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ELEMENTS OF CONVERGENCE AND DIVERGENCE: THE FORMATION OF NEW PRS MODELS IN CENTRAL AND EASTERN EUROPE

[Draft version]

1. Convergence versus divergence debate – theoretical background

After 25 years of regime changes in CEE, there is no consensus among housing policy researchers on the direction in which post-socialist housing systems have developed. It is still unclear whether they are moving along the same trends and converge to a specific (liberal-residual-family based) housing model or the regional trends indicate fundamental divergence? If we compare tenure structures, similarities seem very strong. Each country went through a radical privatization process; and although the methods and pace of the privatization and were different, nearly all of them ended up with a social rental sector barely reaching or remaining below 5-10 percent of the stock. Housing finance systems developed in every post-socialist country after 2000, and mortgage markets expanded fast; and although the institutional structure (funding scheme, etc.) and rate of the expansion was very different, the direction was the same. After 6 years of the Great Financial Crisis (GFC) of 2008, observers were again uncertain as to whether crisis responses supported divergence or convergence trends. Bohle (2014) show differences in the mortgage rescue programs of Hungary and Estonia, the two countries which accumulated large FX loan portfolios. However, we do not know yet, how these differences will affect the form of the housing regimes.

We define three relatively independent aspects (spheres) of the social-economic-political system, which are interconnected and have an explanatory role in shaping the system of housing provision. These include the economic structure, the welfare system and the housing regimes (housing policy environment). We use economic and welfare theories to underpin the paper's main arguments. There is a causal relation between the economic model, welfare system and the housing regimes, but the intermediary variables are also important (such as ideology, the strong lobby capacity of certain interest groups, and path-dependence).

The research question is what kind of capitalism works in a country (or region), how the social and economic inequalities are managed by the welfare programs, and how the housing policy intervenes into the sector. For illustration we showed in the figure a version of the varieties of capitalism approach (Hall and Soskice, 2010), a modified version of welfare regime theory of Esping-Andersen (1990), and a typology of social housing models by (Czischke and Pittini, 2007) based on Kemeny's (1981) work. The housing system (housing provision, housing consumption) is conceived as a consequence of these three relatively independent spheres (economic development model, welfare political forces and housing policy), which are causally interrelated. Though in housing theories there are several attempts to connect the housing system to these sub-spheres of the society, it is not rare that important causal effects of the economic development model or welfare regime are neglected. Kemp and Kofner (2010) use very similar approach comparing private rental sector in German and England: " These differences in the housing market, welfare state, labour market and wider political economy... provide the context within their private rental markets are situated. They in part account for the institutional differences that exit between the private rented sectors in these two countries."

(p. 380) Even one of the most popular housing theories (Kemeny's housing system typology) fails to incorporate in its explanation the differences in the functioning of capitalism and important elements of the welfare system (like income benefit programs compensating for income inequalities). In our paper, we do not intend to establish a new theory, but try to incorporate some of these factors.

This paper raises the dilemma of convergence/divergence in Central and East European (CEE) EU member states from the point of view of the private rental sector (PRS), and attempts to clarify the role of the sector in the transition process, and in future developments. By examining these questions, we try to identify differences and similarities among post-socialist EU countries, aiming to discover the underlying structural causes as opposed to a simple juxtapositional comparison. The article is primarily based on the EU FP7 funded Tenlaw project¹, which focused on the legal regulations of the rental sectors as well as their application in EU countries. While we focus on PRS, it is important to note that most of this sector is typically part of the informal economy due to its limited profitability because of tax/subsidy treatment and the risks involved on both the tenant and the landlord side. Very limited quantitative information is available on PRS in CEE countries, and their reliability is questionable. Accordingly, this paper utilizes the most recent Census data (2011), findings, expert assessments, and – to some extent – the anecdotal information collected by Tenlaw national report authors.

2. Housing market trends: similarities and differences

The mass building of private rental housing was initially a response to the industrialization and urbanization processes of the 19th century, with the pressing need to house industrial workers. But as private renting enjoyed no protection whatsoever, and was fully exposed to economic cycles, it often resulted in conflicts between landlords and tenants, and eventually led to tenant protests when tensions peaked. By the end of World War 1, the unsustainability of unprotected private tenancy has become clear, and first generation rent control (full rent freeze) was introduced in most European countries where the share of PRS was significant in the national (and particularly in the urban) housing stock. This inevitably hurt the interests of landlords, who in turn began to back out of the sector and choose safer and more profitable investment opportunities. As the drawbacks of rigid rent regulations became clear, rent freezes were lifted, and throughout the 20th century decision makers keep trying to strike a reasonable balance in private residential renting that respected landlord interest while also providing protection to tenants. Social rental housing was also inserted in post-World War 2 welfare systems; however, social housing stocks began to shrink after the 1970s, and by the turn of the century, policy makers in many European countries were considering opportunities to improve the efficiency of the housing sector through strengthening private renting, and also to find ways to utilize PRS in social/affordable housing provision.

As for new EU member states in the CEE region, their development path was separated from Western European trends after World War 2: in most socialist countries in Central and Eastern

¹ This paper is built on country reports for the EU FP7 funded TENLAW: Tenancy Law and Housing Policy in Multi-level Europe project, a research project covering 28 European countries funded under European Commission's FP7 (grant agreement no 290694), and summarizes the recent lessons learned about the role and dynamics of private rental sectors (PRSs) in new EU Member States. The countries covered in the paper are Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

Europe the private rental stock was almost entirely nationalized, and was transferred into local council management. While some elements of private renting appeared in some of the CEE countries over time, the sector essentially had to be recreated and re-regulated in the transition process after 1989-1990.

2.1 Housing development: 1990-2015

Regimes changes were immediately followed by transitional recession in the CEE region, from which countries only began to recover from the late 1990s. Despite huge differences in the pace of economic recovery and restructuring and institutional responses, the overall transition process and the major changes in the housing sectors were very similar: the state owned construction and building materials sectors as well as the banking sector were privatized, social housing management was decentralized, and the vast majority of formerly public task housing was privatized.

Since 1990, Central and East European (CEE) countries went through a radical social and economic transformation, moving from centrally planned economies towards market economies, their political systems transforming into multi-party democracies, and fundamental social changes, including increasing income inequalities.

The housing sectors in most CEE countries have been influenced by three key factors: (1) market creation strategies, which help establish new market mechanisms; (2) market correction strategies, which actively alleviate the negative social effects of the new market mechanisms; and (3) path dependence, which in these cases not always or only mean building new policy on socialist heritage, but also the inability of changing popular new policy measures, even if they generate massive losses for the state, or create obvious distortions in the housing sector.

The first major housing policy measures were mass privatization of social rental housing, and restitution, leading to the dissolution of the socialist housing model (the so-called East-European Housing Model, Hegedüs & Tosics, 1996).

First, in the decentralization process most of the public task rental housing stock was transferred to local municipalities, as well as the competence for social housing provision. As the sector was heavily state subsidized during the socialist period with strong very tenant protection measures artificially low rent levels, and municipalities were allocated no adequate financial resources for the management of social housing, the sector immediately began to produce heavy losses to municipalities, who in turn immediately began to privatize as much of their social housing stock as possible. By the late 1990s, social rental housing dropped to a fraction of its previous rate in most CEE countries (Hegedüs, 2013). Lux (2003) differentiated three models of housing privatization: 'fast privatizers' (e.g. Estonia, Hungary, Slovakia, Slovenia), 'slow privatizers' (e.g. the Czech Republic, Latvia, Poland), and the outlier Bulgaria, a country that had a low share of public housing even at the beginning of transition.

Second, restitution was a major policy goal in some of the CEE countries, while the former owners or their legal successors only received varying level financial compensation in others. In countries where *in rem* restitution was effectuated, a new private housing stock emerged, which could become a large and influential initial private rental stock (this trend was the most visible in the Czech Republic). While the radical shrinking of social housing provision ended up as a general trend in all transition

countries, restitution diverged significantly within the region. It is unclear though if this divergence was significant enough to create an independent housing model in restituting countries, as their housing situation and tenure structure so far seems to closely fit overall CEE trends.

Despite some differences in economic, institutional, and housing policy developments, the overall housing outcomes in transition countries are very similar today. Many new EU member states in the CEE region have become 'super home owner' societies, where extreme bias towards supporting owner occupation prevails, despite the drawbacks of the rigid tenure structure which paralyzes much of the labor market. Social housing sectors in the region have become residualized, and the private rental sector also seems insignificant and residual based on official statistical data. It is important to realize that this housing sector outcome was not the result of conscious policy decisions: throughout the region, the development of housing policy was formed by important structural factors, to be discussed under Section 4.

2.2 Tenure structure and housing options in CEE

Influential political and commercial communication prompts consumer ambitions comparable to Western European levels (which was of course an important public expectation from regime changes as well as EU accession). At the same time, economic performance and wages in new EU member states are on a higher middle or high level in a global comparison, but remain modest compared to old EU member states; this also applies to actual individual consumption (AIC). This means that a demand for Western European consumption level is not justified by the economic performance and productivity of new member states. As a consequence, much of the housing stock that became dilapidated during the decades of socialism still remains in a poor condition or only partially renovated even in 2015.

These factors, coupled with increasing income inequalities, mean that low income households in post-transition EU member states can afford three housing options:

- Municipal housing;
- Entering the low end of PRS;
- Obtaining ownership on the low end of the housing market.

As discussed above, social rental housing has become a marginalized sector in all transition countries in the CEE region. Although Eurostat data shows a relatively large 'reduced rate or free rentals' in some transition countries, some of these are the result of unfinished restitution processes (e.g. in Latvia, Lithuania or Romania), or the large share of lower-than-market price rentals in form of subletting only one room; or only letting housing within the trusted network of friend or family (e.g. in Bulgaria); or registering private tenants as family members to avoid taxes (e.g. Slovenia). As a consequence, the number of households in need of affordable housing significantly exceeds the number of available social housing units.

Therefore all the low income households that cannot enter into social renting merely due to its scarcity have to find a housing solution in the low end of the housing market, characterized by poor quality housing, often with limited access to utilities. But the size and quality of inexpensive housing is not their only disadvantage: the more remote housing is from the active labor market, the more affordable it is, which tempts many households to move to areas where they will not be able to

secure a regular source of income, and the transaction costs of moving will leave them without means to move back to more prosperous urban areas.

Table 1. Distribution of population by tenure status, type of household and income group, 2013²

Country/region	Owner occupation rate	Share of market rate rentals	Share of free or reduced rentals
EU-28*	70,0	19,0	11,0
EU-15*	68,5	21,8	9,6
New members states in CEE	86,4	4,7	9,0
Austria	57,3	27,2	15,5
Belgium	72,3	18,5	9,2
Bulgaria	85,7	1,8	12,5
Czech Republic	80,1	16,0	3,9
Croatia	88,5	2,0	9,5
Denmark	63,0	37,0	0,0
Estonia	81,1	3,4	15,6
Finland	73,6	10,7	15,7
France	64,3	19,4	16,3
Germany	52,6	38,9	8,5
Greece	75,8	18,9	5,3
Hungary	89,6	3,2	7,2
Ireland	69,9	16,4	13,7
Italy	73,0	14,3	12,7
Latvia	81,2	8,3	10,5
Lithuania	92,2	1,4	6,4
Luxembourg	73,0	21,8	5,2
Netherlands	67,1	32,5	0,4
Poland	83,8	4,2	12,0
Portugal	74,2	11,3	14,5
Romania	95,6	1,4	3,0
Slovenia	76,6	5,7	17,7
Slovakia	90,5	7,6	2,0
Spain	77,7	13,2	9,1
Sweden	69,6	30,1	0,3
United Kingdom	64,6	17,3	18,1

Source: Eurostat SILC, Distribution of population by tenure status, type of household and income group (ilc_lvho02)

**: member states as of June 2015*

*** : member states as of December 1995*

The risks of renting housing on the low end of private market are clear. In new post-transition EU member states, the sector as a whole is weakly regulated, and most of it functions in the black or

² Note that a significant share (in some cases, the majority) of free or reduced rentals in new EU member states is a result of informal private rentals within the personal networks of accidental landlords. (Drofenik et al., 2015; Hegedüs et al., 2014; Hussar et al., 2014; Jakopič et al., 2014; Podrazil et al., 2014; Yordanov et al., 2014) It is also noteworthy that the relatively large private rental sector in the Czech Republic is partly a result of the so-called 'hostels', the landlords of which systematically abuse the vulnerable position of households with social assistance. (Podrazil et al., 2014)

grey market: parties do not always sign a written contract; existing written residential rental contracts are usually brief, many are prepared without external legal help, and due to their lack of detail as well as lax regulation they leave plenty of room for misunderstanding and conflicts; tenants are hardly ever entitled to housing allowances, and practically never receive financial support that could make their housing costs significantly less burdensome; there is no rent regulations in place in the PRS, and tenants have no protection from unilateral rent changes, short term contracts or contract termination. The risks are numerous on the side of landlords too: as tenancy clearly is unaffordable for many tenants, a number of protective measures were put or left in place, which do not help renter afford their housing, but gives them the right to stay in the housing unit for which they cannot pay the rent, which raises a serious risk to the landlord who cannot access their property, while the tenant may even accumulate utility arrears as well, which the landlord may or may not be able to recover.

The risks of home ownership in the low end of the housing market seem less obvious at first, and need an understanding of the practical functioning of CEE social conditions and housing markets. The risks of a rigid housing market due to the disproportionately high rate of owner occupied housing is well known in the international literature. Paired with the structural changes in transition countries, this could mean that households remain trapped in areas where formerly state supported industries went bankrupt and unemployment has been skyrocketing; the market value of their current home remains well beyond national levels, and hence buying a home in a more prosperous area in their country would be impossible for them. Their only option would be renting, but obviously they are excluded from social housing, and many will not be able to rent either. Besides persons trapped in 'weak market' areas, there is another alarming trend of perverse mobility: many people living in relatively expensive areas choose to sell their home and buy a more affordable house in an inexpensive, remote area. They will not be able to find job opportunities in these areas, but by the time they realize this, they are unable to return to their previous home. And finally, particularly after the GFC, buying a home with mortgage financing turned out to be unaffordable for many households when the economic cycle turns downwards.

Families that have defaulted on their mortgage payments will again have no other option but to move into rental housing. At the same time, buying a home is still more financially reasonable (at least to those who can actually afford it) due to lack or very low level of financial support to tenants, opposed to generous financial support for ownership. Furthermore, much of the political communication within the CEE countries, but also in other European regions popularizes ownership as opposed to other tenure forms. Even the international literature has stated that home ownership has become part of the 'European dream'.

3. The main characteristics of the Private Rental Sector in CEE

Using Kemeny's influential typology of unitary/dual systems, most housing researchers seem to consider private rental sectors in CEE countries as residual, due to both their low prevalence according to statistical data and the widespread role of black or grey market in the sector. This does not always mean the lack of a written contract, but very often means the landlords' avoidance to report their rental income to tax authorities. Reliable statistics are compiled about the PRS – not only on the number of privately rented units, but even on rent levels, rate and use of the deposit and other such details – in many Western and Northern European countries, and usually in South

European EU members as well. In contrast, a large share of landlords in most CEE countries avoid reporting their rented second (or third, etc.) home to authorities, even Census officials, to make sure the information never ends up at the tax authorities. (Based on Tenlaw national reports, exceptions include the Czech Republic, where black market phenomena appear in other forms.)

While housing statistics are often based on the transaction data of tax authorities, this source in relation to PRS is obviously seriously deficient on CEE countries. Moreover, in many cases landlords even seem to hide their leased apartment from Census officials, and report their second home as vacant or in the use of a family member. Much of our analysis has to be based on expert assessments (with the help of on interviews, but also on a good deal of anecdotal information), and on the practical information we could compile, or could gather with the help of fellow researchers in the Tenlaw project. (Bejan et al., 2014; Hegedüs et al., 2014; Hussar, 2014; Jakopič et al., Kolomijceva, 2014; Mikelénaitė, 2014; Panek, 2014; Petrović, 2014; Štefanko et al., 2014; Yordanov et al., 2014)

Obviously, then, in most of these countries PRS is significantly larger than what official data shows – particularly in urban areas. One common point in CEE countries is that institutional landlords, or private companies that also manage rental housing, are almost entirely absent, and the supply side of PRS basically consists of accidental landlords. A significant part of these buy a second home as a form of investment, as they seem to trust investing their savings in real estate more so than in money market opportunities available to them. Another – also significant – part of landlords inherits a second home, and decides to rent it out, at least for some time. Altogether, even though the supply side of market is dominated by accidental landlords, they are a very diverse group; and of course they are much more numerous than what statistical data suggests.

As for the demand side of the market, that is, the tenants, they too are diverse. As any housing subsidy to private tenants is almost entirely absent in the region, or their amount remains only an insignificant (symbolic) fraction of their housing costs, in the case of private renting it often is true that renting is more expensive than buying a home; however, many people still have more benefit from renting; and many simply cannot afford ownership. The most important submarkets of PRS by tenant groups in most of the CEE region are:

- a. foreign professionals, occupying the high end of rental markets: this can be considered a relatively small subgroups (like all high end markets), although its share has been growing constantly;
- b. young professionals who delay buying a home before planning a family; especially after GFC some of them are simply financially responsible and does not want to risk a long term mortgage loan before mortgage markets seem to fully recover, and before they save a sufficient amount for a relatively large down payment;
- c. middle class or lower middle class persons or families who have recently migrated within the country;
- d. students: a wide and stable group of private renters; while some will only rent in the September-June period, many stay in one rental apartment for years (either the owner keeps the flat vacant for reliable renters, or the student renters also stay for the summer, especially in the larger urban centers; some even stay in the rented dwelling after graduation and in the early stage of their career);

- e. lower middle income or low income households who cannot afford ownership; this tends to contain those who have defaulted on their mortgages as a consequence of GFC, and currently are not creditworthy;
- f. many of the poorest households or persons who have no other choice but to enter the lowest segments of the rental housing market.

While most of group a. and a part of group b. and c. will appear in statistics, group d. to f. tends to remain hidden. Groups e. and f. are the most problematic: these are households in need of social or affordable housing, but have no other option but the poorest quality PRS; and there is virtually no reliable data of them – besides the information that these submarkets exist, and we know very little of them.

According to Hungarian survey data, the low income households and the higher income households are over-represented in the private rental sector (U-shape distribution), but the differences according to income groups are not significant. According to the family type, young households without children are overrepresented. (Székely, 2011)

In summary, due to the structural factors shaping its development, 25 years into transition and policy development, PRS in CEE countries could still not crystallize into clear and stable structures; it could be characterized as an amorphous sub-sector within CEE housing regimes, which it has been evolving to this day.

4. Structural factors shaping PRS

The small size of the PRS can be explained by two main factors.

First, financial disincentives discourage actors on both the supply and the demand side (landlords and tenants) from entering in a private rental relation. We used the user cost model to highlight the disadvantages (Hegedüs et al., 2014; Hegedüs-Nagy, 2014) and concluded that from the perspective of an investor (representing the supply side) the factors related to tax treatment of housing, expected return (opportunity cost of the capital), and the full cost of the property (including maintenance, insurance etc.) determine the attractiveness of the investment – in the case of CEE rental markets, result in disadvantages. From the perspective of a potential tenant (demand side), user cost will be lower thanks to a possible subsidy (which in the CEE region is marginal), lower opportunity cost, and lack of an income tax on own housing. The main economic factors explaining the low share of the rental sector are the financial disadvantages in long-term costs, and the lack of a tenure-neutral tax and subsidy system – in fact, an extreme policy bias for owner occupation in a wider EU comparison, with meager or nonexistent tax/subsidy support to private renters. Consequently, entering the private rental sector is not so much an outcome of free choice as a residual solution to fall back on. Neither the demand nor the supply side actors have other realistic alternatives. (Lowe, 2000 & 2003; Erdősi et al., 2000; Hegedüs and Teller, 2008)

Second, the underregulation and the consequent legal insecurity severely curbs PRS development, again from both on the side of landlords and tenants. In most of the new member states the existing legal framework is liberal to the extent that it offers hardly any help in practical cases. Individual tenancy contracts are the principal source of the parties' rights and obligations and the starting point for resolving any disputes, while a huge number of people who depend on rental housing do not

have access to legal professionals in preparing the contract. Even when regulation regarding a particular issue is in place, contracts often remain unenforceable; legal conflict solution (civil litigation) is expensive, complicated and time-consuming; and there are virtually no alternative dispute resolution mechanisms. As a result, parties will often turn to other solutions: they introduce other intermediary actors (like real estate agents, debt-collection companies, etc.), or resort to informal (and in some cases, downright illegal) solutions.

However, as we have seen in the previous section, PRS exists in all of the countries, and play an important role for a much larger segment of the population than what official statistical data shows. Nonetheless, the sector is **very volatile and unpredictable**, and so far no stable structures could emerge in PRS which could provide a solid framework for PRS development. There are three essential structural factors that explain the amorphous nature of PRS in new CEE member states:

- the system of incentives and the behavior of organizational actors in the housing sector, including real estate agents, developers, municipalities, banks, and construction companies;
- the effect of financial and legal conditions on the choices of individual actors (households) both on the supply side and the demand side of PRS;
- and elements of housing policy (subsidies, taxes and legal regulation).

4.1 Housing sector agents: supply side

An overarching characteristic of the private rental sectors in the CEE region is the nearly complete lack of institutional investors. It is a general observation that in PRS the individual landlord plays a crucial role, and in well-functioning private rental sectors the share of institutional investors among landlords is usually at least 20 percent. (Scanlon, 2011) The near complete lack of institutional actors, on the other hand, is extremely rare in old EU member states. In post-socialist member states, there is a number of potential institutional landlords who have considered or have reasons to consider entering the private rental market (e.g. banks, insurance companies, real estate agents); but so far they have preferred short term investments due to the previously described financial and legal uncertainty of PRS.

Although every now and then actors do consider utilizing their housing stock for letting as professional landlords, but these usually are only motivated by temporary and accidental market forces – for instance, their post-crisis inability to market the housing they originally intended to sell. Examples to this include:

- Banks: after GFC, some major banks acquired numerous defaulted properties, which they transferred to agencies to rent them out temporarily. Nonetheless, their eventual goal was to sell these once the market picks up.
- Maintenance cooperatives in Hungary (organisations managing and maintaining owner occupied housing in multi-unit buildings) had gotten access to apartments whose owners accumulated arrears. While renting these was considered an option, they too usually prefer selling.
- Building and building material companies as well as construction lobbies keep pushing policy makers to support the construction of rental housing, including social rental or non-profit housing. However, they only aim to undertake the building, and

would rather not manage the rental stock once it is ready. (The exception to this case was the TBS cooperatives in Poland, which undertook the role of non-profit landlords.)

- In the post-crisis recession, the sales of many housing developers dropped drastically. As a response, many began to rent their units to cover some of the losses. On top, many mortgage defaulters had to enter PRS, which generated the necessary number of tenants on the other side. In the end, however, the disproportionate benefits of owner occupation as opposed to the chronically unsupported rental sector still prompts these actors to return to selling and buying their stock as soon as they have the opportunity. One developer interviewed in Eastern Hungary developed a rent-to-own product, where a higher rent is collected to be used as the tenant's down payment; so eventually the rental tenure is only applied to bridge the time the housing unit can be returned to owner occupation. This arrangement also profits from a 5-year government subsidy to developers who build rental units: the developer receives the subsidy for the 5 years he rents out the unit, while the final goal is still selling their apartments.
- In Holland Park – an example from Poland – ING Real Estate sold two apartment buildings comprising 64 units in 2006 to Keen Property Partners (KPP), which continued letting the apartments for extended periods. After receiving a permit to change the designation to residential purposes in 2009, the investor continued letting the apartments but decided to gradually sell the portfolio to individual buyers. By now only a few units remain in the hands of KPP, all of which are offered for sale – even with a 2-year rent guarantee calculated at a 5 percent rate of return on the investment within one year. (PwC-REAS-CMS, 2013)

4.2 Households' behavior on the supply and demand side of the market

The typical tenants on the *demand side of PRS* are households who do not find (or cannot afford) appropriate housing solution in the owner-occupied sector. As Jan Brzeski (2007) in his presentation argued, the non-beneficiaries of privatization tend to comprise the vast majority of the demand side of PRS, such *the young and mobile (students, yuppies); urbanizing migrants and intra-urban 'nomads'; vulnerable groups in need of emergency housing; permanent urban poor; divorced; single parents*. However, it very important to realize that the majority of potential tenant households have other housing options:

- They may stay with their parents;
- Move to inexpensive neighborhoods (sometimes in remote or rural areas);
- Become homeless and rely on social services;
- Stay in the family home even after divorce;
- Leave the country.

Their decision depends on the availability of the private rental options and on the affordability of the available options. As the second option on the list is not very attractive to most potential tenant groups (indeed, together with entering homelessness it is usually chosen by the most desperate), these households are often willing to pay much more for an acceptable housing solution than the national or regional average housing cost/income ratio. It is not rare that households in the PRS pay

40-50 percent of their income on housing. When low income households lose their property or social tenancy because of financial difficulties, they often end up in the low-end of the private rental sector, in poor quality housing in which rent level and utility costs further overburden their already strained budget.

For much of the important trends and patterns in PRS in CEE, only anecdotal information is available. According to this, the market is greatly segmented in terms of rent, quality, risk management mechanism (amount of deposit, level of landlord control etc.), but in at same time it is also very flexible. While the narrow high end market (for well-off households and expatriates) may be functioning fully legally, the majority of PRS, households who entered the market for lack of more attractive options, is mostly informal.

The near absence of institutional investors makes it obvious that the typical landlord in CEE is the 'accidental' landlord, a person who inherited a property. Many of the new member states undergo a fast aging process, together with the outflow of young and middle aged groups, which affects the housing market. Currently around 30 percent of the population lives in a one person household in CEE countries, which points to demographic trends that gradually increase the stock of available (and rentable) housing. Of course the inherited dwellings can also be sold, but many of the families prefer to keep and rent out as a form of saving.

However, there also are private persons who acquire a second (sometimes third) apartment for investment purposes. Others rent out a room within their apartment, and co-habit with their tenant (many of them to friends, family members, or other reliable contacts, rather than advertising on the open market). On the one hand, there are also a small number of people who invest into property on still a relatively small scale, but maintain 2-10 rental apartments for a living. The typical motive for renting out is investment, although the real estate itself is considered an inflation-safe long term investment (as prices rise), and renting out is rather a way to cover maintenance costs and make a small additional profit. Semi-professional and professional landlords, on the other hand, look to make a reasonable profit beyond retaining the value of the property.

Gradually increasing inequality has a potential effect both on the supply side and on the demand side of PRS. On the low end of the income distribution, households cannot afford homeownership and a growing number of low income households are forced into private renting. Higher income households, on the other hand, may see real estate as a safe investment compared to money market opportunities. However, these decisions very much depend on the market outlook and other investment possibilities. At the upper end of the income distribution scale, households can choose from a wider portfolio of investment and saving forms. Due to the unpredictability of the pension systems, the choice to invest in real estate is a reasonable one for even some of the medium income persons. Interestingly enough, house price increase in the region often took place in times when alternative investment possibilities were considered to be less advantageous (in 1998-2000, 2012-14).

We can conclude due to the unregulated nature of the market and the lack of market correction mechanisms in this field, the behavior of households on both the demand side and the supply side of PRS contribute to the volatility of the sector.

4.3 Public (housing) policy factors

While housing policy, support and construction was a central issue in socialist countries, it lost nearly all of its policy priority position in all transition countries after 1989. Together with the decreasing demographic trends, housing shortage became less important (with the sole exception of Poland, where it is still a pressing issue); this is also demonstrated by the growing rate of vacant housing all over the region.

After the mass privatization of the housing stock, large public housing investments have become nearly nonexistent, despite the importance of social housing regularly emphasized in government white papers. In this aspect, Slovakia is the exception, where 10-15 percent of new build housing is public housing investment. Municipalities in all CEE have become the most important social landlords, but they receive no compensation for this task in the intergovernmental transfer system, which is a strong counterincentive from maintaining and managing their social housing stock (let alone expanding it).

As mentioned earlier and extremely strong home ownership bias is present in all of these societies, despite their already imbalanced tenure structures. A variety of tax advantages, construction subsidies and saving subsidies are available to support ownership and owner occupation, while there are virtually no subsidies to private renters – either tenants or landlords – which result in strong financial disadvantages for all PRS actors. Some subsidies, nonetheless, could actually help would-be landlords because of their unclear targeting.

The legal regulation of the private sector remains liberal to the extent it can be considered chronically underregulated. Basically, the content of rental contracts is entirely up to the negotiation of landlord and tenant, with no intervention (or detailed regulation) from the law. This leaves a lot of black spaces, room of conflict, and not much help in resolving conflicts. Because of the small size of the sector, these conflicts are not considered political priority, maybe with the exception of restitution related cases.

5. Possible role of PRS in new EU member states' housing policy

What would be the possible role of the PRS in post-socialist countries? As a consequence of mass privatization, public housing sector reduced to a small fraction of the housing stock, which is significantly below the needed share to house low income households. Despite some efforts (and political wish) to increase social housing, the prospect of increase publicly owned social housing stock is very improbable because of the fiscal pressure on governments and municipalities. Consequently, the involvement of the private sector in social housing provision has become inevitable to help the households in need. The attempts to introduce PPP models seemed unsuccessful because the subsidy level of the programs was beyond the capacity of the governments. Poland's TBS is the most promising example, but the support for this model has been cut recently. The rental sector has been a neglected area of housing policy, which is not specific to the region.

“Few governments have taken rental housing seriously over the past 30 years ... and recognition of the important role played by the rental sector still constitutes perhaps the

greatest hole in most national housing policies.” (UN Habitat (2003), Global Rental Housing Report)

In this situation, improving PRS seems to be an adequate option. Because of the demographic changes (ageing, out-migration, population decrease etc.), a part of the existing privately housing stock can be used for social purposes. The advantages for the PPP programs would be to restructure the social housing sector in the countries in two aspects: 1. the cost recovery requirement used in private rental sector would stop the deteriorating process in the public sector (or at least alleviate the problem); 2. the national social housing policy guideline will steer municipal housing policies toward more targeted programs.

In transition countries several attempts have been made in this direction, but they faced serious constrains. First, a determined, long term political commitment is missing, as politicians and political parties do not realize the social cost of the poor housing situation of low-income households. Second, lax regulation and the sometimes contradictory legal framework of PRS wages a huge external cost on society. Major changes are needed in tenancy legislation in order to use the sector for social purposes. Third, there is need for a change in the prevailing housing policy paradigm, in which targeting of support should move away from the middle class and subsidizing private ownership, towards targeted social rental programs.

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