

Chapter 8

CONCLUSIONS AND RECOMMENDATIONS

The assessment of the housing sector of Serbia and Montenegro has identified a number of challenges as well as opportunities for reforms to improve access to affordable and adequate housing. Major reforms have been initiated in both republics to develop the framework for a market-based housing system. Housing has not been a political priority so far and the attention to social housing issues is mostly driven by concerns for integration of refugees and IDPs (Internally Displaced Persons). Housing reforms have been eclipsed by economic and political crises. The future reform path, however, requires a significant commitment to the development of the right mix of legal, financial and institutional mechanisms to enable more efficient operation of housing markets and the provision of social housing.

This chapter highlights the major findings of country-specific assessments. It explores progress in housing reforms in Serbia and Montenegro with a particular focus on the following issues:

- Housing conditions: trends and challenges
- Institutional reforms
- Reforms of housing legislation
- Reforms in housing finance and support for housing from public sector.

The evaluation of both republics is then linked to a set of major recommendations for specific reforms to be undertaken at the next stage of housing policy development and implementation. An attempt has been made to highlight the similarities and differences in the housing system of Serbia and Montenegro and to define specific priorities for action in the area of housing policy, institutional, legal and financial reforms.

Introduction

This last decade has brought considerable challenges to the housing sector, due to overall economic difficulties in Serbia and Montenegro and the influx of refugees and IDPs. In 2004, the State Union of Serbia and Montenegro still hosted the largest number of refugees and IDPs in Europe. In 2004 there were 283,349 registered refugees (270,341 in Serbia and 13,008 in Montenegro) from Croatia and Bosnia and Herzegovina, and 226,410 registered IDPs (208,391 in Serbia and 18,019 in Montenegro) from Kosovo. Most of them live in private accommodation, while 17,000 remain in collective centres.

Other challenges stemming from the period of economic and political transition are growing poverty and unemployment. Serbia's GDP today is half that of pre-reform levels: 10.3 % of households live in poverty, and 19.5 % are at risk of falling below the poverty line. The unemployment rate is estimated (based on the ILO definition) at around 12 % while a number of statistics place it much higher. The grey economy is pervasive. In Montenegro, unemployment is as high as 30 %, poverty rates are close to 11 percent. The highest rates of poverty are found among a number of vulnerable and socially excluded population groups. According to the most recent estimates, 22 % of refugees and IDPs live in poverty.

Few housing policy developments in either republic address the need for a comprehensive legal, institutional and financial framework for the efficient operation of the housing sector. The traditional system of enterprise and/or state provision of housing has collapsed. Growing housing demand, in the absence of an adequate framework regulating new private initiative, has led to immense illegal construction resulting in a great number of new unplanned settlements in large urban centres. At the same time, limited public support for the maintenance and management of the existing multi-unit housing has resulted in further deterioration of the housing stock, in the absence of investment in refurbishing or upgrading by homeowners.

The Government of Serbia has started to take measures to tackle the challenges brought by the period of economic and political transition. It has adopted a draft *National Housing Policy* in 2002. The development process, however, was delayed by lack of funding and frequent changes in government. The housing policy received new impetus in 2004 under the Ministry for Capital Investments.

In Montenegro, the Government is preparing a *Housing Policy Action Plan* (HPAP) to address key challenges in the housing sector. The HPAP was initiated by the Ministry for Environmental Protection and Urban Planning, in 2004, and has been developed through consultation with the main national stakeholders in the housing sector, including representatives from banks and housing associations, as well as with international organizations active in Montenegro's housing sector.

In both republics, the development of housing policies needs to be accompanied by a number of changes in the legal and financial framework as well as capacity building to enhance the efficiency of housing sector institutions.

A. Republic of Serbia: Evaluation of housing reforms

1. Housing conditions

According to the preliminary results of the 2002 Census, the population of the Republic of Serbia (7.498 million) relied on a total housing stock of 2.96 million dwellings – an average of 394 units per 1,000 people. Compared with other former socialist countries, the size of Serbia's housing stock seems adequate. The total number of dwellings exceeds that of households by over 341,000 (about 11 percent). Another aspect suggesting a reasonable volume of housing is the continued increase in the stock by 8.1 % between 1991 and 2002, while the population increased by 1 %.

Despite the availability of housing in general, its distribution is not necessarily adequate to meet housing needs. There are many dwellings with more than 3 occupants per room (about 590,000 occupants in just 120,000 dwellings) and over 54,000 people occupy about 18,000 substandard dwellings.

Amenities are a key factor of housing quality. Though new construction has improved access to basic amenities, the provision of piped water and sewer should be a priority for housing policy in the Republic of Serbia. As of 2002, 18 % of rural housing remains without piped water indoors, while 40 % has no access to flush toilet and shower.

Serbia like most other countries in transition, has a high share of homeownership and only about 2.1 % of public housing (58,000 units). When transition started, 77 % of houses were privately owned; this share quickly increased to 97.9 %. Most of the 700,000 socially owned public rental units were privatised. Private rental housing has grown in importance in recent years, particularly in large cities across Serbia.

Though explicitly regulated since 1995, management and maintenance of multifamily housing appears to be problematic. The performance of maintenance is an obligation of owners' associations under the supervision of local administration. Public maintenance companies still dominate the market in all major cities – approximately 62 % of apartments in the 11 major cities are clients of public maintenance companies. Owner's associations have been slow in establishing themselves as legal entities. In addition, the overall impoverishment of the population prevents adequate mobilization of funds to deal with day-to-day repairs. The stock as a whole suffers from continuous insufficient investment in maintenance and depreciates in value.

New housing construction has declined as in most transition countries, with annual volumes ranging between 10,000 and 11,000 in the late 1990s, or an average of 1.4 units per 1,000 people. Most of the housing – 83 % in

2002 - is built by the private sector. In addition to a high share of homeownership, before the transition, Serbia also showed high rates of privately built new housing (72 % in 1989). As construction loans are limited and expensive, most of new construction is pre-sold and financed by the future owners. Reportedly, most cash-investment comes from remittances. A large share of new dwellings are built without building permit. Estimates range from 500,000 to 900,000 across Serbia, resulting in *large informal settlements in cities*. Informal settlements vary in terms of standard (from slums to luxury residences), location (from suburbs to city cores and protected areas) and size (from several small units to over 50,000 residents' settlements). The complexity and vast scale of the illegal construction issue would require much more political attention, resources and wider social involvement.

2. Evaluation of the institutional framework

Public sector institutions. In Serbia, the need to improve the efficiency and transparency of the public sector is a high priority. A decade of politicization and centralization of authority, combined with economic collapse and the outflow of educated and skilled people have left most public institutions in disarray. Frequent changes in regulations, corruption, and misuse of state institutions for political purposes all have negatively affected public administration.

The Housing Affairs section of the Ministry of Capital Investments is the key driving force in housing policy at central government level, but it needs long-term support from other ministries to achieve real change. Recent proposals advanced the idea of setting up a separate National Housing Agency with the potential to introduce stability into housing policy and overcome political fragmentation.

The intention of the government is to move away from the role of provider in housing towards an 'enabling' approach. This will require the development of new skills and methods. National and local government bodies concerned with housing should find ways of encouraging and promoting good practice, and of incorporating the views of a range of stakeholders into policy making.

Local governments have acquired a critical role in housing with some of the newly established Municipal Housing Agencies offering examples of good practice in housing reforms. The issue of sustainable funding is particularly critical for municipalities, as the scale of responsibilities exceeds current resources, particularly in the context of declining donor assistance.

A good number of institutional reforms have been catalyzed by the Settlement and Integration of Refugees Program (SIRP) supported by the Italian government and UN-Habitat, and carried out under the auspices of the Ministry for Capital Investments. At the national level the programme has helped to develop the instruments needed to create housing policies. At the local level SIRP has played a key role in developing the aforementioned Municipal Housing Agencies. These agencies provide experience that will be valuable in extending the provision of social housing.

Private and non-governmental institutions. There are many construction companies in Serbia with the capacity and expertise to undertake housing projects, including large firms currently building apartment blocks. The maintenance sector now includes private companies as well as public enterprises, but the proportion of apartment blocks maintained by each varies greatly between areas. The country has 46 banks and less than 10 of them are owned by foreigners, mainly Austrian banking groups. Real estate agents and other market intermediaries have become established, although most of them operate in the informal sector and are not professionally licensed.

Resident associations in privatized apartment blocks have the potential to influence decisions about their housing. However, there does not seem to be any systematic approach to training residents to exercise their responsibilities. Resident or community-based organizations, though currently few in number, will be essential intermediaries in the dialogue between municipalities, planners, infrastructure services providers and owners of

illegal housing. The recently formed Association of Tenants could help disseminate the experience of local groups.

3. Reform of housing legislation

The period since the approval of the *Housing Law* in 1992, when public provision was replaced by market provision of housing, has witnessed the deregulation and subsequent disintegration of state responsibility. A mere rhetorical obligation that ‘the state takes measures for the creation of favourable conditions for housing construction and for meeting the housing needs of socially vulnerable persons’, has never been implemented. These responsibilities were delegated to municipal governments who played an important role in the administration of Funds for Solidarity Housing Construction. Furthermore, the *Law on Local Self-Government* (2002) that came into force in September 2004 was accompanied by fiscal and budgetary changes that aim to transfer even more power and responsibilities to the local level. Municipal governments will be expected to develop and implement local housing policies in accordance with the *Draft Law on Social Housing*. The draft law merely describes basic responsibilities of the central/republic and local/municipal levels, i.e. the establishment of the National Housing Fund and of the local Municipal Housing Agencies. Municipal governments have the right to allocate land for construction purposes, yet the decision to do so is arbitrary, as the procedure remains unregulated. All urban construction land is owned by the central/republican government. The title to a building does not arise legally until the construction is complete, consequently hindering the development of secured construction financing.

With respect to maintenance and management, although the *Law on Basic Elements of Property Rights and on the Maintenance of Residential Buildings* establish the responsibility of the co-owners of a residential building to maintain the building, in reality such buildings are not maintained. This can to a large extent be attributed to the absence of a comprehensive *Law on Condominiums* clearly setting out the obligations of co-owners and the mechanism for fulfilling those obligations. Furthermore, condominium ownership is not formally recognised, therefore the inability to register such ownership reduces the ability of homeowner associations to raise funds for building maintenance.

The transformation of the previous dual system, which identified title holders and physical characteristics of immovable property, into the new unified Real Estate Register of Serbia was initiated by the introduction of the *Law on State Survey, Land Registration and Registration of Rights to Real Property*. So far, however, the law has not been fully implemented, since the Real Estate Register covers only 55 % of the territory. This can be largely explained by the initial absence of documentation on state ownership of immovable property and the consequent lack of documentation on property transactions since privatisation began in 1992. Implementation will remain incomplete until the issue of the legalization of illegal construction has been resolved.

The implementation of an effective system for the registration of land and immovable property is necessary for the creation of a sound legal framework for property rights and the development of a real estate market and mortgage financing. It would also provide a source of data on land and real estate that allows for the imposition of a fair level of taxation, as well as the development of a coherent land administration and planning policy.

4. Reform of housing finance and state support for housing

Mortgage lending is just emerging in Serbia with initial offerings mainly by foreign banks. A typical loan-to-value ratio is 70 %; the interest rate is approximately 10-12 % and maturity is up to 20 years. The absence of mortgage law and other important legal provisions related to land registration, foreclosure and bankruptcy is a major constraint for the development of housing finance. Furthermore, banks don't have access to long-term resources for mortgage lending. The reform of pension and insurance systems as well as the introduction of investment funds is still ahead.

Despite the absence of a primary market for housing finance, housing transactions have increased considerably, and in Belgrade alone have reached 100,000 in 2004. Purchase prices in the secondary market vary widely depending on location and the condition of the property. Interviews with real estate agencies in November 2004 indicate that the purchase price of a typical 80 m² flat in Belgrade could be between EUR 125,000 and 250,000, while in Novi Beograd (suburban location) it ranges between EUR 50,000 and 75,000. In Niš or Novi Sad the prices are around EUR/m² 900–1,000. Despite widespread poverty, high unemployment and underemployment in Serbia, the above sporadic statistics on housing prices demonstrate clearly that the housing market reflects the size of the gray economy, which is estimated to be 30 – 50 % of the size of the official economy.

Housing costs have increased in Serbia during the transition, but still remain modest compared to other countries in transition. Owners and public sector tenants spend approximately 10 % of their income on housing, while in the private rental sector the share is as high as 27 %.

Public expenditure on housing. Funds for housing were mobilised through income tax, set between 0.3 % and 1 % of salary, which replaced the Solidarity Fund in 2001.¹ The assembly of the municipality defined the tax rate and the allocation of revenues for housing construction. The legislation neither defined conditions for distribution of resources (criteria, target groups, conditions for granting and refunding of resources, etc.), nor enacted other by-laws or monitoring systems. This tax was scrapped in July 2004.

A new policy instrument – a state insurance of mortgage credits provided by the *National Corporation for Insurance of Housing Credits (NKOSK)* – has recently been launched. There is concern about the fact that the NKOSK will be active in the financial market without supervision by the National Bank, without a license, without fulfilling the capital requirements obligatory for other market participants and enjoying an implicit guarantee. In addition, this form of state support for housing appears to be poorly targeted. Given the prices in the housing market, less than 10 % of households can qualify for a mortgage. Without explicit guidelines on targeting two scenarios are possible: (a) NKOSK will insure a large amount of high-risk mortgage credits thus imposing high costs on the state budget; (b) NKOSK will insure only low-risk mortgage credits, thus subsidizing households that least need state support. There are also plans to establish a national housing fund as well as municipal/regional funds.

Other social housing activities of the Government of Serbia have roots in integration programmes for refugees and IDP's. In 1996-2003 the Commissariat for Refugees and UNHCR together with other partners, such as Swiss Disaster Relief and the Norwegian Refugee Council, have provided resettlement assistance for more than 2,400 households. The main components has been assistance to local settlements through full construction, self-help or partial self-help. Another important part has been the rehabilitation and maintenance of the collective centres. Support for the housing sector also includes the reconstruction and extension of the home for mentally disabled children and youth and the rehabilitation of the home for the elderly.

The implementation of the *National Strategy for Resolving the Problems of Refugees and Internally Displaced Persons* has been slow due to inadequate funding. At the moment the government is proceeding with closure of the collective centres, which may leave some individuals more vulnerable for an interim period, if adequate alternative housing solutions are not provided. International and local assistance has focused exclusively on the occupants of collective centres, while other refugees and IDP's living in private, temporary and often inadequate accommodation have been excluded.

Under the Settlement and Integration of Refugees Programme (SIRP) 670 housing units for refugees and local vulnerable people are being built. However, the other components of the programme, in particular those related

¹ The Solidarity Housing Fund resulted in approximately 0.1 flat per 1000 inhabitants. Due to the favourable selling conditions, this fund functioned mainly as the delivery mechanism of highly subsidized owner-occupied housing for middle-income households.

to the institutional housing reform and the establishment of a cost recovery system are of even greater importance to the housing sector.

Implicit housing subsidies. Despite the relatively low level of direct budget allocations to housing, considerable public resources indirectly flow into the sector. This takes a variety of forms: privatization of public/socially owned housing at below market prices; subsidies to cover emergency repairs in multifamily housing; below market rents in public rental housing; non-existent market-based property taxation and land lease prices; no value added tax on housing construction; and no cost-recovery mechanisms for utility infrastructure connection and improvement. This lack of financial transparency and fiscal discipline in the housing sector reflects the rudimentary nature of housing policy in Serbia and needs to be reconsidered. For example, property taxes are based on the dwelling's surface area; an average property tax amounts to 8.000 dinars per year without any reference to market value. Until January 2005 there was no tax on housing construction, which effectively is a universal subsidy of 18 %. Taxes, fees and targeted subsidies are essential policy tools to rationalize housing consumption and encourage private investment in housing. They also mobilize financial resources for social groups in need of housing support.

B. Recommendations for the Republic of Serbia

Serbia does not have a clearly defined housing policy. The general lack of direction, cooperation and follow-up in government housing policies has received little attention so far. In fact no major activities in the housing sector have taken place since the change of regime in 2000. Actors within the housing sector are thus faced with different laws without negotiated goals, priorities or a shared vision. Instead there are many different strategies, policies, and measures, some based on new laws, such as the *Planning and Construction Law* (2003), and some on old ones, such as the *Housing Law* (1992). There is a confusing mixture of old strategic documents like the *Spatial Plan of the Republic of Serbia*, and new strategies adopted recently, such as the *Strategy for Resolving the Problems of Refugees and Internally displaced Persons* (2002), the *Poverty Reduction Strategy Paper* (2003), local strategic plans, etc. As a result, there are many pieces of housing policy scattered in different documents, lacking clearly defined priorities. Additionally, some of the goals and measures stipulated in the different documents are conflicting. An inventory of existing policies, laws and regulations must therefore be made as a basis for any future housing policies and actions. This can be the basis for a comprehensive housing strategy, with clearly defined priorities.

Problems within the housing sector need to be addressed in a comprehensive manner involving all major stakeholders, i.e. the different ministries involved in housing at the republic level as well as local governments, housing associations, non-governmental, private and international organizations.

International donors should be encouraged to pursue greater co-ordination so that their contributions can better complement the development of a national housing policy. The establishment of a structured programme of knowledge transfer, research and capacity development is very much needed to assist the housing policy implementation in Serbia.

The recommendations are grouped in the following clusters:

- Housing policy priorities
- Institutional development and capacity building
- Changes in the legal framework
- Reforms of the housing finance system.

Box 8.1: Recommendations for Housing Reform in Serbia

1 *Housing policy priorities*

Policies on maintenance and refurbishment of existing housing

1.1 One of the highest priorities should be to prevent further decay and inefficient use of the existing housing stock. A comprehensive approach to address these problems requires the following major initiatives: (a) action plans and timeframe for modernization of housing and infrastructure; (b) pilot programmes, including loan and grant arrangements for priority areas; (c) preparation of simple, practical guidelines on energy efficiency measures.

Policies on new construction

1.2 Municipal land policies need to ensure a steady supply of land for housing in general, and for social housing in particular.

1.3. Measures for the legalization of informal housing should be taken in the preparation of the new generation of master plans supplemented with financial packages including residents' contribution to the cost of infrastructure and essential services.

Policies on social housing provision and housing assistance

1.4. Central government is advised to draft, in co-operation with representatives from municipalities, the Law on Social Housing to develop a social housing strategy/programme which defines the objectives of the government and main mechanisms to address these objectives:

- (a) The strategy should focus on the poorest and most vulnerable households living in substandard and/or unsafe housing conditions, particularly refugees, IDP's and Roma;
- (b) The strategy should address housing finance, cost-recovery and subsidy schemes, housing standards, eligibility criteria of beneficiaries, municipal activities, and tasks of non-profit organisations and private developers;
- (c) The government needs to define rental housing as the main form of tenure for social housing.

1.5. Central government is advised to develop and introduce a housing benefit to assist low-income households in the rental sector with rental costs and utility payments. This benefit should be means-tested and tenure neutral (available in the private and social rented housing) with possibilities for limited assistance to poor households in owner-occupied units.

1.6. The draft *Law on Social Housing* (and the necessary sub-legislative acts) should be revised in order to: (a) identify the role of municipal government in financing social housing and the relationship between municipal government and commercial banks; (b) impose an obligation on municipal government to allocate land for the construction of social housing and to establish a procedure for this allocation; (c) define beneficiaries, allocation procedures (means-tested), rents based on cost recovery and management obligations.

1.7. It is also recommended that legislation be amended to clarify the rights and obligations of tenants under lease agreements, by introducing, for example, provisions regulating the premature termination of lease contracts and specifying the sanctions available to the landlord for the non-payment of rent.

2 *Institutional development and capacity building*

Central government

2.1 Structures and mechanisms should be put in place to ensure effective and long-term co-ordination and development of housing policy, particularly with regard to the establishment of the National Housing Fund and adequate staffing levels within the Ministry of Capital Investment.

Local government

- 2.2 Municipalities should ensure that they have sufficient funding and staff to: (a) develop local housing policies, including stakeholder consultation; (b) provide effective and efficient management of housing; (c) monitor the work of local housing organizations; and (d) manage the process of legalizing informal housing.
- 2.3 An assessment should be undertaken to determine the capacity of smaller municipalities to provide an effective housing service, and to consider other options in this area, such as joint arrangements or the use of non-profit organizations.

The experience of the municipal housing agencies, established under the SIRP programme, should be evaluated and information on good practices disseminated.

Private and non-profit housing institutions

- 2.4 A regulatory regime should be established to ensure adequate standards of provision by non-profit housing organizations, and to encourage continuous improvement in their service. This system could build on the experience of housing cooperatives. Non-profit housing organizations should be eligible for capital and/or revenue subsidy, subject to meeting regulatory requirements and providing housing for vulnerable people.
- 2.5 The Government should introduce a licensing scheme to regulate the work of housing market intermediaries - real estate agents, housing managers, property appraisers and maintenance firms – which meets international standards.
- 2.6 The Government, in partnership with municipalities, should support the work of residents' assemblies and associations of homeowners with training in bookkeeping, asset management, contract monitoring and effective negotiation.

3 Changes in the legal framework

Land and property ownership

- 3.1. The *Law on the Basic Elements of Property Rights* should be amended to allow for: (a) transfer of public construction land titles to municipal governments and privatization of construction land through auctions; (b) a clear definition (in conjunction with amendments to other legislative acts) of the authority and responsibility of municipal governments with regard to land management.
- 3.2. The *Housing Law* should be amended to make the right to privatize inapplicable to newly constructed social housing occupied on a tenancy basis. Provisions should be developed to account for adequate supervision of private renting, including contracts, tenant-landlord relations and tenant protection. If applicable, the development of a separate Landlord/Tenant Act should be considered.

Tax legislation

- 3.3. Budgetary legislation may be amended to enable municipal governments to manage housing responsibilities. This may be done by defining and increasing the percentage of central government tax revenue received by the municipal government. In addition, incentives for improvement of the municipal

financial management system can be created by establishing clear debt limits for municipal authority borrowing and municipal credit rating.

3.4. The Government could consider the introduction of tax incentives for the construction of social housing by amending the *Value Added Tax Law*.

3.5. A market value-based residential property tax needs to be introduced.

Mortgaging and registration

3.6. A *Law on Mortgages* is highly recommended where the creditor is able to foreclose without problems: it should include provisions stating clearly the grounds upon which the creditor may initiate action, and a building under construction may be the subject of a mortgage. In Serbia, as in other countries in transition,² it is recommended to introduce, at least as an alternative to a regular “accessory” mortgage, a “non-accessory” pledge on land as a flexible instrument to secure credits.³

3.7. The *Law on State Survey, Land Registration and Registration of Rights to Real Property* should be amended to allow for the registration of titles to buildings under construction and for the registration of condominium property. Tax legislation should also be amended so that income derived from the use of condominium property may be effectively used for the *maintenance of the residential building*.

3.8. The Government could consider the introduction of a *Law on Notaries* to make the registration of titles more effective.

Urban planning

3.9. An exhaustive list of the regulations and standards that must be complied with to acquire building and occupancy permit for housing should be drawn together with detailed guidelines on legalisation of illegal housing. When a building is non-compliant with the provisions of the land use plan and/or with the necessary permit requirements, the rights and responsibilities of the registered owner should be specified.

3.10. The *Law on State Survey, Land Registration and Registration of Rights to Real Property* urgently needs to be fully implemented on the territory of Serbia in order to create legal certainty of property rights and to support the development of a real estate market and mortgage-based financing.

3.11. The profession of notary - according to Western European models - should be introduced in order to assist people with real estate transactions and to increase the security of such transactions.

4 *Reform of the housing finance system*

4.1. In order to promote a functioning primary market, one must ensure transparency of the market, low transaction costs and a reliable legal environment.

Essential components of a reliable legal framework should be:

- Clear and secure laws on property rights, including a complete and well functioning

² Estonia, Hungary, Slovenia, discussed in Poland and Bosnia-Herzegovina

³ Details and model law: Wolfsteiner/Stöcker, “A non-accessory security right over real property for Central Europe” *Notarius International*, 2003, pp. 116 – 124.

Legal principles: Soergel/Stöcker, “EU-enlargement in Eastern Europe and dogmatic property law questions – Causality, accessoriness and security purpose, *Notarius International* 2002, pp. 227 – 244.

Discussion at the European level: Drewicz-Tulodziecka, “Basic guidelines for a Eurohypothech, Mortgage bulletin 21, Mortgage Credit Foundation (Warsaw), May 2005 (available at: www.fukrehip.pl)

property register;

- Problem-free creation and enforcement of loan collateral;
- Swift property transactions at reasonable cost.

4.2. Financial institutions need to develop options for access to long-term capital for mortgage financing. A covered bond system, which is a common instrument in Europe⁴, might be appropriate. This system allows capital to be raised with an interest rate close to government bonds. Besides long-term funding for banks, covered bonds are an important instrument in the development of a capital market. European law foresees privileges for covered bonds as investment instrument for institutional investors (pension funds or insurance companies) due to their inherent security, based on legal provisions.

4.3. It might be advisable to postpone the introduction of mortgage-backed securities (MBS) due to their complicated structure, high upfront costs and lack of standardisation. MBS are suitable for well developed markets. In EU countries, MBS today are used as portfolio and risk management instruments. Current capital relief will diminish under the new Basle II agreement.

4.4 Another instrument for long-term funding is the Bauspar system. However, the State needs to be aware of the problems that subsidising this system might entail. If implemented, it should be construed in such a way that does not imply dependence on public subsidies.

4.5. Given the economic difficulties and fiscal constraints, the subsidy system in Serbia has to be targeted to groups in need of state support. These groups should be able to solve their housing problems through transparent means-tested (income based) subsidies.

4.6. Implementation of housing programmes, including the distribution of housing assistance funds and decisions on guarantees based on government directives, should be done by a specialized institution (e. g. NKOSK/National Housing Fund). There should be only one institution in charge of the implementation of housing programmes. It is therefore recommended that the envisaged National Housing Fund be unified with NKOSK. This institution should be subject to banking supervision and equity rules and have the possibility to attract money from the capital market.

C. Housing reform in the Republic of Montenegro

1. Housing conditions

According to the preliminary results of the 2003 Census, the population of the Republic of Montenegro (617,740) relied on a total housing stock of 253,135 dwellings – an average of 410 units per 1,000 people. The total number of dwellings exceeded that of households (191,047) by over 62,000 (about 32 %). Another aspect appearing to point to a reasonable volume of housing is the 24.3 % increase in the housing stock over the period 1991–2003 while the population increased by only 4.5 %. The rate of new construction in Montenegro is relatively high -- an average annual rate of 6.7 units per 1,000 people, four times higher than the average for Serbia.

Montenegro has a high share of recreational properties and vacant apartments in rural communities. Podgorica and some of the other large cities, however, have attracted a great number of migrants and refugees. Over 6,000 households, many of them Roma, live in substandard dwellings (slums). Vulnerable groups, represented by refugees and poor local households, consume less than 14 m² per person, while the national average consumption is about 26 m² per person.

⁴ A mortgage bond system exists in 22 European countries. The following transitional countries have introduced it: Bulgaria, Czech Republic, Hungary, Latvia, Lithuania, Poland, Romania, Russia and Slovakia. See Annex for further details.

More than 95 % of housing in Montenegro is privately owned. Privatization of socially owned apartments followed the same rules as in Serbia. However, housing shortages in large cities, aggravated by flows of refugees and IDP's, have led to a variety of housing arrangements. Many privately owned units are shared with tenants, sub-tenants or relatives (at least 3,500 in Podgorica).

In Montenegro, as in Serbia, single-family homes are the predominant form of housing. In Podgorica the share of units in multi-apartment buildings is about 30 % (18,000 units). Apartment buildings are generally considered to be problematic in terms of management and maintenance. Reluctance to assume responsibility for maintenance in privatised buildings and financial constraints are seen as the main reasons for continuous deterioration of the housing stock. Although the law requires homeowners to form an association and elect an administrator, this requirement is not systematically implemented. For example, out of 2,200 buildings in Podgorica, expected to set up an association and choose a manager, only 500 have done so. Collection of maintenance fees is poor and emergency repairs often need to be financed by municipalities.

Housing quality is generally good, but there are significant urban-rural inequalities. Although most of the housing stock was built in the last 40 years, with close to 20 % built since 1991, rural housing lacks basic amenities. The condition of water supply and sewerage networks is of general concern, especially in coastal areas and the northern part of Montenegro. The situation is aggravated in expanding cities like Podgorica, where illegal construction creates planning, legal, financial and physical constraints for adequate network connections.

2. Institutional reforms

Public sector institutions. Montenegro's small size makes it particularly crucial to improve the efficiency of public administration, as a large civil service would be unaffordable. A reform strategy was adopted in 2003, aiming at organizational improvements of the public administration and its policymaking and implementation capacity. The municipal administration has inadequate capacities, poor equipment and outdated methods of work. The use of modern financial management, ensuring continuous improvement, or cooperation with stakeholders and the private sector are poorly developed. Much progress has been donor-led, uncoordinated and short term.

The Cadastral service is a major concern, with around half of the territory lacking cadastral information. The implementation of a complete Land Register is hampered by lack of financial resources and inadequate education and training of personnel. In Montenegro, as in Serbia, the profession of notary does not exist, although the assistance of notaries in the acquisition of rights and registration process would be valuable.

Private sector and non-governmental organizations. Montenegro has ten active banks supervised by the Central Bank of Montenegro. A deposit insurance fund is financed by the bank without State guaranty. Broker firms are organized in the Association of Brokers of Montenegro. Real estate agents exist, but they are not professionally licensed. There are many companies with the capacity and expertise to undertake construction projects, including large firms currently building apartment blocks. The associations of homeowners are underrepresented.

3. Reform of housing legislation

In Montenegro the *Law on Floor Property* of 1995, amended in 1998, provides the basis for privatization. In contrast to the situation in Serbia, however, the legislation puts an end to the possibility for the tenant to purchase the apartment within two years of the law coming into force. In further contrast to the situation in Serbia, the owners of buildings constructed on private land have been awarded common indivisible ownership of both the building and the land. Article 15 of the *Law on Floor Property* states that, 'if construction land on which a building was built is privately owned, the owners of separate parts of the building shall be entitled to

common indivisible ownership of such land. If a building was built on construction land which is publicly or state owned, the owners of separate parts of the building shall be entitled to permanent use of the land on which it was built.’

As most land is held in public or state ownership, the effect of this provision has been limited. It should be noted that efforts are made in Montenegro to privatize small amounts of State-owned land through auctions or land lease arrangements; however, a long term plan to disengage the State from land ownership does not exist.

With respect to multifamily housing, as is in Serbia, the law fails to enforce the obligation of residents to take responsibility for buildings, which in practice leads to further deterioration of the stock. Furthermore, legislation fails to clearly elaborate on the circumstances in which public funding from municipal government is to be provided. Although article 41 of the *Law On Housing Property* states that, ‘the costs of regular maintenance, emergency and necessary work shall be borne by owners proportionately to their respective share by the surface of separate parts of block of flats in the total surface of separate parts’ there is no mechanism to ensure that the residents of a building comply with these obligations.

Finally, article 9 of the *Law on Floor Property* states that ‘the funds for meeting the housing needs of poor persons shall be provided by both the republic and municipal government units in line with their respective regulations.’ The responsibility of municipal authorities for the maintenance of such housing has not been clearly defined.

The new *Law on Floor Property*, adopted in 2004, has attempted to solve these and other problems by making it mandatory for residents to pay for building maintenance in an emergency (e.g. failure of mechanical, electrical or heating systems in the building). The respective contribution is based on an average monthly rent paid per square meter of useful housing unit area. As private flat owners cannot afford to pay maintenance fees, this amendment is therefore unlikely to provide a real solution to the problem.

A new *Mortgage Law*, adopted in August 2004, provides a reliable basis for mortgage lending.

4. Overview of housing finance and market issues

The economy of Montenegro is small compared to Serbia. Montenegro introduced the euro as its official currency following a period of dual currency (dinar and euro). Montenegrobanka is the only bank offering housing renovation loans, using housing as collateral. Mortgage loan terms are as follow: 10–12 years maturity, 40 % loan-to-value ratio, 9.5 % interest rate (floating), 20 % down payment. Loans are only given for renovation, not for buying a flat.

A major problem in the housing finance sector seems to be the lack of transparency, in particular with regard to how the State and public entities today finance construction. In addition to the impact on the State budget it prevents banks from taking part in the market and developing a stable housing and real estate financing system. Other problems are the unstable economic situation, the incomplete legal environment and the underdeveloped financial sector.

The data on prices in the housing market are scarce. Typical rents in Podgorica are between EUR 100 and 300 (average EUR 150) for a small apartment, although the average monthly income is only EUR 200. The purchase of a housing unit would require the payment of the total purchase price – between EUR 50.000 and 150.000 – to the real estate developer upfront (with huge risk involved) in the case of new construction, or to the owner in the case of real estate transaction in the secondary housing market.

Whereas the supply of rental units seems to be rather scarce in Podgorica, a large number of units are offered for rent in the coastal towns of Bar, Kotor, Bar, Budva. These are typically vacation homes offered off-season for rent at prices slightly lower than those in Podgorica. Typical sale prices for houses with adjacent land in

Podgorica range between EUR 65,000 and 150,000. Apartments appear to be priced in the same way, about EUR 1,000 per m2. Given the lack of credit for the purchase of residential properties, and the official income data, prices in the housing market reflect the size of the grey economy and the lack of other opportunities for investment.

5. Social housing needs

Montenegro's *Housing Action Plan* deals with tenure options for social housing and proposes either owner-occupancy with affordable, subsidized loans or social rental housing. The target groups identified for social housing are family welfare beneficiaries, pensioners, Roma, refugees and IDP's, young people and individuals who have not solved their housing problems. Over 10,000 families in Montenegro are welfare beneficiaries. In addition, there are 92,000 pensioners, some without accommodation of their own, although they have contributed to the Solidarity Housing Fund. At present, it is estimated that around 20,000 Roma live in Montenegro, often in unsafe and substandard accommodation. The domestic Roma population is estimated to be around 3,200, the rest being refugees and IDP's from Kosovo. The total number of refugees and IDPs in Montenegro is as high as 43,000. IDPs do not have the right to legal employment, nor are covered by social assistance -- they have no support except for sporadic humanitarian aid.

In conclusion, the need for social housing in Montenegro is huge. Funds for housing for pensioners and disabled people should be provided by the Fund for Pension and Disability Insurance. The Ministry of Labour, Health and Social Welfare administers housing units for temporary use, but the number is small – 65 units, for instance, in Podgorica. Local governments are required to use 1 % of the municipal budget to provide housing for the most vulnerable people. Podgorica, for example, has 100 apartments for disabled people, single mothers, refugees and the poorest families.

UNCHR and SDC have provided 230 housing units for new family settlements for refugees and IDP's in six locations, reaching 1,050 beneficiaries. In addition to this, the self-help program, through delivery of construction materials for new housing or an extension of the existing unit, has targeted 145 families.

D. Recommendations for the Republic of Montenegro

Officials in Montenegro have started to revise the overall housing policy framework, most prominently through development of the *Housing Policy Action Plan* approved in 2005. It is important to continue with the integrated approach to solving the problems within the housing sector under the lead of the Ministry of Environmental Protection and Physical Planning.

The implementation process needs to be accompanied by a number of changes in the legal framework as well as effective institutional reforms.

The Housing Policy Action Plan (HPAP) contains the redefinition of central and local government housing support for socially vulnerable groups, as well as identification of low-income and vulnerable groups requiring special care. Furthermore, it refers to the design of social housing mechanism for these groups. The main target group for social rental housing should be the most vulnerable individuals and families. In addition, it is essential to strengthen the capacities of municipalities in planning and implementation of social housing programmes, especially in the growing cities of Podgorica, Niksic, Bar and Herceg Novi. The introduction and development of local solutions and tools for the implementation of social housing activities is highly recommended.

Box 8.2: Recommendations for housing reforms in Montenegro

1 *Institutional development and capacity building*

Central government

1.1. Structures and mechanisms should be put in place to ensure effective and long-term co-ordination and development of housing policy particularly with regard to the establishment of the National Housing Agency in Montenegro.

1.2. The reform of the Real Estate Register (Evidence) of Montenegro should have a high priority. A uniform system has to be fully implemented within a short period of time. As a first step, the actual needs should be identified in a feasibility study and a work plan should be developed.

1.3. Central government needs to strengthen the capacity of the statistical bureau to ensure more adequate and timely dissemination of critical housing information.

Local government

1.4. Municipalities should ensure that they have sufficient funding and staff to: (a) develop local social housing policies; and (b) manage the process of legalizing informal housing.

Private and professional housing institutions

1.5. A housing market and land administration can function only through close cooperation of the public sector (policies, legal framework, institutions, land register and rights registration) with the private sector (mortgage-based financing systems, notaries, surveyors and real estate agents). All of these elements either do not exist at all, or are not well developed in Montenegro. The introduction of professions such as notaries, real estate appraisers and housing managers would improve the operation of the housing market. Similarly, the profession of real estate agent has to be regulated with regard to qualifications, licensing, monitoring of activities, fee structures and creation of a professional organization. The regulations for licensed surveyors have to be reviewed and improved.

The profession of notary, in particular, needs to be introduced to assist people in their real estate transactions and to increase the security of such transactions.

2 *Changes in the legal framework*

2.1. Legislation should be amended to allow for: (a) transfer of public construction land titles to municipal governments and privatization of construction land through auctions; (b) a clear definition (in conjunction with amendments to other legislative acts) of the authority and responsibility of municipal governments with regard to land management.

2.2. Legislation should be amended to make the right to privatize inapplicable to newly constructed social housing.

2.3. Provisions should be developed to account for adequate supervision of private renting, including contracts, tenant-landlord relations and tenant protection. If applicable, the development of a separate Landlord/Tenant Act should be considered.

2.4. The *Law on Housing Property* should be amended to ensure that residents in multifamily buildings comply with their obligations to pay for regular maintenance, emergency and necessary work. The establishment of a homeowners association as a legal entity, in the case of new construction, needs to be mandatory.

3. *Reform of the housing finance system*

3.1 The development of a transparent housing and real estate finance system is highly recommended. The State or State-owned entities shall - as a rule – not finance housing for the general population. This may entail amendments to current legislation (e. g. Art. 61 of the Law on Housing Property). The main task of the State in real estate finance should be to play a supporting role. Lending to borrowers is the task of banks and other market participants.

3.2. The improvement of the legal environment for mortgage lending, especially with regard to land registration and foreclosure, is highly recommended.

3.3. The introduction of an instrument to raise long-term funding for mortgage lending needs to be considered. A covered bond system, like the one recommended for Serbia, might be appropriate. Due to the size of the market in Montenegro a specialized mortgage bank can be created.⁵

3.4. Caution should be used in implementing a tax-privileged Bauspar system, as discussed in the HPAP. The Government needs to be aware of the problems that subsidising this system might entail. If implemented, it should be construed in such a way that does not imply continuous dependence on public subsidies.

3.5. Given the economic difficulties and fiscal constraints, the subsidy system in Montenegro has to be targeted to groups in need of state support. These groups should be able to solve their housing problems through transparent means-tested (income based) subsidies.

3.6. Taxes and subsidies should be transparent. Tax advantages need to be shown every year in the State budget as non-realized income.

4. *Social housing development*

4.1. It is highly recommended that social rental housing be allocated to the most vulnerable individuals and families. Access should be means-tested and social rental housing should be exempt from privatization.

4.2. Central government is advised to formulate a social housing programme which focuses on the needs of the most vulnerable households living in substandard housing, particularly refugees, IDPs and Roma. The programme should include the main mechanisms for addressing social housing needs, such as finance, subsidies, allocation, standards, and role of different actors, particularly local government and the non-profit sector.

4.3. It is recommended that a housing benefit system be introduced, starting with a gradual increase of family welfare benefits to cover part of housing costs. Low-income and vulnerable households renting in the private sector, refugees and IDPs should be eligible for housing benefits. Incentives need to be provided to municipalities to increase their commitment to resettlement and inclusion of refugees and IDPs.

4.4. Central government, in partnership with large urban municipalities, needs to implement the programme for the legalization/upgrading and location of Roma settlements.

⁵ The institution can be modelled on the covered bond institutions in Switzerland (Pfandbriefbank and Pfandbriefzentrale) or in Austria (Pfandbriefstelle). It can be by the State (but without explicit or implicit State guarantees) together with interested banks with the clear aim to be privatised in the long run. Participation has to be free for every bank, interested in using the service and offering mortgage loans. The problem of transferring the mortgage to the central entity can easily be solved by law.