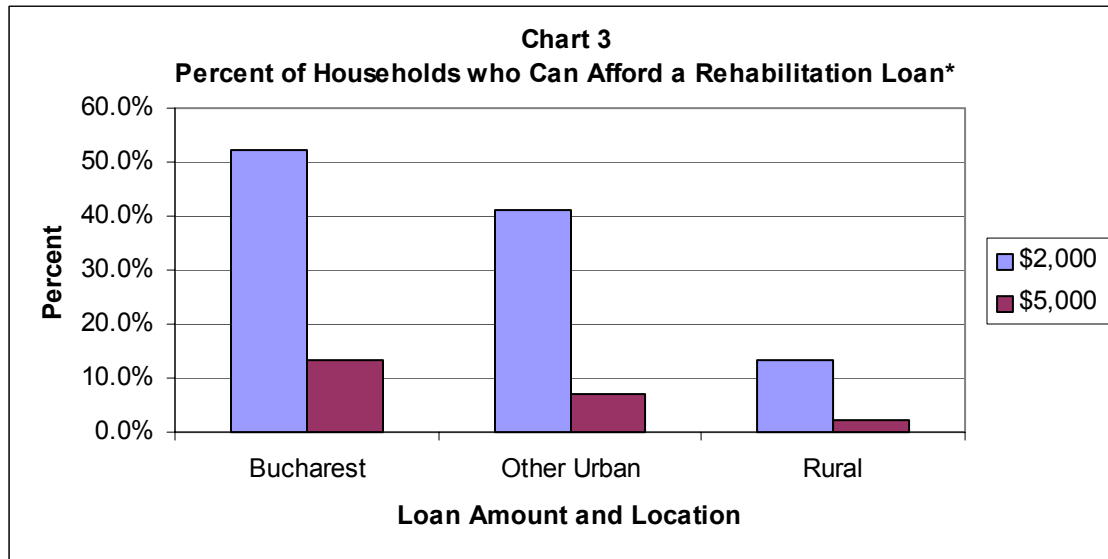


Chart 1 indicates the proportion of households that can afford an existing, two room flat in a central area of Bucharest, an outlying area of Bucharest, and in Slobozia and Oradea. In the “expensive” zone of Bucharest (zone B on the chart), almost no households can afford to purchase an existing flat with a small downpayment; even with a large downpayment (75 percent), only 11 percent of households could buy in this type of district. The situation is greatly improved on the outskirts of Bucharest (zone D), where 70 percent of those with a large downpayment could buy/trade-up to another unit. Nearly 10 percent of those with only a small downpayment could also purchase. By contrast, in the other urban areas, affordability is far more favorable; those already owning (assumed to have a 75 percent downpayment), would be relatively free to choose their circumstances.



An even greater contrast is presented by those trying to purchase new homes (see chart 2). A modest flat in Bucharest—priced at \$18,000—is affordable only to about one fourth of the income distribution. A smaller number can purchase modest villas, while high cost villas are beyond the reach of all but a handful of households. (In rural areas, where both land and labor are less expensive, the situation would, of course, be better; however, there is assumed to be less demand in these areas.)

Finally, as shown in chart 3, the picture is substantially more sanguine for rehabilitation loans, 10 year loans at an interest rate of 20 percent, which is assumed to be a feasible target in the medium term. Based on the specific income distribution for Bucharest, over half of the households there could afford a reasonably sized (\$2000) rehabilitation loan; 13 percent could afford a loan of \$5000. In other urban areas and rural portions of Romania, affordability is lower because income is lower, but it is still substantial for the \$2000 loan.



Characteristics of a Successful Lending Environment in the Medium Term

In the medium term, it is likely that conditions will converge to offer Romania not only an improved economic picture, but also a more effective institutional and legal structure; These factors will encourage bank lending, including lending for housing finance. Thus, Romanian banks could see a fairly sizeable demand for market-based loans. The situation could be significantly improved with technical assistance to the sector. The key factors for a successful lending environment (in addition to macroeconomic improvement) would include the following:

- Adequate competition among banks (this has already begun in earnest).
- Appropriate loan products; as discussed below, considerable increase in affordability would result from special mortgage products now used elsewhere in the region.
- State subsidy policies consistent with market-based lending; that is, a level playing field across the banks and subsidy policies which do not compete with market-based lending to those who can afford it (this issue should be discussed with the Government).
- An adequate legal framework; this is underway and would benefit from further assistance.



- Appropriate supporting institutions, such as the Central Bank (NBR), the Romanian Banking Institute (RBI), and a credit bureau. The first two are in place and play active and important roles; plans are also being developed for the credit bureau. Technical assistance would help put training in place as well as the regulatory and supervisory framework needed for the special features of housing finance.
- Increased efficiency in bank operations, allowing a reduction in the interest rate margin; this should improve through competition, but could also be assisted with training, information systems, IT planning, and similar technical assistance.

Technical Assistance Recommendations

Technical assistance would assist Romanian banks, as well as the National Bank of Romania and the Banking Institute, to introduce a safe and sound system of mortgage finance. Alternative mortgage products can assist in a very substantial way with affordability if the macroeconomic environment continues to improve. A summary of the suggestions presented in section 4.0 is as follows:

(1) Staff Training Assistance to Banks via the Romanian Banking Institute

Bank staff training and training of trainers would best be conducted through assistance to the Romanian Banking Institute. Staff training in housing finance is probably one of the first steps, as there has been relatively little experience so far with market-based housing finance. The RBI could engage key bankers and staff of RBI to conduct training of trainers

Risk analysis was specifically requested by several banks as a component of training in housing finance, as the risk elements in housing finance are somewhat unique, and relate among other factors to the long-term funding discussed below.

(2) Training and Development in Other Components of Housing Finance

New mortgage products. If Romania's inflation continues to fall, even somewhat slowly, and does not exhibit too much volatility, Romania's housing affordability problem could greatly benefit from dual indexed mortgage products, which have proved very successful under similar circumstances, especially in Poland (and also in Hungary, France, Turkey, and Mexico).

Improved information technology (IT) platforms for housing finance and their integration with other retail banking activities was mentioned by a number of banks

as important to effective underwriting and servicing of housing loans. The U.S. is a world leader in this area.

Condominium owners associations and rehabilitation lending. A variety of problems face the operation of condominium associations, required by law to be established in each privatized building. In the context of housing finance, developing procedures for bank loans for building-level capital repairs is an important missing element for maintaining and improving the existing stock. Training would help banks understand the potential importance of this market and how to access it. In addition, USAID may wish to reconsider its decision to end assistance to the condominium sector, since owners will need assistance in organizing associations and planning and implementing renovation projects with bank financing.

(3) Legal Framework

Mortgage Law and Related Laws. Assistance with improvements to the Mortgage Law is important to solidify and improve the first steps taken by the draft legislation. Related assistance should be directed toward the Securities Law. As discussed below under capital market funding, the Mortgage Law and the Securities Law together do not provide an adequate framework for issuance of mortgage bonds or MBS.

Laws Relating to the Rental Sector. The Civil Code and other relevant documents need to be reviewed prior to providing suggestions regarding landlord tenant relations. It is important, however, to encourage and formalize the rental sector.

(4) Assistance to the National Bank of Romania

Regulation and Supervision. As discussed, regulation and supervision of housing finance entails some additional and unique features relative to the oversight of other loans; the NBR notes that this would be an effective type of support for their monitoring program in the medium term.

Credit Bureau. Establishment of a credit bureau is key to the banks' underwriting, as this is the facility which will ultimately provide the data for a bank to determine a household's gross debt ratio.

Indexes for variable rate mortgage products. The NBR requested special assistance with this technical topic. Both the inflation rate and the exchange rate are currently quite volatile, and thus do not provide an appropriate basis for indexation.



(5) Capital Market Funding and Access to Long-Term Funds

Access to Long-Term Funds. Beginning to plan for a mechanism to access long-term funds from the capital market will be crucial to achieving an adequate volume and to decreasing term risk, i.e., short-term liabilities funding long-term loans. The approach to secondary market funding might include a liquidity facility and/or securitization (MBS). The Federal Housing Finance Board, which is in essence a liquidity facility, might play a role in this development.

(6) Preparation of Industry-Wide Risk Analyses

Databases and Analysis. One of the unfortunate legacies of the socialist period is a tendency to withhold information. More data collection, information systems, and data analyses are required. The design of these could benefit from lessons learned elsewhere.

CONCLUSIONS

If current trends continue, and if Romania follows a path of economic recovery similar to that of other transition countries such as Poland, Hungary, and the Czech Republic, the development of an active housing finance sector should be possible within the next several years. Therefore, assistance in the further development of the technical and legal structure for housing finance, along with staff skills and appropriate mortgage products, would provide a valuable and solid foundation for the long-term.

Given the progress made to date in bank privatization and restructuring, the functions of the National Bank of Romania (the Central Bank), improvements to the legal structure for lending, and the desire of key Romanian banks to move forward aggressively with market-based housing finance, this is a propitious time to help Romania build a solid housing finance system. In this manner, a secure and effective structure will be in place when economic circumstances allow higher volume and broader based lending.

A well-functioning housing finance system can greatly facilitate economic improvement. A large majority of Romanian households have an asset against which to borrow—either for housing or as collateral for some other purpose. Rehabilitation loans will help maintain the existing stock. Loans to purchase new or existing housing—in combination with further development of the rental sector—will support the labor mobility that is crucial to economic development. The relatively low level of new housing construction should not obscure the fact that housing finance can play an extremely important role in revitalizing Romania's housing sector, and thereby its economy. A major share of the demand will come from purchase of existing units,

“trading-up” (or simply moving) by those who already own a unit, and rehabilitation of existing units.

THE PROSPECTS FOR HOUSING FINANCE IN ROMANIA

1.0 ROMANIA'S HOUSING SECTOR

This section updates selected information from a USAID-sponsored housing sector study conducted in late 1994.¹ Although the main focus of this earlier study was not housing finance, it did conclude that the prospects for market-based housing finance were not good at that time. The present study identifies key developments in the sector with respect to housing demand and affordability, especially those that have occurred during the last five years, and discusses their importance for the future development of housing finance.

Like the previous study, this report presents information about the entire country in addition to three cities. Two of these cities, Bucharest and Oradea, were included in the earlier study. In the present study, Slobozia replaces the third city, Brasov, because it was felt that Brasov and Oradea were fairly similar with respect to population size and economic activity. Slobozia introduces more variation into the study because it is a smaller city (less than 60 thousand people) that is suffering from economic problems despite having a strong economic potential based on its surrounding rich agricultural land. All of the included cities are places where USAID has supported various activities. By including these three cities, we can gain some insight into how cities can vary from the overall national trends.

1.1 Sources of Housing Need

In a traditional housing needs framework, physical housing needs arise from several sources: (1) units to accommodate growth in the number of households; (2) units to reduce overcrowding; (3) units to replace decaying units (i.e., depreciation); and (4) units to replace substandard housing that cannot be upgraded. Another category of need consists of units that require upgrading to become standard units. In Romania, housing needs are not driven by population growth and overcrowding; instead, the largest source of housing need is associated with maintaining or replacing existing housing.

Demographic Factors and Overcrowding

Overall, the demographic influence on demand has been weak, although many believe that members of a large cohort consisting of persons in the early 20's to early 30's are having difficulty acquiring housing outside of their parents' homes. By 1998 the

¹ See "The Transition to a Market-Based Housing Sector in Romania," by Francis Conway, Harold Katsura, Ileana Budisteanu, and Ileana Pascal, January 1995, UI project No. 6283-107. Some of the data and key findings from this earlier report have been incorporated into the present report. Most of the new numerical data for the present report were compiled by Nic Taralunga, the Romania representative of the Institute for Housing and Urban Development Studies. Bogdan Voicu of the Research Institute for the Quality of Life provided analyses and data from the Need for Housing survey conducted in March 1999.

population stood at about 22.4 million, slightly down from the 22.8 million in the 1992 census (see Table 1.1). The natural rate of increase currently is negative in both urban and rural areas (-1.7 per 1000 inhabitants for the country, -0.5 urban, -3.5 rural).² The slight drop in the population combined with a slight increase in the existing housing stock is responsible for a small drop in average household size. The average household size was about 3.0 persons in 1998, compared to 3.1 in the 1992 census and 3.2 in the 1977 census. Urban households are smaller than rural households; for the cities covered by this study, the average household size was about 2.7 in Bucharest (1997); 2.9 in Oradea (1997/1998), and 3.3 in Slobozia (1998).³

Table 1.1
Total Population, Housing Stock, and Average Household Size: Various Years

	1995	1996	1997	1998
<i>Population</i>				
Romania ^a	22,582,000	22,524,000	22,463,000	22,396,000
Bucharest	2,054,079	2,037,278	2,027,512	2,016,131
Oradea	N/A	222,741	223,288	N/A
Slobozia ^b	57,193	57,125	56,913	56,310
<i>Housing Stock</i>				
Romania	7,782,000	7,811,000	7,837,000	N/A
Bucharest	776,849	778,666	780,173	N/A
Oradea	N/A	N/A	N/A	80,761
Slobozia	N/A	N/A	17,744	N/A
<i>Average Household Size^c</i>				
Romania	3.0	3.0	3.0	3.0 ^d
Bucharest	2.8	2.7	2.7	N/A
Oradea ^e	N/A	N/A	N/A	2.9
Slobozia	N/A	N/A	3.3	N/A

Notes

N/A Not available

a From U.S. Bureau of the Census, International Data Base.

b 1998 data is actually for 1 January 1999; 1997 data is for 1 January 1998; etc.

c Computed from above figures, assuming a 4 percent vacancy rate in the existing stock.

d From National Commission for Statistics, AMIGO for 1998, July 1999.

e Estimated from 1999 and 1998 data.

In a strictly numerical sense, there is not a severe overcrowding problem. The 1992 census is still the best source of data for understanding the type of units in which

² The natural increase rate is the difference between the gross birth and death rates per thousand population. These figures are for mid-1999 (National Commission for Statistics, seria POP, no.2, 1999).

³ When we had to compute average household size and number of persons per room, we assumed the vacancy rate was 4 percent for all locations. We wanted to base these measures on the occupied stock as opposed to the total stock. As a result, our figures may appear to be slightly higher than some other published figures (usually not more than a 0.1 percentage point difference). The only known vacancy data comes from the 1992 census. In 1992, the vacancy rate was 6.2 percent for the country; in Bucharest it was 3.6 percent.

overcrowding occurs. Table 1.2 was presented in the earlier study, and it is reproduced here. The table shows that based on a two persons-per-room adequacy standard, only about one-tenth of all occupied units were overcrowded in 1992. Roughly half of these overcrowded units were two-room units.⁴ Persons living in one-room units are the most likely to be overcrowded; about 29 percent of one-room units were occupied by more than two persons. In comparison, about 13 percent of two-room units, 4 percent of three-room units, and just 1 percent of 4-room units had more than two persons-per-room. Although one-room units were the most likely to be overcrowded, they made up only 12.5 percent of the occupied stock. Furthermore, roughly 45 percent of one-room units contained only one person, and just 15 percent (i.e., less than 2 percent of all occupied units) contained over three persons. Nationwide, the number of persons per room fell from 1.53 to 1.21 between 1977 and 1992. As of the late 1990s, the number of persons per room was approximately 1.1 in Bucharest (1997), 1.2 in Oradea (1997), and 1.4 in Slobozia (1998).

Table 1.2
Number of Occupied Units by Household Size and Number of Rooms: 1992

Persons	1		2		3		4		5+		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
1	401,059	5.58	563,475	7.84	193,650	2.69	44,815	0.62	11,240	0.16	1,214,239	16.90
2	236,320	3.29	933,602	12.99	486,455	6.77	131,565	1.83	33,914	0.47	1,821,856	25.35
3	122,319	1.70	699,161	9.73	500,452	6.96	134,463	1.87	34,866	0.49	1,491,261	20.75
4	67,373	0.94	550,160	7.66	548,062	7.63	169,555	2.36	42,175	0.59	1,377,325	19.16
5	31,971	0.44	215,351	3.00	258,852	3.60	116,908	1.63	37,657	0.52	660,739	9.19
6	17,724	0.25	99,736	1.39	129,461	1.80	73,347	1.02	28,352	0.39	348,620	4.85
7	10,395	0.14	49,456	0.69	55,887	0.78	32,124	0.45	13,182	0.18	161,044	2.24
8	4,501	0.06	19,103	0.27	19,520	0.27	11,557	0.16	5,479	0.08	60,160	0.84
9	2,098	0.03	8,517	0.12	8,175	0.11	4,978	0.07	2,424	0.03	26,192	0.36
10+	1,990	0.03	8,116	0.11	7,670	0.11	4,825	0.07	2,710	0.04	25,311	0.35
Total	895,750	12.46	3,146,677	43.78	2,208,184	30.73	724,137	10.08	211,999	2.95	7,186,747	100.00

Source: 1992 Census.

Housing consumption has continued to creep upwards since the last census. Housing consumption rose a lot between 1977 and 1992, with the average floor space per person increasing from 8.9 square meters to 11.5 square meters. Over this same period, the average dwelling size rose from 29.6 to 33.6 square meters.⁵ By 1997, per

⁴ This overcrowding measure is sensitive to the applied standard. For example, using an overcrowding standard of one person per room, about half of all occupied units would be overcrowded. However, if one modified this standard by reclassifying two persons in a one-room unit, three persons in a two-room unit, and four persons in a three-room unit, as uncrowded, about 30 percent of occupied units would be considered overcrowded. About three-fourths of all occupied units are two- or three-room units. Approximately 70 percent of two-room units house three persons or less and close to 80 percent of three-room units contain four persons or less.

⁵ Floor space and dwelling size measures exclude kitchens and bathrooms.

capita living space reached 11.8 square meters (11.5 in urban areas and 12.1 rural areas).

Overcrowding may be more of a qualitative problem than a quantitative one. A large segment of the population believes that young adults face serious problems in acquiring housing, which results in them having to live with their parents. For many Romanians, this sharing of housing by adults is unfamiliar and constitutes overcrowding. There are more people in the 25 to 35 age group than any time in recent history, in part, because of a state-enforced birth control ban in the second half of the 1960's. The population pyramid data in Table 1.3 show that around 16 percent of the population is in the 25 to 34 age group, and another 8 percent is in the 20 to 24 age group. Special tabulations from a recent survey sponsored by the Ministry of Public Works (see Table 1.4) indicate that about 11 percent of households have at least one child between the ages of 25 to 35 inclusive. About half of these households contain a married child. Rural households were slightly more likely than urban households to have an older married child present (about 7.4 percent, versus 5.5 percent for Bucharest and 4.0 percent for other urban areas), and were considerably more likely to have older married children with children (4.8 percent). There are clearly many older children living with their parents; however, they are not necessarily in overcrowded conditions, in a numerical sense.

Table 1.3
Mid-Year Population, by Age and Sex: 1999

Age	Population both sexes	Population both sexes (in percent)	Population male	Population female	Sex Ratio (in percent)
Total, all ages	22,334,312	100.0	10,915,744	11,418,568	95.6
0 – 4	1,100,508	4.9	563,079	537,429	104.8
5 – 9	1,316,505	5.9	673,168	643,337	104.6
10 – 14	1,728,216	7.7	881,042	847,174	104.0
15 – 19	1,701,391	7.6	867,737	833,654	104.1
20 – 24	1,960,052	8.8	1,003,531	956,521	104.9
25 – 29	1,785,918	8.0	903,387	882,531	102.4
30 – 34	1,682,782	7.5	852,916	829,866	102.8
35 – 39	1,320,725	5.9	664,155	656,570	101.2
40 – 44	1,635,365	7.3	812,161	823,204	98.7
45 – 49	1,569,721	7.0	773,025	796,696	97.0
50 – 54	1,222,441	5.5	593,624	628,817	94.4
55 – 59	1,112,173	5.0	525,423	586,750	89.5
60 – 64	1,236,618	5.5	567,736	668,882	84.9
65 – 69	1,098,964	4.9	491,689	607,275	81.0
70 – 74	883,184	4.0	378,299	504,885	74.9
75 – 79	577,405	2.6	222,035	355,370	62.5
80+	402,344	1.8	142,737	259,607	55.0

Source: U.S. Census Bureau, International database.

Table 1.4
Percentage of Respondents with Older Children Present: March 1999

Category	Bucharest City	Other Urban	Rural	Total
Have at least one child (25-35) that is married with a child, and lives with you	—	1.9	4.8	3.0
Have at least one child (25-35) that is married with no children, and lives with you	5.5	2.1	2.7	2.7
Have at least one child (25-35) that is married, and lives with you	5.5	4.0	7.4	5.7
Have at least one child (25-35) that lives with you	11.0	9.7	12.5	11.1

Source: Special tabulations from the 1999 Need for Housing survey conducted by the Research Institute for the Quality of Life.

It is hard to interpret what these figures mean, partly because we lack comparable data from other countries, and partly because they only offer a static “snapshot” of the population. The only sure way to understand what type of hardships these young adults and couples face is to observe them over time. This is the first generation that has had to obtain housing from the marketplace. For some, acquiring separate housing may never become a reality; yet, for others, this prolonged stay with their parents is temporary. For the latter group, the time spent in their parents’ homes is a time to save and an opportunity to consume more than they could if they were on their own. These young adults will eventually move into their own homes, but unlike their parents, they are likely to do so without the assistance of the state.

The urban share of the population has been quite stable during the 1990s, after having gone from 43.6 percent in 1977 to 54.4 percent in 1992. In 1997, the urban share was still only 55.0 percent, and it is expected to remain at this level through the year 2000. Table 1.5 shows that, overall, both medium and large cities have been retaining their share of the total population during the nineties (about 14 percent and 9 percent, respectively). Following a 4.4 percent surge between 1989 to 1990 (around the time of the people’s revolt), the population of Bucharest has fallen in almost every year, from 2.13 million in 1990 to 2.02 million in 1998.

Table 1.5
Urbanization: 1990 to 1997 (in percent)

	Year							
	1990	1991	1992	1993	1994	1995	1996	1997
Urban share of population	54.3	54.1	54.3	54.5	54.7	54.9	54.9	55.0
Urban population annual growth rate	2.4	-0.5	-1.5	0.3	0.2	0.2	-0.4	-0.1

Population in cities of more than 750,000 inhabitants

	Year							
	1990	1991	1992	1993	1994	1995	1996	1997
Percent of total population	9.2	9.1	9.1	9.1	9.1	9.1	9.0	9.0
Percent of total urban population	16.9	16.8	16.7	16.7	16.6	16.5	16.4	16.3
<i>Population in cities of more than 200,000 inhabitants</i>								
Percent of total population	14.4	13.3	14.0	14.1	14.2	14.3	14.3	14.4
Percent of total urban population	26.4	24.6	25.8	25.8	25.9	26.0	26.1	26.1
<i>Largest city: Bucharest</i>								
Population (thousands)	2,127.2	2,107.2	2,065.7	2,066.7	2,060.6	2,054.1	2,037.3	2,027.5
Growth rate (percent)	4.4	-0.9	-2.0	0.1	-0.3	-0.3	-0.8	-0.5

Source: National Human Development Report.

The stability of the size of the urban population is intriguing given that most experts probably anticipated a rise in the urban share following the relaxation of residency restrictions. The economic pull of cities, particularly of Bucharest, would seem to encourage urban growth and fuel crowding in cities. However, among the cities covered by this study, only Oradea has shown some signs of growth in recent years.⁶ Our earlier study noted that unemployment and economic hardship stimulates internal migration, but one could not predict whether economic difficulties push people towards or away from cities. Many urban residents have family or economic ties to the countryside, and this enables rural areas to serve as economic refuges.⁷ Another factor that may be inhibiting urban growth is somewhat artificial. Although the numbers involved are not yet huge, the distinction between urban and rural areas has begun to blur as people construct first or second homes in rural “suburbs.” In Bucharest, people tend to associate this trend with rich households who build large villas and commute to work. However, cities such as Slobozia are surrounded by a continuum of housing types ranging from those that are urban in character to those that have a rural level of amenities. It is unclear to what extent present definitions capture residences that perhaps should be classified as urban.⁸

⁶ Figures for Oradea, and perhaps other cities, may be deceptive. Oradea was believed to have lost about 8 percent of its population between 1990 and 1994 (dropping from about 230,000 to 211,000 persons). The present population estimate is 223,288 for 1997. However, city officials in 1994 believed there were as many as 20,000 persons living in the city who were not registered as residents. Therefore, it is unclear to what extent the city is really growing, if it is at all.

⁷ Unfortunately, we did not have data on population flows among urban and rural areas. Large flows can occur without altering the overall urbanization rates.

⁸ Of course, the opposite problem exists as well. Some urban areas contain land that is rural in nature.

Condition of the Housing Stock

In addition to demographic factors, housing needs arise due to the condition of the existing housing stock. Housing that is damaged beyond repair (e.g., some earthquake-damaged buildings), or housing that is fully depreciated, requires replacement. A large portion of the stock is upgradable and requires investment to raise it up to an acceptable standard.

Although the size of the housing stock appears to be adequate for much of the population, the quality of units varies considerably, and much of the stock is suffering from inadequate maintenance. In our earlier study, we noted that the problems are particularly acute in multifamily structures, in which residents may be able to deal with rudimentary maintenance, but often lack the cooperation and managerial skills needed to cope with larger expenditures and capital improvements. Some progress has been made in this area, in part, due to USAID-sponsored condominium technical assistance (which ended earlier this year). However, the numbers of associations still requiring training and support is large, and deferred maintenance often results in even bigger, more expensive problems.

Quality is hard to measure with the available statistics since they generally focus on service levels and space rather than structural and operational aspects of buildings. In addition, the large rural population, which suffers from a low level of services, tends to influence overall figures for the country. Table 1.6 shows how rural areas lag far behind urban areas in access to piped water, hot water, and sewerage systems. The table also shows, however, that disparities in service levels can exist even among prominent cities. Oradea, for example, lags behind Bucharest with respect to drinking water available from a tap (81.5 percent of units versus 93.7 percent) and sewerage coverage (75.0 percent of units versus 92.4 percent). In fact, most indicators for Oradea fall below the national averages for all urban areas in 1992.

Table 1.6
Share of Total Units with Various Services in Bucharest (1998), Oradea (1998), and Romania (1992)
(in Percent)

Service	Bucharest	Oradea	Romania		
			Urban	Rural	Total
Drinking water ^a	93.7	81.5	88.2	14.3	53.6
Hot water	86.6	N/A	76.7	4.9	43.1
Sewerage	92.4	75.0	86.4	10.0	50.7
Electricity	99.8	100.0	99.5	93.6	96.7



Service	Bucharest	Oradea	Romania		
			Urban	Rural	Total
Heating					
Central	75.6	68.0	71.9	1.7	39.1
In-house	7.9	N/A	N/A	N/A	N/A
Stove	16.2	N/A	N/A	N/A	N/A
Other	0.3	N/A	N/A	N/A	N/A

Notes

N/A = not available

a In general, this means piped water.

Source: General Department of Statistics of Bucharest, 1998; Oradea, local official; 1992 census.

The age of structures and structure type are related to quality, and are major determinants of capital improvement needs. Table 1.7 shows how nearly half (46.7 percent) of Bucharest's stock was built before 1945; over a fifth was built before 1930.⁹ Oradea's stock is also quite old, with 41 percent built before 1945, and three-quarters before 1970. Additional data for Oradea shows how 2-to-4 unit structures are likely to have been built during (or prior to) the first part of the century, while most single-family units were built during the middle of the century. Flats came to dominate construction from the seventies onward. Unfortunately, a great deal of this multifamily construction was of poor initial quality and maintenance has been lacking, so a situation has developed where much of the newest housing is in the poorest condition. This is the case in Slobozia, where despite having a relatively young housing stock (with 90 percent built after World War II), many buildings are in bad shape. About 89 percent of the Slobozia's total housing stock consists of flats. For the whole country, about 78 percent of the total urban stock is in large apartment blocks, and an additional 15 percent is made up of small multifamily structures.

Table 1.7
Total Housing Stock by Year Built, for Bucharest, Oradea, and Slobozia: 1992 (in percent)

Year Built	Bucharest		Oradea			Slobozia Total
	Total	Total	Single-Family	2 to 4 units	Flats	
Before 1915	11.3	15.9	12.1	49.9	3.3	90 percent
1915-1929	10.1	7.8	8.2	12.5	0.7	less than
1930-1944	25.3	17.3	20.5	15.6	1.0	50 years old
1945-1960	29.4	18.7	23.3	8.6	2.5	
1961-1970	11.3	15.7	19.0	5.2	7.4	
1971-1980	7.6	15.1	13.0	6.4	36.0	

⁹ This data is from 1992, but the stock has not grown a great deal since 1992.

Year Built	Oradea					Slobozia Total
	Bucharest Total	Total	Single- Family	2 to 4 units	Flats	
1981-1985	2.4	4.9	1.9	0.7	26.4	
1986-1990	1.9	4.1	1.5	0.9	21.9	
1990-1992	0.3	0.4	0.4	0.1	0.6	
Unknown	0.4					
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: 1992 census; local estimate for Slobozia.

Many buildings require rehabilitation due to major earthquakes in 1977, 1986, and 1990. In Bucharest, the older housing stock is not very resistant to earthquakes, and an estimated 4,699 apartments are in danger of collapsing. The municipality conducted studies on about 2,500 “at risk” buildings, and found, for example, 300 five-story structures, built before 1940, to be seriously damaged. The present per square meter cost of upgrading damaged buildings is about two million lei. The municipality has had difficulty with the temporary relocation of households during the rehabilitation work. In 1998, the municipality allocated 1.2 billion lei for studies and structural upgrading; however, according to the law, owners are responsible for repairing their units.

The existing housing stock of any country requires a large continuous investment just to maintain its output (the so-called “flow of services” from housing). In calculating housing needs, analysts sometimes express this investment in monetary terms, and sometimes in terms of physical dwelling units. For example, if a typical new dwelling costs \$20,000, then 5 dwellings is the unit equivalent of \$100,000 worth of investment in repairs and improvements.¹⁰ The normal depreciation of buildings can be expressed in terms of units, and many are surprised at just how big of an investment this can be. A good example of this is the frequently cited needs estimate of one million new dwellings, which appears in a 1995 UN report.¹¹ This figure does not refer to a current need, but rather cumulative production over a period of roughly fifteen to twenty years. The majority of this need estimate (60,000 units per year) is attributable to the replacement of “old and defective” dwellings, that is, the depreciated and destroyed stock. So, for example, given a total stock of 7,837,000 units in 1998, 60,000 units a year would represent a depreciation rate of about 0.8 percent per year (the equivalent of about a 130 year building life). Over 15 years, 900,000 units are required just to replace old and defective units. Of course, this does not literally mean 900,000 new units need to be built; however, it does mean that an investment equivalent to the cost of 900,000 units is necessary if the level of services provided by the existing stock is to be preserved.

¹⁰ This \$20,000 figure is just for illustration purposes. However, it roughly corresponds to the new construction cost of a minimum standard two-room flat.

¹¹ See the “Romanian Human Development Report 1996,” UNDP, 1995. This document does not cite another source for these figures.

When interpreted properly, the million unit estimate underscores the importance of investing in the rehabilitation and maintenance of the existing stock. Recent housing production has only been around 25,000 to 30,000 units a year, and the net addition to the total stock has been only slightly less than this production figure.¹² Given the prior discussion on depreciation, it is clear that the total size of the stock is being maintained through investments that are extending the life of the existing stock. However, households are also likely consuming a lower level of housing services by allowing their units to depreciate. If sustained, this behavior will ultimately result in a lower standard of living, and the economic depletion of what for most households is their greatest financial asset.¹³

1.2 Development of the Market

The Sales and Rental Markets

Although the economic downturn of the past few years has slowed the overall demand for housing, particularly for new construction, the rapid and extensive privatization of the housing stock has contributed to the development of an active and fluid real estate market. Table 1.8 shows that by 1997, 94 percent of the total stock was privately owned. The corresponding figures for Bucharest, Oradea, and Slobozia are 93 percent (1997), 85 percent (1998), and 87 percent (end of 1997), respectively.¹⁴ The increase in private ownership fueled a boom in residential sales transactions, which went from about 39,000 transactions in 1990 to a peak of about 226,000 transactions in 1993. The level then fell off to about 180,000 transactions in 1994 and 170,000 in 1995. The 170,000 transactions in 1995 represents about 2 percent of the total stock. An important point to note about this activity is that it mostly involves existing properties.¹⁵ The decline in new construction activity does not significantly diminish the role that housing finance could play in facilitating mobility and improving living conditions.

¹² Additions to the stock are not always the result of construction. It is possible for large numbers of units to move in and out of the housing stock due to use conversion.

¹³ The quality problems due to poor maintenance and the lack of rehabilitation are reflected in market prices. Units on higher floors can sell for 20 to 30 percent less than similar units on lower levels if they do not receive adequate water pressure and heating.

¹⁴ Rural areas enjoy the highest privatization rates, which explains why the figures for the cities are lower than the national rate.

¹⁵ Total new construction in 1995 was only about 36,000 units, of which 27,000 were built with private funds. About 22 percent of the transactions in 1995 took place in Bucharest, which has the most active market. Slobozia had 480 transactions in 1998, and Oradea has had about 4,600 thus far in 1999.

Table 1.8
Total Housing Stock By Type Of Ownership

Year	Number (000's)				Percent			
	Total	Public	Private	Other	Total	Public	Private	Other
1995	7,782	565	7,186	31	100.0	7.3	92.3	0.4
1996	7,811	515	7,266	30	100.0	6.6	93.0	0.4
1997	7,837	443	7,363	31	100.0	5.7	94.0	0.4

Source: Annual Statistics Book 1998.

The boom in sales transactions was facilitated by an emerging broker industry. By 1996, 500 (out of 2,000) real estate companies in Bucharest listed brokerage as their main activity. The National Romanian Association of Realtors (ARAI) was established in 1994 and has become a leader for the real estate industry. ARAI belongs to the Central European Real Estate Association Network. Brokers represent buyers and sellers and typically receive commissions from each. While commissions are negotiable, a broker might receive 6 percent on an average size sale, and perhaps 3 percent on a larger sale (split evenly by the buyer and seller). For land sales, the commission ranges from 4 to 6 percent (again, split).¹⁶

A rental market has also developed, although it is difficult to gauge its size.¹⁷ It is widely believed that much of the market is hidden because of tax evasion. One survey suggests that about 3 percent of households in Bucharest rent units from private owners. An additional 4 percent of households are rent-free renters. Figures for other urban areas and rural areas are lower.¹⁸ Brokers tend to view the rental market as being divided into two segments: a small high-end luxury market catering to the international community, and a second, larger market, for Romanians. The former tends to operate in hard currencies (USD and DM) exclusively, while the latter accepts payments in hard currencies and lei. The luxury market has been hit hard in recent years, and rents have plummeted. Part of this has been due to international events, such as the Asian crisis, but part of the problem may have been overbuilding by developers who were drawn to this market by the lucrative rents. In contrast, the mass market primarily consists of existing flats, mostly in the outer parts of cities. Brokers participate in the rental market,

¹⁶ This broker information is from "Romania - Country Report," by Victor Adrian Stan, Executive Officer of ARAI, Bucharest, October 1996.

¹⁷ Surveys consistently fail to ask about tenure characteristics. The survey we refer to here is one of the first we know of that tries to identify owner-occupants and renter-occupants.

¹⁸ This survey was carried out by the Research Institute for the Quality of Life on behalf of the Ministry of Public Works in March 1999. Because the sample was fairly small for Bucharest, these figures should be viewed cautiously.

and typically receive a month's rent as a commission (split between the tenant and landlord).¹⁹

The rental market faces some constraints, but their impact on prices and supply are not clear. An ARAI report notes that the marketability of both residential and commercial rental properties is hindered by a lack of telephone lines, although presumably this would affect sales as well. Also, the taxation of rental income has been reduced from 40 percent to 15 percent, but it is unclear to what extent this reduction has stimulated supply, if at all. It may, however, affect supply at the margin since tax evasion is illegal, and those not willing to risk breaking the law may now find it profitable to bring their units onto the market. The fact that some people have bothered to properly report their rental income means there is an incentive to do so, even if not strong. We can only speculate as to whether illegal renting alters the tenant-landlord relationship in favor of the tenant or landlord with respect to recourse in the event of non-payment or the desire of the owner to evict.

The market provides numerous options for households desiring to improve or adjust their housing situations. For example, households can trade up by selling or trading their existing home and paying the difference between the value of their unit and a better unit. Others can tap some of their home equity by trading down to less expensive units. A household seeking more space and privacy with a high value unit can sell its unit and use the proceeds to help purchase two less expensive units. The rental market also offers a range of options. Young people who want to live apart from their parents can share apartments. Some families double-up or move to a second home outside a city so they can get a cash income by renting their flats. Finally, those desiring newly constructed units can self-finance their purchase by paying installments to a developer as the work proceeds.

The Construction Sector

The housing construction industry is in a deep recession, and new construction has slowed considerably.²⁰ Table 1.9 shows that nationwide, privately financed construction held steady at about 25,000 units per year from 1995 to 1997. However, over this same period, publicly funded construction fell from about 9,000 to 3,500 units, a loss which was felt most in urban areas. The near term prospects do not look any better for the construction industry as a whole. After surveying 750 companies, the National Commission for Statistics estimated that by the end of this year, the volume of overall construction activity will be half of what it was in 1998. During the last five years, the industry has suffered from huge layoffs, forcing tens of thousands of workers to go abroad, particularly to Germany and Israel. Table 1.10 summarizes the contraction in

¹⁹ See "Romania – Country Report"; this also contains some material from an interview with the author.

²⁰ The construction industry is almost entirely privatized (99 percent) according to the Association of Construction Companies (ARACO). Much of this occurred during the past five years.

the number of employees. By the end of July 1999, the total number of workers fell to 342,600—half of what it was a decade earlier.

Table 1.9
Housing Production: Various Years (Number of Units)

	Total		Urban		Rural	
	Public	Private	Public	Private	Public	Private
<i>Romania</i>						
1995	8,970	26,744	8,780	6,219	190	20,525
1996	4,015	25,201	3,933	5,808	82	19,393
1997	3,494	26,149	3,360	6,896	134	19,253
<i>Bucharest</i>						
1995	N/A	N/A	2,471	1,179	N/A	N/A
1996	N/A	N/A	1,247	662	N/A	N/A
1997	N/A	N/A	1,024	483	N/A	N/A
<i>Oradea</i>						
1997-1998	N/A	N/A	N/A	275 ^a	N/A	N/A
<i>Slobozia</i>						
1996	N/A	N/A	22	61	N/A	N/A
1997	N/A	N/A	0	95	N/A	N/A
1998	N/A	N/A	0	22	N/A	N/A

Notes

N/A = not available

a Combined public and private production.

Sources: Annual Statistics Book 1998; General Department of Statistics of Bucharest, 1998; local officials.

TABLE 1.10 EMPLOYEES IN THE BUILDING SECTOR

Year	Romania	Bucharest	Oradea	Slobozia
1989	700,000	N/A	N/A	N/A
1996	475,000	69,200	4,704	3,135
1996	439,000	55,900	5,524	N/A
1998	470,576	N/A	7,250	N/A
1999	342,600	N/A	N/A	N/A

Notes

N/A= Not available

Sources: Romanian Statistical Year Book 1998; IHS Romania srl: Urban Policies and Strategies of Oradea, 1998; Urban Design: Urban General Plan of Slobozia, 1999.

The key problem facing housing builders is that new construction prices generally exceed the prices of existing units by large amounts, making new units unattractive to

buyers. Because of the large price difference, many households purchase and upgrade existing units instead of buying new units. It is unclear to what extent new construction costs are raised by artificial constraints that might be remedied. As in most countries, developers cite excessive red tape as a problem. The costs of processing a lot of paperwork are real, but a bigger problem can be the unexpected delays associated with this processing. Developers can tolerate a high level of bureaucracy if they can predict how long each step will take. Other problems that are commonly cited in other countries, such as shortages of building materials or inefficient building technology, do not appear to be problems in Romania. Building materials are available at competitive prices from domestic and international sources.

There are conflicting views as to whether land prices constrain production by contributing to higher costs. People point to the sharply rising land prices in prime locations such as downtown Bucharest (where prices per square meter can exceed \$US 500), but often overlook the availability of land in surrounding neighborhoods and on the periphery which sells for as little as \$US 10 to \$US 50 per square meter (see Table 1.11). In Oradea, land is available for \$US 45 to \$US 65 in central areas, and for \$US 3 to \$US 10 in suburban areas. Land is also available for just a few U.S. dollars per square meter or less in Slobozia, depending on the location. It is more likely that the real constraint is the availability of land that is serviced, or that can easily be serviced. Another constraint is the difficulty of assembling large parcels of land. Specifically, larger projects possess a higher risk of encountering property claim disputes.²¹

Table 1.11
Land Prices for Six Zones in Bucharest

Zone	Description	Price (\$US)
1	Central district area	over 500
2	North part of the city	200 to 500
3	The first ring neighborhood	100 to 200
4	West and south part of the city	50 to 100
5	Residential, high density	10 to 50
6	The second ring neighborhood	up to 10

Source: Institute for Housing and Urban Development Studies (IHS).

The problems of the housing construction industry are likely to remain as long as the relatively soft market for existing units continues. The survival of some firms may depend on their ability to adapt to the market for renovations and upgrading. In the

²¹ In our previous study, we cited a number of factors that were believed to contribute to rising land costs: (1) jurisdictional and titling problems with land on the periphery of some cities restricts supply; (2) inflexible land use rules, including rules governing the conversion of agricultural land, unnecessarily restrain the amount of land available for residential purposes; and (3) in some cities, inadequate infrastructure capacity raises the cost of servicing land.



meantime, many builders (particularly some of the larger firms) face an even bigger threat to their existence in the form of overdue payments from state organizations. The amount owed builders has reached \$US 700 million, and is expected to increase by 18 percent this year.

1.3 Affordability and Effective Demand

Housing affordability takes on a different meaning in a country with widespread free-and-clear ownership. In principle, any owner could trade his or her present home for another one of at least similar value, provided he or she could cover the transaction costs. Thus, there is a very high degree of affordability and potential effective demand among homeowners. Beyond this asset-driven affordability, however, it can be demonstrated that prices for existing housing are not particularly high relative to incomes. It can also be shown that rising utility prices have not necessarily had an adverse effect on affordability.

Given the weak economy and a relatively loose housing market, it is not surprising that housing prices are not extraordinarily high. The price structure is governed by market conditions, with higher prices for properties in central locations and more economically active cities. Table 1.12 displays current existing unit market prices in Bucharest for flats of various sizes in different zones.²² Table 1.13 is a similar table displaying current market rents. The two tables are remarkably consistent in the sense that the rents and prices are in proportion with each other (just as economic theory would predict). Again, this is a sign of a properly functioning market. The tables shows that a wide variety of prices and rents exist that are affordable to a wide range of incomes. Prices, of course, are much lower in other cities, although, like Bucharest, they cover a wide range depending on location and amenities. Table 1.14 presents existing unit prices for flats in Oradea and Slobozia. Existing units rent for about \$US 40 to \$US 60 per room, per month in Oradea. Although we do not have comparable rent figures for Slobozia, we would expect rents to be roughly half of those found in Oradea based on the differences in the purchase prices of existing housing in the two locations. Rents of about \$20 to \$30 per room would not be out of line with rents in other economically depressed cities, which run about \$25 per room.²³

Table 1.12
Market Prices of Existing Units: Bucharest (September 1999) (U.S. Dollars)

²² These zones are used by real estate brokers, and do not correspond to Bucharest's six sectors.

²³ While the role of the State has diminished, it still controls about 5 to 6 percent of the total stock. Rents are well below market levels. A new law is proposed that will set the base rent for state-owned apartments at about 125,075 to 143,000 lei for two-room apartments, and around 111,300 to 151,075 lei for three-room apartments. These amounts are subject to further adjustment based on geography, with renters in large municipalities paying up to four times these amounts. It is not clear how inflation is going to be taken into account.

Zone	Rooms			
	1	2	3	4
A	20,000 to 35,000	30,000 to 60,000	40,000 to 65,000	60,000 to 100,000
B	10,000 to 25,000	25,000 to 40,000	30,000 to 50,000	35,000 to 55,000
C	7,500 to 12,000	12,000 to 28,000	18,000 to 32,000	20,000 to 40,000
D	4,000 to 7,500	7,000 to 15,000	10,000 to 16,000	12,000 to 20,000

Source: Institute for Housing and Urban Development Studies (IHS) market survey.

Table 1.13
Market Rents of Existing Units: Bucharest (September 1999) (U.S. Dollars)

Zone	Rooms			
	1	2	3	4
A	200 to 500	300 to 650	400 to 800	700 to 1,500
B	150 to 250	200 to 450	350 to 600	500 to 900
C	80 to 100	150 to 250	250 to 400	300 to 600
D	70 to 80	80 to 150	150 to 250	250 to 350

Source: Institute for Housing and Urban Development Studies (IHS) market survey.

Table 1.14
Market Prices of Existing Units: Oradea and Slobozia (September 1999) (U.S. Dollars)

	Rooms			
	1	2	3	4
Oradea	2,500 to 14,000	4,500 to 17,000	7500 to 21000	9,000 to 36,000
Slobozia	900 to 1,200	3,000 to 4,200	3600 to 4800	4,200 to 5,500

Source: Institute for Housing and Urban Development Studies (IHS) market survey.

Relative affordability can be judged by comparing household incomes to prices. It is hard to come up with a precise figure for income, but most sources place the average gross wage at around \$US 100 to \$US 120. Table 1.15 presents a family income distribution from a housing need survey conducted by the Research Institute for the Quality of Life for the Ministry of Public Works.²⁴ This distribution is broadly consistent with the wage figures just cited. According to this table, the median family income for the country falls somewhere between 1 and 1.5 million lei (\$US 67 to \$US 101). The average family income is going to be higher than the median because the means of incomes are always higher than their median values. In addition, the average urban income is going to be higher than the national average. Based on Table 1.15, the median family income for Bucharest is around \$US 120.

²⁴ The term "family" as used in this survey is approximately equivalent to a household.

Table 1.15
Distribution Of Families By Total Monthly Income: March 1999

Amount (lei)	Bucharest City	Other Urban	Rural	Total
Almost none	1.9	1.3	2.1	1.7
Less than 100,000	0.9	0.4	2.7	1.5
100,000 to 250,000	0.0	1.0	9.2	4.6
250,000 to 500,000	7.5	6.1	21.2	13.1
500,000 to 1,000,000	9.3	18.0	34.0	24.5
1,000,000 to 1,500,000	18.7	21.6	12.6	17.3
1,500,000 to 2,000,000	18.7	21.1	9.6	15.6
2,000,000 to 2,500,000	12.1	11.3	3.4	7.8
2,500,000 to 3,000,000	11.2	8.8	2.5	6.2
3,000,000 to 4,000,000	8.4	5.0	1.5	3.7
4,000,000 to 5,000,000	3.7	2.9	0.8	2.0
5,000,000 to 7,000,000	4.7	1.7	0.4	1.4
7,000,000 to 10,000,000	1.9	0.4	—	0.3
More than 10,000,000	0.9	0.4	—	0.3
Total	100.0	100.0	100.0	100.0
N	107	522	523	1,152

Exchange rate March 1999: \$US 1= 14,925 lei.

Source: Special tabulations from the 1999 Need for Housing survey conducted by the Research Institute for the Quality of Life.

Fortunately, we do not need a perfect income figure to make our point. Let us assume that a typical household in Oradea has a cash income of \$US 80. This figure, however, refers to cash income only and understates real family income because it excludes the imputed value of homeownership. Let us conservatively say that the privatized two-room flat this household occupies could be rented out for \$US 40 per month. This household has a true gross monthly income of \$US 120, or an annual gross income of \$US 1,440. We can now compare this figure to a modestly priced two-room existing flat in Oradea. A \$US 4,500 dollar unit is about 3.1 times the annual salary of the family, while a \$US 6,000 unit is about 4.2 times. In comparison, housing price-to-income ratios ranged from 2.4 to 6.6, with a median of about 3.9, when they were computed for a selection of industrial countries in the early 1990's.²⁵ Repeating this analysis for high-priced Bucharest yields similar results, since cash incomes (and imputed incomes) are higher.

²⁵ See "Housing: Enabling Markets to Work," by the World Bank, 1993. Most of these ratios used data from the mid to late 1980's, and were computed using median prices and median incomes. The imputed income is necessary to make fair comparisons with other countries.

The point of this exercise has been to simply show in very broad terms that housing prices of existing units are not unusually high with respect to incomes. It helps explain why the market functions by demonstrating how effective demand can exist even when incomes seem so low. A cash-poor household that owns its unit can consume just as much as a household with a higher income that has to rent or finance its home. This includes the act of purchasing a new home. Both can purchase the same home: one by trading (or selling and buying), and the other by bank financing (if available) or self-financing. The availability of finance obviously benefits the non-owner the most.

As noted earlier, the high cost of new construction has put this option out of reach for many households. The price of new construction for flats is around \$US 350 to \$US 400 per square meter of total floor area, which means the price of a minimum standard two-room unit, with 52 square meters of total floor area, is about \$US 18,000 to \$US 21,000. This range represents the lower end of the market, and these prices are similar to the amounts the private sector would charge to build units comparable to those planned for the government's new housing program to be implemented by the newly created National Housing Agency (NHA). The NHA plans to charge only about \$US 12,000 for a two-room flat (roughly \$US 200 to \$US 250 per square meter), but this figure excludes charges for land, infrastructure, profit, taxes, and financing costs.

There is no general rule of thumb for the price of a single-family home (known locally as a villa). We did not obtain construction costs for rural areas, where most single-family homes are built (often with incomplete services, and using some self-help). In urban areas, a relatively small number of villas have been built recently, and many of these were built by rich households. While prices for high-end units can easily exceed \$US 100,000, it is nevertheless possible to obtain a modest villa with services on the edge of Bucharest for around \$US 25,000 to \$US 30,000. This is still well beyond the means of most urban households.

Finally, some people believe rising utility prices may be adversely affecting housing affordability; however, it is unclear whether utility prices, in real terms, are any higher today than they were at the time of our previous study. In our previous study, we noted that it was hard to estimate what people living in flats were paying for communal services. In late 1994, charges for communal services were believed to make up around 20 percent or more of a typical household's cash income.²⁶ In comparison, during the summer of 1999, communal services (which include cold water, hot water, heat, garbage collection, common area electricity, and routine maintenance) in Bucharest cost about \$US 5 per month, per person. This cost can double or triple during the winter months. Distributing this extra heating cost over twelve months might add, say, \$US 3 to \$US 5 to the average monthly per person cost. A three-person household with an income near the median (roughly \$120 in Bucharest), would then be paying about \$US 24 to \$US 30 per month for communal services, or roughly 20 to 25

²⁶ In May 1993, subsidies for communal services were phased out.



percent of its income. Therefore, it does not appear that the relative cost of communal services has changed significantly during the past five years.

2.0 GOVERNMENT HOUSING POLICY AND PROGRAMS

At the national level, government policy is dominated by the desire to build new housing and to help young households purchase this housing. Because of the overwhelming influence this “young household” phenomena has on housing policy, it merits further discussion. From an international perspective, it is unclear whether this cohort faces a unique problem. The problem in Romania centers on the inability of members of this group to become homeowners. In market-based industrial countries throughout the world, young people have difficulty accumulating resources to purchase homes. Relatives and friends often provide financial assistance to these households when they want to buy. While they save, they rent units, sometimes sharing them, or live with relatives. This also happens in Romania, however the perception is that this is an unusual hardship. This perception is understandable since this is one of the first generations that has had to solve its housing problems through the marketplace. It did not benefit from the privatization windfall, and, for many, there is little chance of receiving significant housing assistance from the state. So there is a crisis with respect to coming to terms with the new reality, and it comes at a time when there is a large number of young adults.

Perceptions play a major role in the housing problems of many Romanians. Many of the people that one would expect to be able to find homes, such as young professional couples and individuals, *can* afford to rent units, even though these units may not be of the standard of their parents’ homes. The locations may be worse, and services may be lower than that to which they are accustomed. Faced with long commutes and lower quality, many young people choose to live with their parents until they can afford a better housing solution. There are more young people in this situation than ever before, but this problem does not represent a failure of the housing market. Young households have difficult choices to make, and they may not like their options, but their situation is not extraordinary by regional or world standards.

In recent years, the government’s primary approach for assisting prospective homeowners is through subsidized financing. In 1997 and 1998, the government offered loans to about 11,000 households in which it subsidized the difference between the market rate of interest and the 15 percent interest paid by the borrowers. This program was offered through the National Savings Bank (CEC), and was targeted on young people. For 1999, the program has received a new budget allocation to cover an additional 8,000 loans. However, unlike the earlier round—in which nearly all of the loans were used to purchase existing housing—70 percent of the new loans must be used to purchase newly constructed units.

The government's latest initiative is the creation of the National Housing Agency (NHA), which was formed on September 15, 1999, under the auspices of the Ministry of Public Works and Regional Planning. Its objective is to expand the existing stock, and therefore has a new construction focus.²⁷ Under the initial program, the NHA plans to build 12,500 apartments throughout the country depending on land availability.²⁸ In many ways, this new program is a classic government-run, build-and-sell program. Dwelling prices are set by the NHA based on the size of units. A studio apartment is 145 million lei, a two-room apartment is 200 million lei, and a three-room apartment is 275 million lei. Actually, these are maximum amounts that will be financed; purchasers may spend more on their units if they have their own funds. The prices are subsidized because local governments are expected to contribute land and infrastructure free of charge.²⁹ Apartments will be built and be ready for occupancy within twelve months after signing a contract. The contractor(s) will be selected by the government as part of the overall bid for the program in which the government has guaranteed the payment of the \$US 300 million the program is expected to cost. This is in addition to 85 billion lei that the government has already set aside for the program (60 billion lei are reserved for young couples and people less than 35 years of age). Program beneficiaries will receive a euro-based loan with an interest rate of 6 to 7 percent, and must make a downpayment of 20 percent. The maximum monthly payment is two million lei. Young people may qualify for smaller downpayments, no interest for the first year, and a longer term.³⁰

The government's supply-oriented actions are somewhat surprising, given that they come at a time when most of the world has shifted to a philosophy that assigns government the role of supporting and enabling the development of housing by the private sector. Furthermore, by continuing to offer various deep subsidy programs, the government may actually be heightening expectations among young people, and perpetuating the idea that the government should provide housing for them. This mindset can destroy individual initiative among some young households.

²⁷ About 85 percent of the credits must be used for new construction (Curentul, 27/09/99). In principle, NHA funds may also be used to finance the purchase of existing units and rehabilitation work.

²⁸ Many local governments are reluctant to contribute land free of charge (Ziarul Financiar, 6/10/99). So far, 12 hectares in Bucharest, and 13,000 hectares in the rest of the country, have been identified for the program.

²⁹ According to a recent ordinance, the state will retain ownership of the land. The land will be administered by the local city council. The unit owner may use the land without paying a tax.

³⁰ The program is not targeted on poor households, and richer households actually have a better chance of meeting the financial qualifications for the loan. Two of the selection criteria reward the ability to afford larger downpayments and shorter loan terms. Other selection criteria include: marital status; the health of the applicant; the applicant's existing space; and the applicant's ownership of other dwellings. As of the end of September, 28,000 applications had been purchased (for about \$US 3), and 12,500 of them had been submitted to NHA (including 7,317 from Bucharest; 661 from Constanta county, and 524 from Cluj county).



There is one other loan program that is targeted on owners affected by earthquakes. These owners qualify for 5 percent, 20 year loans, as long as their net family incomes fall below the national average. The loan proceeds may be used to pay for structural studies and rehabilitation work.

The international donor community presently is not active in the housing sector. Some organizations are, however, involved in shelter-related projects. The World Bank, for example, is currently implementing a Bucharest water supply project, a power sector rehabilitation project, and a general cadastre and land registration project. In addition, as noted previously, until August of this year, USAID supported a condominium technical assistance program. Also, the real estate agent association (ARAI) has received some assistance from the Eastern European Real Property Foundation.³¹

At the local level, priorities other than new construction are being expressed. For example, the broker community in Bucharest is trying to develop a program in which the city would purchase existing units for social housing. Brokers believe they can deliver existing units to the city for far less than it would cost the city to construct new units. This is a perfect illustration of the price advantage existing units hold over newly constructed units. In Slobozia, local officials are keenly aware of the problems of deteriorating existing buildings; however, they feel the state should create a program that would fund rehabilitation work. In Oradea, there is also interest in rehabilitation work, but for a different reason. Oradea has very old stock with a lot of historical value, and there is a great deal of interest in preserving it.

3.0 DEVELOPMENT OF THE HOUSING FINANCE SECTOR

3.1 *The Economic Backdrop to Developing Housing Finance*

Romania, as compared with a number of the of the other transition economies in CEE, is only just now experiencing a serious restructuring of its economy. While a major focus is on privatization and restructuring of the industrial sector, the financial and banking sectors have also been major targets for improvement. The National Bank of Romania (NBR) is heavily involved in the banking sector reform process, working in conjunction with the World Bank and the IMF. NBR provides detailed and critical analyses in its Annual Reports and Quarterly Bulletins; thus, a history of events in the real economy as well as developments in monetary, fiscal, privatization, and banking policies is readily available. Only a brief commentary will be provided here on some of the key issues; several economic aggregates and forecasts are presented in Table 4.1.

Inflation, having been brought under some degree of control in 1995, surged again in 1997 to hyperinflation levels, as the “real” economy collapsed. While the

³¹ A newspaper article in late August mentioned a possible EU grant for 1,300 social houses, but we were unable to verify this claim.

Government is struggling to get inflation under control, it faces many structural problems. The current account trade deficit, for example, combined with large external debt service and failure to attract targeted amounts of foreign capital, is an ongoing problem. Privatization of industry has been slow and halting, exacerbating the ability to attract foreign investors. The NBR considers the legal structure to be a somewhat confused mix of old laws from the centrally planned and inter-war periods, and current practice in the West.

Table 3.1
Summary of Main Economic Indicators (percent change)

	Change in Real GDP	Growth in Real wages	Inflation	Unemployment	Commercial Lending rates/ deposit rates	Exchange Rate
1994	3.9	1.6	136.7	10.9	91.4/58.9	1767
1995	7.1	0.9	32.3	9.5	48.6/36.5	2578
1996	3.9	-0.2	38.8	6.6	55.8/38.1	4035
1997	-6.9	-1.2	154.8	8.9	63.7/51.6	8023
1998	-7.9	0.2	64	10.3	56.9/38.3	10,951
1999 est.	-3.0	-0.4*	48.6*	11.3*	75.6/52.1*	16,037*
2000 est.	0.5	N/A	20	N/A	N/A	N/A
2001 est.	2.5	N/A	N/A	N/A	N/A	N/A

Source: National Bank of Romania, Annual Report, 1998 and Statistical Bulletin, July 1999 and Central European Economic Review, October 1999. * signifies annual rate in July or month of July 1999 for lending rates and the exchange rate.

The financial and legal problems, which have a particular impact on the conduct of housing finance in Romania, include the following:

- Under the current macroeconomic circumstances, demand will be very constrained; economic growth is negative, growth in real wages is essentially zero, and unemployment has risen annually since 1996.
- Interest rates are not only high, but also equally damaging, they are volatile. This further disrupts economic activity and potential demand—most especially for credit—through very high levels of uncertainty. Thus, in general, but especially in the case of housing finance, even if banks are somewhat protected from interest rate risk through variable rate products, borrower ability to pay suffers in the face of abrupt changes in scheduled amounts due.
- There is an extremely large gap between the banks' lending rates and deposit rates—currently over 23 percentage points. (For reference, we can look at the range in interest rate margin in Europe; in Swiss banks it is around 0.9



percent and in Greek banks 2.3 to 4.7 percent). This large gap in Romania can signify a number of problems, including, of course, inefficiencies in bank operations. However, the excessive risk inherent in very volatile conditions is disruptive.

- Although a new mortgage law is now under discussion in Parliament, at present banks apparently cannot use the property being purchased as collateral, and must rely on other assets, particularly other properties owned by the would-be borrower. Clearly, this limits an already small potential market.
- Under conditions such as those now prevailing, and in which the Government must raise funds via short-term Treasury bills, issued at high rates, there is a tendency for banks not to develop portfolios, but rather to simply invest in Government paper. This is especially damaging to long-term lending such as housing finance.

On the other hand, there is now some good news on the horizon as well:

- Inflation is again falling and is expected to continue fall. Growth in (real) GDP is expected to become positive during 2000 (or at least by 2001).
- As noted, the banking sector is in the midst of a process of privatization, consolidation, mergers, and foreign investment. The process of privatization and restructuring is now nearly complete for the banks that already have a portfolio in housing finance.
- There are at least six banks with aggressive plans to expand consumer and retail lending, including housing finance. The financial position of most of these banks is adequate or good. This will have a very positive impact on the ability of mortgage lending to go forward in the next stage of development, in a competitive, market-based environment.
- The new mortgage law, although it certainly needs additions and clarifications, is a positive step forward in the legal structure for housing finance.

In summary, if current trends continue, and if Romania follows a similar path of reform as other countries in CEE such as Poland, Hungary, and the Czech Republic, the development of an active housing finance sector should be possible within the next several years. Therefore, timely assistance in the further development of a technical and legal structure for housing finance, together with improved staff skill and appropriate mortgage products, would provide a valuable and solid foundation for the long-term.

3.2 The Privatization and Restructuring Process in the Banking Sector: Impact on Housing Finance

There are currently 33 banks with Romanian legal status and 9 banks, which are foreign legal entities. Although problems certainly remain, the process of privatization and foreign investment is making progress in strengthening banking institutions and introducing needed technical infrastructure. As noted, the restructuring process is being carried out by the National Bank of Romania (NBR, the Central Bank) in conjunction with the World Bank and IMF. The NBR has done extensive analyses with regard to the banks' condition, the possibilities for restructuring versus revocation of license, and the potential clients, both domestic and foreign, for the privatization process.

This section focuses on six Romanian commercial banks engaged in retail banking, five of which already offer housing finance. Although these banks now offer housing loans—that is, construction finance, purchase of new or existing units, and rehabilitation loans—under the present economic conditions, their portfolios are small, usually about one to two percent of their total loans. All six banks have concrete plans for focusing on consumer lending and housing finance in the future.³² The banks of interest are:

- Romanian Commercial Bank
- Romanian Bank for Development
- BancPost
- Transylvania Bank
- Ian Tiriac Commercial Bank
- Savings Bank (CEC)

Both Romanian and foreign investors) privately own bank Transylvania and Ian Tiriac Bank. The privatization process for the other banks which have an interest in housing finance is nearly completed. BancPost is now almost fully privatized, and the process is continuing. The Romanian Bank for Development has also been recently privatized. In the opinion of the Central Bank, both are now in a strong position. The Romanian Commercial Bank, the next to last to be privatized in this group, should be substantially privatized by mid-2000. The Savings Bank (CEC) will be the only remaining state-owned bank (in our interest group); the future of its subsidized lending program could be a problematic issue.

The privatization and restructuring process will have a very positive impact on the ability of the banking sector to go forward in the next stage of development, a crucial aspect of which is strong competition within Romania.

³² Other banks, which may have an interest in housing finance, include the International Bank for Religions, Bank Bucharesti, and Bank Romanescu. All are small banks and were not contacted during this TDY. As does Bank Transylvania, Bank Romanescu has ownership participation with the Romanian-American Enterprise Fund.

Table 3.2 summarizes some of the key features of these banks, and a brief commentary follows.

Table 3.2
Summary Profile Of Selected Banks

Bank	Net Assets: 1998 (bil. lei)	Ownership	Privatization	Primary Focus	Housing Finance
Romanian Commercial Bank	26,415,885*	State	Under development for the year 2000	Consumer Loans	Currently small; a future focus
Romanian Bank for Development	11,143,618	Foreign and domestic private; state	Privatization completed in 1998	Economic Development	Currently small; a future focus
BancPost	4,468,095	Foreign and domestic private; state	In process; nearly complete	Consumer Loans	Currently small; a future focus
Bank Ian Tiriac	5,120,272	Private (foreign and domestic)	N/A	Lending to Industry	Consumer lending a future focus
Bank Transylvania	2,890,310	Private (foreign and domestic)	N/A	Consumer Loans	Currently small; a future focus
Savings Bank (CEC)	12,092,386	Only fully state-owned bank	Planned for the future; no schedule yet	Savings accounts; consumer loans	Previously subsidized lending for housing

Source: National Bank of Romania, Annual Report 1998. * The Romanian Commercial Bank (RCB) will absorb Bancorex (which was recently closed by the NBR). Bancorex had assets of lei 27,600,732 in 1998; this will increase RCB's assets, but it is not known by how much.

Romanian Commercial Bank (RCB). RCB is the largest commercial bank in Romania, with an extensive network of branches. The RCB is currently state-owned, but will be privatized during the year 2000. A team headed by Merrill Lynch is now drawing up the privatization feasibility studies; the schedule for privatization will likely be set back somewhat by the process of its merger with Bancorex. A USAID staff member in Romania feels that RCB is one of the best state-owned banks and thus is an excellent candidate for privatization.

The NBR also states that RCB is one of the nation's best commercial banks. It is well capitalized and liquid, and has made progress in solving its problems with non-performing loans. The RCB wants to maintain its diverse base in the economy. Interestingly, the president of RCB noted during our interview that the Romanian Bank for Development (see below) must now have its loans approved by Societe Generale in Paris, which not only causes delays, but defeats the benefits of knowledge of local

circumstances. The important inference from this discussion is that RCB does not want a dominant foreign partner, but rather a minority interest.

The RCB currently offers housing loans, which amount to about 1 percent of its portfolio; it plans to continue with a strong interest in consumer finance in the future.

Romanian Bank for Development (RBD). RBD is now privatized, with a majority share (51 percent) held by Societe Generale (SG). One of the largest banks, RBD is considered by the NBR and other observers to be a strong bank. The RBD currently offers housing finance loans, although they make up less than 1 percent of its total assets of 8,000 billion lei. However, there are 5,000 active clients at the present time; since 1991 the bank has had about 18,000 housing finance loans. At the current time, the bank requires a 30 percent downpayment; the maximum duration of 7 years has just been changed to 15 years. Prior to passage of the new mortgage law, the most frequent form of collateral used by the bank was another property; also acceptable are the land where a new house would be built. RBD, as are all the banks, is anxiously awaiting passage of the new Mortgage Law.

BancPost. BankPost is considered by the NBR to be an excellent smaller bank. Now privatized, GE Capital holds a 35 percent share, and the Banco Portugues Investimento Group holds another 10 percent, while the Romanian private investment funds (SIFs) hold 30 percent. The EBRD and the IFC each lent the bank \$10 million, which will be converted into shares. The bank is now 83 percent privatized, and expects to be fully privatized by April 2000. The bank plans to aggressively market retail lending, including housing finance.

BancPost wishes to become a very strong retail bank, and will begin its focus on mortgage lending in the near future. It has a strong capital position, is liquid, and has a relatively low volume of non-performing loans (GE, in performing its due diligence found 4.3 percent of the portfolio as overdue or non-performing, and all were said to be recoverable). One third of the bank's loans are consumer loans; this is primarily car loan, credit cards, and consumer goods. The planned-for new products include housing loans and leasing. GE's strategy also includes a very strong interest in housing loans, and the bank is waiting for the new mortgage law to be put in place. The bank plans to use the 2,500 offices of the Romanian Postal Service to collect deposits.

Bank Transylvania. Bank Transylvania is a small private bank with Romanian and foreign capital. The Bank is one of two with a collaboration protocol with the American-Romanian Enterprise Fund, which provides \$50 million for financing SMEs. This bank currently offers housing finance and will continue with its plans to market housing products.

Bank Ian Tiriac. Launched in 1990, Ian Tiriac is a private bank with domestic and foreign investors, including a participation of \$40 million from a syndicate of international banks and investors, and a 20 percent equity stake with the EBRD, the first



CEE bank to receive such a participation. The bank does not currently focus on retail lending, but plans to introduce this next year; housing will follow other retail products during the year 2000.

Bank Ian Tiriac has worked with USAID's Loan Portfolio Guarantee Program, which covered a total of 35 loans representing \$1.5 million; USAID feels the Bank has done a good job. The current president is a former president of ING Bank in Romania, who hopes to improve the bank's management.

The Savings Bank (CEC). CEC is expected to be transformed into a commercial bank and then privatized, but the schedule is not clear. CEC conducted the GOR's subsidized interest rate lending programs in housing finance until they were ended in favor of the new National Housing Agency program. However, as noted, apparently the subsidized program may move ahead again. This bank could benefit greatly from restructuring, privatization, and modernization. While it has a large branch network, it does not have an automated IT system, and recording is still done manually. It is currently not developing much of a lending program, but rather just holding a large volume of Government paper.

There are potentially serious "level playing field" issues which must be considered with regard to CEC; that is: will CEC's subsidized lending program offer interest subsidy loans to the same potential clients to whom the private banks would offer market rate loans? If this is the case, the CEC would possess unfair advantage and would impact negatively the emergence of effective demand for market loans that will ultimately be important in Romania's recovery. (Also, the CEC used to benefit from a state guarantee on deposits, but this has now been offered to all banks up to an amount of 42 million lei.)

3.3 Medium-term Prospects for Mortgage Lending

The Future Lending Environment. Given current interest rates, few households can afford housing loans, either for rehabilitation or to purchase a new or existing house. This is generally true whether we consider fixed rate loans, variable rate loans, or special "dual-indexed" loans discussed below. As noted, a small portfolio of market-rate loans does exist in at least five of the Romanian banks. This is likely to be testimony to the situation of a few households and developers whose income is reliably expected to increase faster than the rate in inflation (or any increase in interest rates), and thus for whom it is advantageous to be in debt. But this situation is certainly the exception.

In the medium term, however, it is likely that conditions will converge to offer Romania both an economic scenario, and an effective institutional and legal structure, which will encourage bank lending, including for housing finance. The key parameters include the following:

- Improved economic conditions with regard to both real income and interest rates
- Adequate competition among banks and appropriate loan products
- State subsidy policies consistent with market-based lending—that is, a level playing field
- An adequate legal and administrative framework
- Appropriate supporting institutions, such as the central bank, the Romanian banking institute, and a credit bureau
- Increased efficiency in bank operations, allowing a reduction in the interest rate margin

What are the prospects in the medium term—say by the year 2001 or 2002—for much of this scenario to be realized?

Economic Growth and Inflation. As noted above, the National Bank of Romania expects economic growth to turn positive (in real terms) by sometime in 2000 or 2001. If history elsewhere in the region is any guide, Romania may indeed emerge from its restructuring efforts in a year or so with positive economic growth. Hungary, the Czech Republic, Poland, Croatia, Slovakia, and Slovenia all experienced about three years of negative economic growth in the early nineties, during major restructuring efforts.

NBR also expects inflation to fall to 20 percent in the year 2000, with further declines expected in subsequent years. Again, with other CEE countries as a guide, inflation may take considerable time to fall to really tolerable levels—for example, 10 percent and below. If inflation falls only to 15 to 25 percent, however, alternative mortgage products designed for this can be utilized. The reality of these forecasts depends on a number of factors coming together to stimulate growth while the NBR continues to create a monetary environment allowing inflation to fall. As noted, not only must inflation fall, but the fall should be steady—without the severe ups and downs which Romania has continued to experience.

Bank Structure, Competition, and a Level Playing Field. With the privatization process well underway, and an apparently strong focus on consumer lending, including housing finance, being planned, Romania should have a competitive banking structure. Competition in market-rate lending is stressed here because it has proved so important elsewhere in the region in making banks more efficient, and thereby lowering rates. Similarly, a level playing field would require that the State Savings Bank does not retain special privileges (such as deposit insurance in the past) that offer an unfair advantage.

State Subsidy Policies Consistent with Market-based Lending. Another important aspect of fair competition is that the State Savings Bank and the National Housing Agency—if they offer loans at subsidized interest rates, or with other subsidy



features—target them only to households that could not otherwise borrow. In other words—subsidy policies that do not compete with the market-rate loans that the banks are offering.

An Adequate Legal Framework. As discussed below, the legal framework for housing finance is just now being sorted out. The New Mortgage Law is very definitely a major step forward. It would seem to be adequate in a number of respects, including the long-awaited use of the property as collateral for the mortgage loan. In addition, the law provides an approach to foreclosure, which does not require court proceedings. There are, however, remaining issues to clarify and other legislation which must be made consistent with the new Mortgage Law. Thus, the Mortgage Law is apparently not consistent with the Securities Laws and the Securities Law itself has a variety of shortcomings. Some of the issues in the Securities Law are now being addressed by Parliament. Two issues are of concern to the housing sector and housing finance: (1) the issuance by local government of bonds, which would finance local infrastructure (among other things) and (2) the issuance of debt instruments such as mortgage backed securities (MBS). The Mortgage Law notes the issuance of “mortgage bonds”, but the law is inadequate to support the legal infrastructure required by securitization—for example, a SPV (special purpose vehicle), and transfer issues concerning the mortgage portfolios (taxes, regulations, permissions, etc.).

Reduced Interest Rate Spreads. At present, the spread between bank lending rates and deposit rates is immense in Romania. This is no doubt a function of many factors: however, not only must operating efficiency be improved, but the risks associated with uncertain, high, and volatile interest rates reduced. Until the monetary situation stabilizes, it will be difficult to determine the other causes of this high interest margin.

3.4 Affordability and Effective Demand in the Medium-term

As has been noted, long-term lending, except for limited exceptional circumstances, is not feasible under present interest rate and uncertainty conditions. Our analysis of affordability, therefore, is hypothetical and refers to a time period which is a year or more from the present.

The affordability analysis is based on the income distribution and the prices for apartments and houses discussed in section 1.0. For reference, median household income is assumed to fall somewhere between 1.5 and 2.0 million lei per month (in March 1998 prices), or approximately \$120 per month. Tables 3.3 and 3.4 provide the income and price data used in the analysis.

Table 3.3
Summary of the Income Distribution

Summary of Income Distribution (lei range and US\$ midpoint of range)	Bucharest	Other Urban	Rural	Total
0 – 500,000 (\$16)	10.3	8.8	32.2	20.9
500,000 – 1,000,000 (\$ 50)	9.3	18.0	34.0	24.5
1,000,000 – 1,500,000 (\$84)	18.7	21.6	12.6	17.3
1,500,000 – 2,000,000 (\$117)	18.7	21.1	9.6	15.6
2,000,000 – 2,500,000 (\$150)	12.1	11.3	3.4	7.8
2,500,000 – 3,000,000 (\$184)	11.2	8.8	2.5	6.2
3,000,000 – 4,000,000 (\$235)	8.4	5.0	1.5	3.7
4,000,000 plus (\$450)	11.2	5.4	1.2	4.0

Table 3.3 provides a summary income distribution based on the special tabulations (described in section 2.0) which provide, as closely as possible, the income distribution for Bucharest, other urban areas, and rural areas. The data for each area have been aggregated into eight groups for easier reference. Clearly, urban and rural areas have very different distributions of income; even among urban areas, Bucharest and the other urban areas exhibit different distribution of income. Although the estimations in the analyses presented below—of the percent of a households with a given income distribution which can afford a particular house or flat—are very approximate, it is fortunate (and rather unusual) to have this type of detailed data available for analysis in a transition country.

Table 3.4
Exemplary Market Prices for Flats and Villas: Existing and New Construction

Area	Existing 2-Room Unit (\$US)	Existing 3-Room Unit	New Construction 2-Room Unit	Villa Moderate Cost	Villa High Cost
Bucharest Zone A	\$ 45,000	50,000			
Bucharest Zone B	33,000	40,000			
Bucharest Zone C	20,000	25,000			
Bucharest Zone D	10,000	13,000	18,000 / 21,000	25,000	100,000
Oradea – moderate	4,500	7,500			
Oradea – higher cost	17,000	21,000			
Slobozia	\$ 3,600	4,200			

Affordability and DIM Loans: A Less Stringent Monetary Scenario

The analyses presented below, illustrating purchase of existing and new flats and villas, utilize a special dual index mortgage product (DIM) instead of conventional (fixed or variable rate) mortgage loan products. Long-term loans using conventional mortgage loans will not be affordable to a large number of households until interest rates fall to 10,



for example. This is not expected to occur in the near future. Even if inflation falls to 15 percent a year or so, lending rates would probably remain at 20 percent or above.

Table 3.5 illustrates approximate loan sizes available to households utilizing a dual index mortgage (DIM). There are a number of designs for these types of loans, but the basic principle is that both the interest rate and the repayment rate are pegged to indices. The interest rate can be pegged to a variety of indexes, just as for a variable rate (single index) loan, while the repayment rate is generally pegged to a wage index.

DIMs are designed to accommodate economies where inflation, and thus interest rates are moderately high. Thus, our macroeconomic scenario could assume that inflation falls to 15 to 25 percent, which certainly appears to fall well within the range of the NBR's plans. Furthermore, there can be limited (but not an excessive amount) of instability within this range.

The main advantage of a DIM approach is that borrowers can achieve greater affordability, while lenders can achieve variable market-based rates. The major "flaw" of conventional loan products in inflationary situations is the so-called "tilt" effect. For a loan that would in fact be affordable to a borrower over the long-term, at the early stages of the loan, the initial payment ratios are very large relative (in real terms) relative to the later payment ratios—that is, in the later years as real income increases.

DIM loans have proved extremely valuable in the Polish context; a very substantial proportion of Poland's housing finance loan portfolio consists of DIMs, and banks have gradually developed their own specifications. DIMs have met with problems in Mexico, however, and at least some of the reasons for the differences in success are due to the rather more extreme interest rate instability in Mexico³³

³³ See Loic Chiquier, "Dual Index Mortgage: Conditions of sustainable Development in Poland", and Sally Merrill, "Poland: Housing Finance at the Millenium: An Assessment of Achievements and Outstanding Issues".

Table 3.5
The Potential for Dim Loans in Romania: Loan Size by Income Group

Monthly Income (lei) March 1999	Monthly Income U.S. \$ (March 14,925)	DIM Loan = 30 X monthly income	Initial Repayment: 1.2 percent of loan amount monthly	Maximum Cost/ Sales Price: Loan + 50 percent Downpayment
Group I 0 – 1,000,000 (19.6 percent)	0 – \$67	0 – \$2,010	0 – \$24	0 – \$3,050
Group II 1,000,000 – 1,500,000 (18.7 percent)	\$67 – \$100	\$2,010 – \$3,000	\$24 – \$36	\$3,050 – \$4,500
Group III 1.5 – 2.0 mil. (18.7 percent)	\$100 – \$134	\$3,000 – \$4,020	\$36 – \$48	\$4,500 – \$6,030
Group IV 2.0 – 3.0 mil. (23.3 percent)	\$134 – \$201	\$4,020 – \$6,000	\$48 – \$72	\$6,030 – \$9,000
Group V 3.0 – 5.0 mil. (12.1 percent)	\$201 – \$335	\$6,000 – \$10,050	\$72 – \$126	\$9,000 – \$15,075
Group VI 5 – 7 mil. (4.7 percent)	\$335 – \$469	\$10,050 – \$14,070	\$126 – \$169	\$15,075 – \$21,100
Group VII 7 – 10 mil. (1.9 percent)	\$469 – \$670	\$14,070 – \$20,100	\$169 – \$241	\$21,100 – \$30,000
Group VIII 10 mil. + (0.9 percent)	\$670+	\$20,100+	\$241+	\$30,000+

Table 3.5 illustrates a typical (but conservatively underwritten) DIM loan. Households can borrow up to 30 times monthly income. The initial payment ratio is 1.2 percent of the loan amount, which yields a payment ratio of 30 percent of income. In our example, a household with median income (about the midpoint in income Group III) could obtain a loan of about \$3,500 (about the midpoint of the loan sizes for that group). Households in Group IV and above—about 43 percent of the households in Romania based on the Survey—could afford loans of \$4,000 or more. And those in Group V and above—about 20 percent of the income distribution—could obtain loans of \$6,000 or more. When a downpayment is added to this figure—and see the section below with regard to downpayments—a much more positive picture of “releasing” effective demand emerges.



DIMs are highly technical loan products. They could not be easily implemented in Romania without technical assistance.³⁴ However, the benefits may be well worth the effort. The following points should be noted about DIMs:

- The tilt effect dominates presentation of fixed rate—and variable rate—amortization schedules in inflationary environments. Initial high payment ratios cause loans to appear “more unaffordable” than they actually are in the long-run;
- The main benefit of the DIM loan is to avoid the tilt effect, and thus allow participation by a much broader range of the income distribution in formal lending for housing finance;
- DIMS work well in an environment of modest inflation—that is, 15 percent to 30 percent rather than hyper-inflation;
- DIMS will work in a relatively stable inflationary environment, and concordance between the indexes for the interest rate and the wage rate must be fairly stable.

In summary, DIMS could help many existing homeowners to purchase a better unit and more new households to enter the market. Also, many more low-income households could afford a small rehabilitation loan with a dual-indexed product.

Affordability and Effective Demand in the Medium Term

There is an immense diversity of circumstances in Romania with regard to being able to purchase a home. While Romania’s situation is not unique among some of the transition nations, it offers a different profile from the housing situations in the U.S. and much of Europe. The rental sector is much smaller than in most nations outside the transition economies. Many of the poorer households—were they living outside Romania—would be renters.

This situation offers both advantages and disadvantages. On one hand, most homeowners now hold a valuable asset that can be used as collateral if a loan is required for rehabilitation, or in order to move and purchase as alternative unit. On the other hand, some owners are too poor to afford even a modest rehabilitation loan. Also, many of those who do not own are likely to be “liquidity constrained” (lack an adequate downpayment) and/or would not be able to service a large loan. The key factors—and assumptions—in the analysis include the following:

³⁴ In Poland, much of the assistance came from international donors and consultants who established the Mortgage Fund (World Bank, USAID, EBRD, and Government of Poland). Polish experts than assumed operations.

- Households with equivalent incomes face very different affordability circumstances depending on two key factors: (1) location and (2) whether or not they are currently homeowners.
- Those who currently own units—and this is a substantial majority—hold a valuable asset and in many cases could easily “trade-up”. Thus, the affordability tables distinguish four groups of households:
 - Those who do not own a unit but can provide a 10 percent downpayment.
 - Those who many of may not own a unit, but can provide a 25 percent downpayment.
 - Those who already own a reasonably valuable unit, and are thus (arbitrarily) assumed to have a 50 percent downpayment.
- Those who already own a highly valued unit, and can thus provide a 75 percent downpayment.
- Households currently owning a unit in Bucharest would generally be able to purchase larger and/or higher quality units outside Bucharest. Conversely, for those selling units owned outside Bucharest in order to move into the city, the affordability scenario is less rosy.
- As noted above, prices in Bucharest in all locations exceed those in Slobozia and nearly all in Oradea. Clearly, in terms of affordability, households are far more able to move out of Bucharest than to move into it from elsewhere.

Tables 3.6 and 3.7 indicate the proportion of households that can afford an existing, two room flat in four areas of Bucharest, ranging from city center to outlying areas, and in Slobozia and Oradea. In the “expensive” zones of Bucharest (zones A and B), almost no households can afford to purchase an existing flat with a small downpayment; even with a large downpayment (75 percent) only 6.8 percent and 11 percent of households could buy in these types of districts. The situation is greatly improved on the outskirts of Bucharest (zone D) where 70 percent of those with a large downpayment could buy/trade-up to another unit. Nearly 10 percent of those with only a small downpayment could also purchase. When a three room existing flat is used in the analysis, the findings, affordability is more limited but the “shape” of the findings is similar. In contrast, in the other urban areas (Table 3.7), affordability is far more favorable; those already owning (assumed to have a 75 percent downpayment), would be relatively free to choose their circumstances.

Table 3.6
Affordability of Existing Housing in Bucharest: Proportion of Households Who Can Afford to Purchase Existing Flats: Bucharest Income Distribution

Size and Location of Existing Flats	Sales Price	% Able to Purchase: DIM Loan + 10% Downpayment	% Able to Purchase: DIM Loan + 25% Downpayment	% Able to Purchase: DIM Loan + 50% Downpayment	% Able to Purchase: DIM Loan + 75% Downpayment
2 ROOM FLAT					
Bucharest Zone A	45,000	< 1%	<1%	<1%	6.8%
Bucharest Zone B	33,000	< 1%	<1%	1.8%	11.0%
Bucharest Zone C	20,000	1.5%	2.5%	7.5%	31.5%
Bucharest Zone D	10,000	9.4%	13.9%	31.5%	70.6%
3 ROOM FLAT					
Bucharest Zone A	50,000	<1%	<1%	<1%	4.8%
Bucharest Zone B	40,000	<1%	<1%	0.9%	9.0%
Bucharest Zone C	25,000	<1%	1.0%	4.8%	19.6%
Bucharest Zone D	13,000	5.2%	9.0%	13.9%	60.9%

Table 3.7
Affordability of Existing Housing in Oradea and Slobozia: Proportion of Households Who Can Afford to Purchase Existing Flats

Size and Location of Existing Flats	Sales Price	% Able to Purchase: DIM Loan + 10% Downpayment	% Able to Purchase: DIM Loan + 25% Downpayment	% Able to Purchase: DIM Loan + 50% Downpayment	% Able to Purchase: DIM Loan + 75% Downpayment
2 ROOM FLAT					
Oradea – moderate	4,500	30.5%	44.6%	70.0%	91.2%
Oradea – higher cost	17,000	<1%	2.0%	6.8%	27.2%
Slobozia	3,600	50.5%	59.2%	77.2%	94%
3 ROOM FLAT					
Oradea – moderate	7,500	9.4%	14.8%	35.0%	76.2%
Oradea – higher cost	21,000	<1%	0.8%	1.8%	17.0%
Slobozia	4,200	35%	66.2%	73.2%	92.5%

(DIM loan and Alternative Downpayment Assumptions)

An even greater contrast is presented by those trying to purchase new homes, however (see Table 3.8). A modest flat in Bucharest—priced at \$18,000—is affordable only to about one fourth of the income distribution. A smaller number can purchase modest villas, while high cost villas are beyond the reach of all but a handful of households. The table also illustrates that the Government’s estimate of housing costs under the new subsidy program—\$12,000—is also beyond the reach of many households. (In rural areas, where both land and labor are less expensive, the situation would, of course, be better; however, there is not assumed to be as much demand in these areas.)

Table 3.8
Affordability of New Construction:
Proportion of Households Who Can Afford to Purchase New Flats or Villas

Size and Location of Existing Flats	Sales Price	% Able to Purchase: DIM Loan + 10% Downpayment	% Able to Purchase: DIM Loan + 25% Downpayment	% Able to Purchase: DIM Loan + 50% Downpayment	% Able to Purchase: DIM Loan + 75% Downpayment
ANL Program Subsidized	\$12,000	2.0%	7.4%	10.4%	n.a.??
Moderate Cost Flat	\$18,000	<1%	<1%	7.4%	24.7%
Moderate Cost Villa	\$25,000	<1%	<1%	1.6%	10.0%
High Cost Villa	\$75,000	<1%	<1%	<1%	<1%

(DIM loan and Alternative Downpayment Assumptions, nation-wide income distribution; payment to income ratio at 30 percent.)

Rehabilitation Loans Using Conventional Mortgage Products

As shown in Tables 3.9 and 3.10, the picture is substantially more sanguine for rehabilitation loans. For the analysis of the affordability of rehabilitation loans we have assumed conventional loan products (variable rate loans), a 10 year loan period, and an interest rate of 20 percent. This interest rate is assumed to be a feasible target in the medium term; if this is not the case, rehabilitation loans can also be made using DIMs.

As seen in Table 3.9, in Bucharest (based on the specific income distribution for Bucharest), over half of the households could afford a reasonably sized (\$2000) rehabilitation loan; 13 percent could afford a much larger loan of \$5000. In the other urban areas and the rural portions of Romania, affordability is lower because income is lower, but it is still substantial for the \$2000 loan.



Table 3.9
Affordability of Rehabilitation Loans*: Proportion of Households Who Can Afford to Rehab

Loan Amount	Bucharest: % affordability	Other Urban Areas: % Affordability	Rural Area: % Affordability
\$2000	52.3%	41.1%	13.4%
\$3000	30.8%	14.8%	5.0%
\$5000	13.3%	6.9%	2.2%
\$10,000	2.0%	<1%	<1%
\$20,000	<1%	<1%	<1%

Loan Assumptions: 10 year loan at 20 percent interest; conventional mortgage product; payment to income ratio of .30. The income distributions used in the analysis are specific to Bucharest, other urban areas, and rural areas.

Finally, Table 3.10 looks at affordability in another manner; the table indicates the ratio of the loan repayment to income that would occur for rehabilitation loans of different sizes. For example, for a loan of \$2000, households with income of \$100 (that is, below the median income) would find it difficult to service a loan requiring 39 percent of their income. With an income of \$200 per month, however, the rehab loan becomes much more feasible.

Table 3.10
Affordability of Rehabilitation Loans: Payment to Income Ratio by Loan Size

Monthly Income	Loan \$2000	Loan \$3000	Loan \$5000	Loan \$10,000	Loan \$20,000
\$100	.39				
\$200	.19	.29	.43		
\$300	.13	.19	.29		
\$400	.10	.15	.22	.43	
\$500			.17	.32	
\$600			.14	.29	
\$700			.12	.25	.49
\$800			.11	.22	.43

The loan assumptions are a conventional (fixed or variable) loan for 10 years at 20 percent interest rate.

3.5 Other Issues in Effective Demand

Romania's mass privatization, very pervasive and more rapid than that for most of its CEE neighbors, has both positive and negative consequences that must be addressed when looking at effective demand.

Asset Value of Homeownership: Turnover and Reallocation of the Existing Stock. On the positive side, the asset value of existing homes can provide a

very substantial downpayment for households who wish to trade up or simply move elsewhere. The extensive privatization has provided new owners with a considerable asset with which to provide collateral for trading units—trading up, trading down, reallocation based on size, reallocation based on geography, and so forth.

Thus, assuming the Mortgage Law is passed and adequately operative, households who now own a unit are definitely at an advantage over those who do not. The examples cited above assumed that the downpayment was roughly equal to 20 to 50 percent of the loan, which is the case for many purchasers, and certainly for most first-time buyers in other countries. In the examples, the combined amount of the loan and downpayment would allow the household to purchase units in the Bucharest locations noted. In contrast, many Romanian households who now own a unit, and who wish to move, could simply “swap” units, while others who wished to trade up could do so with a very modest loan.

This “asset-value” situation should certainly enhance effective demand, affordability, and mobility in Romania. And it is a widespread phenomenon. In Romania, the correlation between income and total assets is likely to be lower than would be expected, especially when compared to an established market economy. In other words, households with low incomes—but who possess substantial assets (a valuable apartment)—can move or trade up with only a small loan. Thus, it might be expected that a fall in interest rates would transform this potential demand into effective demand.

Demand for Rehabilitation Loans. Another result of widespread privatization is likely to be a considerable demand for rehabilitation loans—in a better interest rate environment. Rehabilitation will ultimately be very important to maintaining Romania’s housing supply. Rehab lending could prove one of the banks’ most popular products, especially in the near future when smaller loans will be more affordable. There is a strong need therefore, to address the thorny issues in borrowing for rehab in the condominiums, when the requirements pertain to building-wide components (roof, elevators, heating, etc.) rather than just to individual units. Many problems still exist within the condominium structure and Owners Associations, including consideration of loans for capital repairs.

A Deteriorating Stock of Existing Housing. The negative aspects of mass privatization must also be addressed. Many households who now own homes in Romania would, in the majority of other societies, normally be renters. In other words, given their income level, they would not have accumulated enough assets to purchase a home, nor could they service a large loan. Furthermore, while much of the housing stock is in a deteriorating condition, there are major barriers to addressing the problem. First, many of the households in condominiums cannot afford to pay for their share of major capital repairs, and in some cases not even routine maintenance; secondly, as discussed above, it is difficult to arrange for loans through the condominium association because of organizational as well as financial problems. Although this is not the focus of



this report, it is recommended that the Government address the rehabilitation issue rather than spend its limited funds on new construction.

USAID sponsored a condominium development program that had two important results: the passage of Romania's first national Condominium Law in 1996, which requires the organization and registration of an owners' associations in all privatized apartment buildings, and the preparation of a training program for owners on condominium organization, management, and renovation. Because of the magnitude of privatization (there are an estimated 3 million former tenants who are now owners) and the poor condition of most of the multifamily housing, the potential market for condominium rehabilitation loans is enormous. Unfortunately, USAID discontinued its support for this program in August 1999. As a result, it is unlikely that there will be pervasive registration of owners' associations in the near future, nor will most owners understand the benefits of investing in rehabilitation of their properties or how they can access bank loans for this purpose.

Rental Sector. Finally, it should be stressed that the smooth operation of the rental sector is especially important. First, the rental sector is important to economic development in Romania, especially with regard to labor mobility.³⁵ Secondly, the rental sector will have an impact on effective demand for owned units. A well functioning rental sector supports the ability to move and sell and purchase alternative housing. Thus, the legal structure necessary to formalize landlord/tenant relations should be addressed in Romania.

3.6 *The Legal Framework*

The legal framework is an essential component of the housing finance system. It must establish the right to use real property (land or buildings) to secure a loan, set certain general conditions for lending procedures and loan terms, and provide remedies in the event of borrower default that are adequate to control credit risk.

Throughout CEE, new mortgage laws have been adopted in recent years, primarily to alleviate credit risk and deter borrower default. While a successful mortgage lending system must be predicated on the assumption that a very large percentage of borrowers will repay their loans, legal remedies for default provide both a necessary backstop or last resort for dealing with bad loans and a deterrent to nonpayment. If the borrower knows he must pay or the bank will have the power to take away his home, he will do everything possible to avoid a default. On the other hand, if he knows the goal of the legal system is to protect his individual interests and to keep him in his home, even at the expense of all the other parties involved, the borrower will have little incentive to pay other than his own good intentions.

³⁵ A recent study has confirmed the importance of the rental sector to labor mobility, and thereby to economic performance. See A.J. Oswald, "A Conjecture on an Explanation for High Unemployment in the Industrialized Nations", University of Warwick, Working Paper No. 475, 1996.

The strength of the legal system is an element lenders evaluate in determining credit risk and “pricing” for their loans. Risk is measured in terms of both the likelihood of default and the costs of collection in the event of default. Weak or unclear laws make collection a lengthy and expensive process, even if it is ultimately successful. By helping to assure that borrowers repay their loans, and that lenders have speedy access to collateral if they do not, strong laws help make mortgage credit available and affordable for many people.

Pre-Transition Legal Issues

Before transition to a market economy, residential lenders in CEE did not usually rely on the property itself as security for the loan in case of default, even if this were legally possible, but were far more likely to use remedies such as garnishment of the borrower’s wages and collection from guarantors. Because the lender was in effect the state and the largest employer was the state, there was essentially a closed system in which wage garnishment was quite effective in collecting delinquent loans.

In early studies of housing finance systems, there were two recurring conclusions about the suitability of the pre-transition legal framework: first, that the laws allowed a borrower to use real property as collateral to secure a housing loan³⁶ (in other words, mortgage lending was a legal possibility), and second, that other laws, regulations, and firmly entrenched practices made security for mortgage loans so weak that true mortgage lending was simply not feasible from a market standpoint. In almost all cases, foreclosure and execution of a mortgage loan involved a long, expensive judicial procedure or series of procedures, making foreclosure an extremely unattractive option to lenders. Even if the lender succeeded in obtaining a transfer of title to the property through the courts, meaningful access to the property so it could be sold could still remain a long way off. The principal problem was that in order to evict the borrower, the lender not only had to initiate additional execution procedures (sometimes involving additional court hearings), but also had to provide the evicted family with alternative housing.

The Proposed Mortgage Law in Romania

In Romania, a new Law on Mortgage Loans for Real Estate Investments (“Mortgage Law”), was submitted for adoption by the Senate on October 9, 1998. The law is currently being debated between the two houses of Parliament, and is expected to pass soon.

³⁶ Bankers and lawyers interviewed for this report stated that under existing mortgage law in Romania, the subject property (the property that the proceeds of the loan will be used to purchase or construct) cannot itself be security for the loan. Whether this is in fact part of the current law or only a matter of practice on the part of banks, the new draft mortgage law, discussed below, makes it clear that the subject property can secure a mortgage loan.



The proposed law includes significant improvements over current Romanian law and banking practices. Elements of a strong, market-based legal framework include the following:

- The subject property—the property to be purchased or constructed with the loan proceeds—can be used as security for the loan.

As noted above, this was not permitted under previous Romanian law. In addition to personal and third party guarantees, bankers usually required borrowers to own other property to use as collateral, which severely limited the number of people who could qualify for a mortgage loan.

- In the event of default, the lender can hold a foreclosure sale of the property without court intervention. (Article 22)
- The lender may conduct its own execution procedures in some cases, “under the law”. (Article 24)
- The lender need not provide the borrower with alternative housing after eviction. (Article 23)
- Notice periods required before the lender can take action are short, allowing expedited and cost effective execution procedures. (Article 21)³⁷

Deficiencies in the Law

The law provides no details on how execution and sale of collateral are to be implemented, or what rights the borrower may have to challenge non-judicial foreclosure and eviction. It may be that such matters are to be covered in an implementing decree (known in Romania as “methodology”) or a separate execution law. In any case, it is clear that substantially more detail is required on implementation of these procedures. The terms and conditions of sale of the mortgaged property must be regulated to protect the parties’ interests, and there must be provisions on how the proceeds of the sale will be distributed, i.e., what is the order of priority in payment among all the borrower’s creditors.

While non-judicial foreclosure and eviction are forward-looking provisions, now adopted in most other countries in CEE as well as more established market economies, there should also be counterbalancing provisions, such as an opportunity for court

³⁷ In fact, the notice provisions in the law seem unreasonably short. The law provides that after delay in payment (for which no minimum length of time is stated), the lender need only allow 15 days from delivering notice to the borrower before it may terminate the loan agreement, accelerate the loan balance due, and initiate execution procedures. Theoretically, this could occur in as short a time as 16 days from the date a payment is due. Thirty to 60 days might be more reasonable, particularly in cases where the lender intends to proceed without judicial action and to undertake execution and sale of the property itself.

hearing to protect the rights of borrowers from the mistakes or overreaching of lenders. The costs of such procedures can be charged to the borrower, assuming the lender prevails, to deter frivolous defenses against appropriate bank actions.

In addition to these structural deficiencies, the proposed law establishes terms for loans that seem unnecessarily restrictive. These matters, which would be better left to the competitive marketplace to determine or for the parties to negotiate in the loan agreement, include the following:

- Article 2 mandates that mortgage loans be for a minimum of 5 years for legal persons and 10 years for natural persons. There is no justification for disallowing a loan with a shorter term if the parties both agree.
- Article 3(5) provides that a mortgage may be transferred to another asset “with a value at least as high as the previously mortgaged asset.” The only requirement for transferring the mortgage should be that the new property be sufficiently valuable to secure the debt, especially in cases where loans have been amortized over a period of years so the balance due is significantly lower than the original loan amount. In any case, the issue of transfer should be left to the parties to negotiate, either in the original loan agreement or subsequently; it should not be regulated by law.
- Article 7 limits the types of business establishments that are subject to the law. There is no rational basis for doing so.
- Article 10 provides that the loan proceeds will be delivered to the seller or construction contractor rather than the borrower, except in cases where the construction will be carried out by the borrower. This should be a matter of agreement between the borrower and the seller or the contractor; the law should not require the lender to pay a third party in all cases.
- Article 13 provides that in cases of prepayment, additional periods of interest are required, depending on when in the term the loan is prepaid. The issue of prepayment penalties should be determined by negotiation between the parties. Alternatively, the law could set an upper limit on penalties but not require them.
- In addition to requiring insurance on the mortgaged asset, the law requires a borrower under the age of 55 to obtain life insurance for the benefit of the lender. Again, this should not be required, at least in all cases, but may be the subject of negotiation in cases where the lender believes it to be appropriate. Conceptually, in mortgage lending the primary security is the mortgaged property. In case of the borrower’s debt, if the heirs do not pay or the property is not sold to a purchaser who assumes liability for the mortgage, the lender’s



remedy should be access to the property, not to life insurance proceeds.

3.7 Supporting Institutions in Housing Finance

The supporting institutions most relevant to housing finance include a strong central bank, an active association of bankers, bank training institutes, and credit bureaus. Romania scores well on the first three of these groups, and the fourth—the credit bureau—is now in planning. These institutions are important to the long-run success of any banking sector activity, including housing finance. Under a technical assistance program, some of these organizations are likely to serve several roles: (1) as recipients of assistance, (2) as deliverers of assistance to individual banks, (3) as assistants in developing training programs or legislation, and (4) as homes for training of trainers.

National Bank of Romania. A USAID staff member (Privatization and Financial Markets section) considers NBR to be one of the best Central Banks the region. As mentioned, NBR is playing a major role in the banking sector reform and restructuring process. NBR is said to be active and far-sighted; the data collection and analyses at the aggregate level (macroeconomic, monetary, balance of payments, etc.) seem good. The NBR is under-staffed, however. For example, although the technical procedures for bank monitoring are being developed (with USAID assistance), the small staff assigned to this task have no hope of timely completion.

Discussions with NBR suggest that they would welcome assistance in developing procedures and Manuals for regulation and supervision of housing finance. They are aware of the special requirements involved in monitoring a long-term portfolio. They also requested special assistance with interest rate indexation methodologies; these would assist the banks to introduce improved variable rate (and dual index) mortgage products.

The Romanian Banking Institute (RBI). The RBI is a non-profit education and training institution founded in 1991 by NBR and the Romanian Banks Association (RBA). Since that time through 1998, it has offered course work to 24,000 persons. The Training Center and the Information Technology Department (IT), and Resource Research Center offer short- and medium-term courses and workshops. Academic courses are delivered through the Banking College and Bank Management Facility (four and five year courses of study); for the 1998/99 academic year, over 400 students are enrolled in the colleges.

RBI indicated it would welcome assistance in developing courses in mortgage finance, if indications are that this would become a larger share of bank portfolios. The RBI's own staff, together with representatives of individual banks, would seem ideally suited to custom-tailor housing finance course material to specific Romanian circumstances. They would also help deliver training courses, and eventually to internalize the entire process through training of trainers and their own staff.

Romanian Bankers Association (RBA). The RBA is a non-profit professional organization established in 1991, which now has a membership of 39 banks. The team met with two of the principals of RBA (Ion Ghica, president of the Romanian Commercial Bank and Elena Petulescu, president of BancPost). RBA's general goals are to ensure inter-bank dialogue, to create its own IT regarding banking operations (see section 6.0 below regarding IT), to publish special materials, and to contribute to the optimal operations of the RBI, among others. The Romanian Bankers Association has worked to establish a "level playing field" with regard to deposits. (As noted above, the State Savings Bank (CEC) previously had a monopoly on state guarantee of deposits, which RBA worked to have extended to all banks.)

As discussed in section 6.0 below, RBA would be an ideal candidate to assist with data collection and analysis for the industry; housing finance would be called forth as a special component of this analysis.

The Credit Bureau. One aspect of the legacy of the Soviet system is that banks—as well as many other real estate-related institutions—have been reluctant to share information. Some banks do not, as yet, have IT systems that make it easy to release aggregate or specific information; however, banks, as well as appraisers, realtors, and developers have not had a tradition of providing mutually "beneficial" information in any event.

In underwriting mortgage loans, banks should ideally calculate the gross debt ratio—the combined payments a household must make on all its installment debt relative to income. A bank holding a consumer's car loan, for example, would need to release this information to a competing bank that was attempting to underwrite the mortgage loan. If banks can underwrite with more confidence about the true value of the household circumstances, including its gross debt ratio, then loan-to-value ratios and payment ratios could be made less conservative when circumstances permitted.

The NBR has just recently decided to set up a credit bureau within the NBR's Risk Management Department. This is an extremely important step for Romania. Ultimately, this function may be taken over by the private sector, but for the time being, it is fortunate that NBR has taken the lead. Technical assistance in designing the data collection efforts, confidentiality procedures, and software would be an important addition to the effort, as credit bureaus have had little or no tradition in the region.



4.0 SUMMARY OF MAJOR FINDINGS IN HOUSING FINANCE

The Economic Environment

- Under current economic circumstances, long-term lending is not affordable to any but a handful of borrowers, whose somewhat unique income position apparently allows them to take advantage of the situation regarding inflation and/or the falling exchange rate. However, the National Bank expects inflation to continue falling and real economic growth to become positive during 2000.

The Banking Sector in Housing Finance

- The privatization and restructuring process is almost complete, especially for those banks that will most likely offer consumer lending and housing finance. Housing finance lending will take place on a market basis, conducted by private banks, with a substantial level of competition.
- A number of important banks already offer mortgage finance; under current circumstances their portfolios are small, as would be expected, but at least they have some experience in developing the required skills and procedures, including competing for customers and providing them with flexible housing finance loans that meet their needs under current conditions.
- These banks are fully ready to take advantage of technical assistance in mortgage finance.

Demand for Housing Finance and New Mortgage Products

- Given the need for improved labor mobility in transition economies, it is important in both the rental and homeowner markets that dwellings can be readily exchanged.
- The vast majority of households, however, cannot afford new housing. A larger number can afford to purchase existing dwellings.
- Also, because of the massive privatization in Romania, many households have a valuable asset. These households could purchase alternative units with only small bank loans involved, which could be relatively affordable to a substantial segment of the income distribution under reasonable improvement in inflationary conditions.
- Similarly, maintenance of the existing stock is extremely important to upholding the current supply. Loans for rehabilitation are thus particularly

important, especially since they are also relatively more affordable because of their smaller size and shorter duration.

- Dual indexed mortgage products could, potentially, prove to be of substantial assistance to affordability in Romania. Importantly, the monetary authorities also appreciate the need to reduce the volatility of inflation as well as the its level, so that introduction of specialized mortgage products can be considered feasible.

Legal Structure for Housing Finance

- Lack of an appropriate legal structure for mortgage lending has limited potential borrowers to those with substantial other collateral. The proposed Mortgage Law is certainly a step in the right direction; however, not only does the proposed law need important changes and additions, it also needs to be coordinated with improvements to other laws.

Supporting Institutions: the National Bank of Romania, the Romanian Banking Institute, and the Credit Bureau

- The National Bank of Romania has established its role as an effective institution in assisting with bank privatization and restructuring, and initiating regulation and supervision. Thus, in the future, the NBR could be very effectively assisted in tailoring its monitoring policies to the unique aspects of housing finance. Careful treatment of mortgage lending has been proved necessary worldwide, given the real estate “bubble” problems, as well as the high risks inherent in commercial lending, problems that have contributed to so many of the international financial crises.
- The Romanian Banking Institute would provide a good counterpart for training bankers in housing finance skills; its curriculum in commercial banking and other issues seems broad-based (all the banks interviewed support the RBI except the Romanian Commercial Bank, which apparently relies on in-house training).
- A well-structured credit bureau is an invaluable component of the consumer lending business; assistance in its development would be an important addition.

Government Housing Subsidy Policies

- As discussed above, our findings with regard to the housing market suggest that the Government would benefit from re-directing its subsidy policies toward existing units. At a minimum, however, its subsidized lending should



not “compete” for customers with households that can afford market-based loans from the banks. The National Housing Agency and CEC programs should target subsidized loans only to those who cannot afford other solutions.

5.0 TECHNICAL ASSISTANCE RECOMMENDATIONS FOR HOUSING FINANCE IN THE MEDIUM-TERM

5.1 *Suggestions for Technical Assistance*

Given the progress made to date in the banking system, the functions of the NBR, improvements to the legal structure, and the desire of key Romanian banks to move forward aggressively with market-based housing finance, it is a very timely moment to help Romania build a solid housing finance system.

Housing finance will be crucial to enabling the emerging housing market in Romania to work effectively. Without housing finance, households will be unable to leverage their funds effectively, thereby slowing down rehabilitation, new construction, labor mobility, and development. As the transition countries mature, mortgage debt will become one of the major sources of debt in the economy and the foundation of significant capital market activity.

The banks that were interviewed during this TDY, as well as the National Bank and others, offered numerous suggestions for technical assistance in housing finance. A sample of these comments follows:

- Bank Post, for example, had numerous suggestions for technical assistance, including suitable mortgage products; software applications for housing finance, especially servicing; staff training programs; training of trainers; and assistance with recourse to capital market funds via a secondary market type funding source.
- The Romanian Commercial Bank suggested that training be conducted in construction finance as well as mortgage (take-out) lending (an important point, since construction finance is generally more technically complicated). Also, improved sources of long-term funds will be important. However, the president thinks the capital market would need to be educated to understand mortgage-related debt instruments used for long-term funding (experience elsewhere has proved him fully correct).
- The Romanian Bank for Development noted that there has already been discussion of some sort of secondary market mechanism for obtaining funds from the capital market. A number of the large banks have discussed the issues, including plans for a draft law to be submitted to Parliament

concerning a special fund for this purpose. The fund would be private or a public/private partnership; government might play a guarantee role. Thus, in their opinion Romania would benefit from assistance regarding the institutional structure and legal requirements for securitization.

- The National Bank of Romania had numerous suggestions, which are noted below. However, the Bank stressed regulation and supervision in particular, noting that not only would its supervisory staff benefit from assistance, but that the banks themselves should be helped to understand the requirements that NBR might impose.

We have sorted these types of comments into suggestions regarding training, legal matters, regulation and supervision, and access to capital market funding.

(1) Staff Training Assistance to Banks via the Romanian Banking Institute

Bank staff training and training of trainers would best be conducted through assistance to the Romanian Banking Institute. Staff training in housing finance is probably one of the first steps, as there has been relatively little experience so far with market-based housing finance. The state's subsidized interest rate programs as implemented by the Savings Bank do not provide acceptable models. The training might begin with a combined team of U.S. training experts, RBI staff, and Romanian bankers and with as much hands-on experience as possible in housing finance, or at a minimum, consumer lending. The RBI could engage key bankers and staff of RBI to conduct training of trainers

Risk analysis was specifically called forth by several banks as a component of training in housing finance, as the risk elements in housing finance are somewhat unique, and relate, among other factors to the long-term funding discussed below.

(2) Training and Development in Other Components of Housing Finance

New Mortgage Products. If Romania's inflation continues to fall (even if somewhat slowly) and does not exhibit too much volatility, Romania's housing affordability problem could greatly benefit from dual indexed mortgage products, which have proved successful especially in Poland, but also in Hungary (and are used in France, Turkey, and Mexico).

Improved information technology (IT) platforms for housing finance and their integration with other retail banking activities was mentioned by a number of banks as important to effective underwriting and servicing of housing loans. (The U.S. is a world leader in this area.)



Condominium Renovation Lending. A variety of problems face the operation of the condominium associations. In the context of housing finance, developing procedures for bank loans for building-level capital repairs is an important missing element for maintaining and improving the existing stock. Training would help banks understand the potential importance of this market and how to access it. In addition, USAID may wish to reconsider its decision to end assistance to the condominium sector, since owners will need assistance with planning and implementing renovation projects with bank financing.

(3) Legal Framework

Mortgage Law and Related Laws. Assistance with improvements to the Mortgage Law is important to solidify and improve the first steps taken by the draft legislation. Related assistance should be directed toward the Securities. As discussed below under capital market funding, the Mortgage Law and the Securities Law together do not provide an adequate framework for issuance of mortgage bonds or MBS.

Laws Relating to the Rental Sector. (The Civil Code and other relevant documents would need to be reviewed prior to providing suggestions regarding landlord tenant relations.)

(4) Assistance to the National Bank of Romania

Regulation and Supervision. As discussed, regulation and supervision of housing finance requires some additional and unique features relative to the oversight of other loans; the NBR notes that this would be an effective type of support for their monitoring program in the medium term.

Credit Bureau. Establishment of a credit bureau is key to the banks' underwriting, as this is the facility which will ultimately provide the data for a bank to determine a household's gross debt ratio.

Indexes for variable rate mortgage products. The NBR requested special assistance with this technical topic. Both the inflation rate and the exchange rate are currently quite volatile, and thus do not provide an appropriate basis for appropriate indexation.

(5) Capital Market Funding and Access to Long-term Funds

Access to long-term Funds. Beginning to plan for a mechanism to access long-term funds from the capital market will be crucial in the long-term to achieving an adequate volume and to decreasing term risk (short-term liabilities funding long-term loans). The approach to secondary market funding might include a liquidity facility and/or securitization (MBS). (The Federal Housing Finance Board, which is in essence

a liquidity facility, might play a role in this development. A liquidity/refinancing approach to obtaining wholesale funds from the capital market may be a more appropriate approach in Romania at this time.)

Romania is on a different course of development in housing finance than some of its northern neighbors in the region. The institutional structure which is emerging has many roots in continental and U.S. systems. The influence of German/Austrian mortgage banks and Bausparkassen is not evident, and solutions to capital market funding could follow the approaches mentioned above.

(6) Preparation of Industry-Wide Risk Analyses

Databases and Analysis. One of the unfortunate legacies of the Soviet period, as mentioned above, is a tendency to withhold information, especially in situations which in the U.S. and most other Western markets, sharing that information assists the entire group. For example, in the U.S., not only is information on housing finance collected by regulators, it is voluntarily sent to the Mortgage Bankers Association and the secondary market institutions for analysis. The analyses are sometimes of aggregate trends and sometimes are samples of data taken from individual loan records, which are transformed into microeconomic databases for analysis of numerous risks (including default, late payment, pre-payment, and so forth). The published information is invaluable in assisting bankers assess risk and make marketing decisions.

These data collection concepts generally do not exist in CEE countries. Once the benefits are recognized, however, the process can begin. For example, in the fall of 1999, for the first time, the Polish Banks Association sponsored a survey of housing finance among its member banks; this is being carried out by a Polish research firm in conjunction with assistance from the Urban Institute.

The Romanian Banks Association and/or the RBI could begin planning for such data collection activities. Then, by such time as the portfolios in housing finance begin to grow, the methodology and processes for data collection and analysis would be in place. Romania badly needs to increase the efficiency of its banking operations (as evidenced by the very large spread between lending rates and deposit rates, for example), and analysis of data collected by RBA would be of assistance in this regard.

5.2 Donor Assistance Relevant to Housing Finance

Donors involved in assistance related to housing finance (banking sector, capital markets, and so forth) include USAID, the World Bank, the IMF, IFC, EBRD, EU Phare, Canadian Aid, and British Know-How. USAID has carried out an active program of assistance in Romania, many aspects of which are related to, or of relevance to, assistance which might be carried out in housing finance. The first is the Capital Markets Program, a 3 year, \$27 million effort. There have also been a variety of



programs to assist SME (small and medium enterprises), and a Finance Company Project is now under development; SME loans are an important aspect of many banks' portfolios. USAID has also provided assistance to NBR with regard to both onsite and off site supervision, including development of manuals and training programs. USAID has supported four long-term advisors to the Ministry of Finance, specializing in macroeconomic issues, debt restructuring, budgeting, and bank privatization (the latter as a supplement to the World Bank program). Bank Ian Tiriac works with USAID's Loan Portfolio Guarantee Program. Finally, USAID has previously sponsored assistance to the condominium associations.

The World Bank and the IMF, in addition to a variety of structural adjustment, debt, and privatization issues, are working in conjunction with NBR in bank privatization and restructuring. EBRD and the IFC are involved, as noted, in equity assistance to BankPost. EBRD has also assisted Bank Ian Tiriac. Technical assistance and material support has been delivered to the Romanian banking Institute by British Know How, EBRD, the U.S. Treasury, USAID, EU Phare, and the governments of France, Belgium, Switzerland, Netherlands, and Luxembourg. RBI has developed academic partnerships with a variety of European institutions and in the U.S. with University of Virginia and City University Seattle.



ANNEX I

ROMANIA AND THE REGION

Effective Demand for Housing. CEE nations overall have had difficulty during the transition process to distinguish expressed demand and effective demand. The expressed demand is for each household to have a house or flat which meets certain standards. Effective demand, in contrast, is determined by the economic situation facing both the households and the Governments of the region. Based on a household's own resources, combined with a mortgage loan from the banks, and (if relevant) the subsidy programs of the government, some number of households will be able to obtain owned housing at market prices. *The rest simply cannot afford to purchase a home, and will occupy rental flats. This is the common pattern worldwide.*

This generation of young households now coming onto the market in the CEE countries are the first generation to face a housing sector in which the Government does not provide subsidized housing for all, one in which their own resources are insufficient to purchase a even a modest home are market prices.

Thus, the concept of a "supply shortage" must be considered carefully in Romania, as discussed in section 1.0. There may be shortages only in major cities. There are strong supply constraints (lack of land, lack of housing finance, lack of infrastructure, difficult permitting processes, lack of building materials) which seriously constrain supply even in the face of "effective" demand. In contrast, it may be the case that "need" cannot be supported by household and Government resources—that is, the demand is not effective at the moment. In this case, it serves al a long-term goal.

Romania differs in degree only from similar affordability problems faced in Hungary, Poland, Slovakia, Bulgaria, the Baltics, and so forth. In Romania, income is considerably lower and inflation considerably higher than in most of the region. Also, many of these countries experienced the very difficult phases of restructuring earlier in the 1990s; the pattern of falling real GDP, excessive inflation, budget deficits, and devaluation were similar, however.

The massive privatization of flats has left Romania with a very small rental sector. This has two important consequences:

- Rental housing is the typical source of housing world-wide for most low and modest income households.
- Other governments in the region assist poor households in the rental sector through a housing allowance program, which generally helps pay both rent and utilities. Romania does not have such a program.

Table A1 provides a brief overview of Romania's macroeconomic and housing situation as compared with other nations in CEE.

Table A1
Regional Comparisons of Income and Housing

Indicator	Romania	Bulgaria	Czech Republic	Hungary	Poland	Slovakia	EU
GDP per capital \$ 1998	\$1,806	\$1,464	\$5350	\$4,676	\$4,075	\$3,741	\$20,000?
GDP per capita \$PPP	\$4,990	\$4,414	\$10,787	8,879	6,972	8,391	
Average gross monthly wage	\$121	\$109	\$365	320	447	259	
GDP growth (real)	- 7%	3.5%	0.3	3.3	3.0	1.8	
Unemployment	11.3%	13%	9.0	9.4	11.8	18.3	
Inflation	48.7	1.0%	1.4	10.1	6.3	13.6	
Discount Rate	35.0%	4.2%	35.0	19.3	15.5	8.8	
Dwelling per 1000 persons*	345.5	411.0	363.0	394.0	299.0	273.0	N/A
No. persons per dwelling	2.87	2.43	2.75	2.53	3.34	3.66	2.66
Rooms per dwelling	2.47	Average 3.00	Average 3.00	2.96	3.00	3.00	4.40
Persons per room	1.23	< 1.0	<1.0	<1.0	1.10	1.10	N/A

Sources: Central European Business Review, * Relansarea Constructiei de Locuinte, Ministry of Public Works (1996 housing data).

ANNEX II

LIST OF PERSONS INTERVIEWED

I. BANKS

BancPost
Elena Petculescu, President
Ion Ciobanescu, General Manager
Liana Teodorescu, International Relations

Bank Transylvania
Connelia Tatiana Barbu, Director
Stelian Tomozei

Romanian Bank for Development
Costica Dragut, Manager
Elena Cosma, Work-out Department
Antoanela Bostinaru

Romanian Commercial Bank
Emilian Radau, Director
Niculae Balan, Director Loans

Bank Ian Tiriac
Gabriel Cristescu, Manager, International Division
Carmen Nedelea

National Bank of Romania, Surica Rosentuler, Monetary and Foreign Exchange Department

National Savings Bank (CEC), George Staicu. Director

II. PRIVATE SECTOR

Calin-Andrei Samfirescu & Partners, Arin Octav-Stanescu,

Stoica & Associates, Cristiana Stoica

Romanian Banking Institute, Liliana Ionescu, Director

Adrian Altarescu, Architect

Opportunity Associates, Dana Nicolescu, Director



Dana Nicolescu
Director
Opportunity Associates – Romania
Bucharest

John Petersen
Director, GFG Division
Associates in Rural Development, Inc.
Arlington, VA

Eliza Visan
Triumf Imobiliare
Bucuresti

Doru-Puiu Tiberiu
Managing Partner
ROM INVEST Consulting SRL
Bucuresti

III. GOVERNMENT

Lazlo Borbely
Secretary of State
Ministry of Public Works and Land Use Planning
Bucharest

Sorin Mugur Dumitrescu
Deputy Director
Department of European Integration and International Relations
Ministry of Public Works and Territorial Planning
Bucharest

Bogdan Sosoaca
Sef Departament
Primaria Municipiului Bucuresti
Departamentul Patrimoniu Imobiliar

Ing. Constantine Croitorescu
Expert cadastru A,B,C,D
Ministry of Public Works and Land Use Planning
Bucuresti



Constantin Dragan
Presedinte Director General
S.C. "Proiect Bucuresti" S.A.
Bucuresti

IV. PROFESSIONAL ORGANIZATIONS

Adina Dana Ababei
International Department
National Association of Romania Valuers (ANEVAR)

Dan Ioan Popp
Presedinte
Asociatia Romana a Agentilor Imobiliari (A.R.A.I)
Bucuresti

RSSDAQ, National Securities Market, Septimiu Stoica

V. USAID

Dennis Robertson
Edward Landau
Don Anghel
Corina Ionescu