OECD Workshop in Housing Finance, 5-6 December 2002

Country Paper – Poland

I. Macroeconomic Characteristics

The population of Poland was on a slightly upward trend in the 1990s and reached the level of 38.6 million in 2001. (see Table 1).

During the last years Poland's economy has shown signs of a slowdown. The average GDP growth was above 5% in 1997-99. Annual GDP growth in 2001 amounted to 1.1% (as against 4.0% in 2000). The prime reasons for this slowdown were sluggish domestic demand and a decrease in capital spending. Growth continued to be propped up by exports. Preliminary estimates are that GDP growth in the first half of 2002 came to 0.5% (a similar figure to first quarter of the same year), representing an increase on the fourth quarter of 2001 (when it had stood at 0.2%).

Industrial output was 0.2% lower in 2001 than in the year before. Labour productivity, as measured by output per employee, rose by around 5% compared to the year 2000, although a contributing factor was the 5.1% reduction in average employment.

Consumer price growth in 2001 was slower than in the previous year. Annual CPI inflation (December-on-December) stood at 3.6% (compared to 8.5% in 2000). Annualised average inflation came to 5.5% (compared to 10.1% in 2000; see also Table 5). Industrial producer prices in December 2001 were down 0.3% year-on-year. All of the various indices of core inflation fell on a twelve-monthly basis. From January to June 2002, consumer price growth was lower than in the same period of 2001 (1.1%, as against 3.2%). Twelve-month consumer inflation was running at 1.6% (compared to 6.2% in the first half of 2001). Producer prices rose 1%, whereas the same period of last year had seen a decrease of 0.5%. Twelve-month indices of core inflation also continued to come down.

The official interest rates of the National Bank of Poland were cut down six times in 2001, by a total of seven and a half points, which led to a fall in both the lending and deposit rates offered by the banks to their customers and in the yields on basic money market instruments. In 2002 the Monetary Policy Council cut interest rates down seven times and now the basic interest rate stands at 7.75% (central bank discount rate). With such low inflation, real interest rates in Poland are still one of the highest in the region.

Average monthly employee earnings in the corporate sector went up by 7.1% in 2001, to stand at 2,203 zloty (gross). The purchasing power of average wages was up by 1.6% in 2001, while that of old-age and disability pensions rose 4.5%. In the first half of 2002 average gross monthly employee earnings in the corporate sector amounted to 2,225.3 zloty, a rise of 4.4% year-on-year.

The exchange rate for the US dollar at the National Bank of Poland averaged 4.0939 zloty in 2001, with the euro trading at an average of 3.668 zloty (giving depreciation against the zloty compared to average exchange rates in 2000 of 5.8% and 8.5%, respectively - see Table 2). In 2001, in comparison to previous year, the zloty gained a nominal 3.8% to the dollar and 8.6% to the euro. In the first six months of 2002, the average mid-rate for the dollar at the NBP was 4.0859 zloty, while the euro averaged 3.6679 zloty.

The situation on the labour market deteriorated. At the end of 2001, the jobless total amounted to 3.15 million (up by 15.3% on the previous year), while the rate of unemployment stood at 17.4%, an increase of 0.6 points on the month before and 2.3 points compared to December 2000. At the end of June 2002, 3.09 million people were out of work, while the unemployment rate stood at 17.3% (compared to 15.9% a year earlier).

II. Housing Sector Overview

Present condition

The total housing stock in Poland in 2001 amounted to 11,945.9 thousand dwellings. In years 1997-2001 the average rate of the housing assets increase was about 0.6% a year. The average usable floor area of a dwelling is currently 61.7 m^2 and was steadily growing over the last twelve years due to a significant increase of the average usable floor area of completed dwellings (see Table 7). The same trend was recorded in the average usable floor area per capita. In 2001 the respective index was 4.3% above the 1997 value. The number of dwellings per 1000 inhabitants at the end of 2001 reached 309.2 (see Chart 2).

In 1997 a severe breakdown in housing was reversed and the number of dwellings completed was more than 73 thousand or about 18% above the 1996 figures. Data for years 1998-2001 confirmed the upward trend in housing. In 2001 105.9 thousand dwellings were completed, which means an increase of 20.9% in comparison to the results of 2000 (see table 10). The most dynamic growth was recorded in the new types of housing i.e. in dwellings for commercial sale or rent (46.7%) and in dwellings constructed by social housing associations (54.8%). The average rate of yearly increase of dwellings completed for commercial sale or rent in 1997-2001 amounted to 55% while in dwellings constructed by social housing association 158%.

In spite of the above mentioned results, there is a large deficit in the number of dwellings in Poland, currently estimated at over 1.5 million. The problem will grow even more acute in the near future as the baby boom generation of early 1980s is leaving their parents' homes right now.

Despite large housing needs, annual output of the housing construction industry is still insufficient. In 2000, slightly more than 2 newly completed dwellings per 1000 inhabitants were offered on the market while this figure reached 2.7 in 2001. Due to decrease in building permits and commenced investments recorded in years 2000 and 2001, it is estimated that in next years there ought to be a downward trend in dwellings completed in the housing market.

In terms of average age of dwellings, Poland is doing relatively well even when compared to the Western European countries. The oldest part of the resources, i.e. constructed before 1919 accounted only for 13% of the total while over 40% of the resources are dwellings built after 1970. Respective figures for the Western European countries were 20 and 30%. Unfortunately, due to poor technologies and significant rehabilitation backlog, the deterioration of dwellings is often very high even in relatively new stock.

The size of the rental sector in Poland has been diminishing over the decade. There are several factors shaping the process. New construction is dominated by owner-occupancies: individual, cooperative and provided by developers on profit basis. The tenure structure is also affected by the privatisation of the existing units (sale to sitting tenants). The relatively high dynamics of the privatisation is due to considerable discounts offered to buyers, which are typically 80% of the market value and higher. Another factor is the shift of titles within the housing cooperatives. The rental cooperative titles to existing units were transformed into ownership cooperative titles[1]. The preferential conditions for transforming the titles are used as an incentive to faster repayment of the old loans granted to cooperatives before the transition. It is worth noting, however, that the pace at which the public rental stock has been transformed into owner-occupied stock is much slower than in other transition countries.

The demand for new housing is fairly restricted under present conditions. Average monthly income to 1 sq. m. price ratio is between 0.6 to 0.8 depending on the region. The majority of the population cannot afford either renting or buying a new dwelling at market prices. The cost of credit and fairly high transaction costs aggravate the problem.

On the supply side, there is still a problem of serviced land for housing. The infrastructure is a responsibility of the municipalities, which lack the budgetary resources for necessary investment. As a result, overall cost of residential development is higher (either final tender prices for serviced land are higher or cost of construction is transferred onto investors).

III. Housing policy

During the period of transition different types of direct and indirect financial support for the housing sector have been introduced. State budget expenses allocated for housing purposes are summarised in Table 15, but these figures do not fully reflect the scale of State's assistance provided in other, indirect forms. Taking into account overall impact of housing tax relieves and preferential VAT rate on construction materials and services, the total value of government's support should be at least doubled (see Table 14 for tax deductions figures).

One of the government housing policy priorities has been development of affordable rental housing co-financed by preferential credit granted from National Housing Fund resources. Long-term indexed mortgages at preferential interest rates (half of market levels) can be granted to housing cooperatives and social housing associations (non-profit

[1] Since April 2001, holders of cooperative titles are able to apply for the transfer of such title into full ownership.

developers) for building dwellings for income-eligible households. Rents in social housing associations' stock cannot exceed 4% of the current value of the rented flat yearly.

Since 2000, due to sharp up-growth of demand for dwellings completed from NHF resources, the main condition of further development of NHF financial program remains the assurance of sufficient financial means to the fund. The credit granting model relied heavily on state budget financial resources. The government undertook measures to expand possibilities of gaining financial means for NHF from non-budgetary resources. In February 2001 amendment to Several Forms of Housing Support Act was passed, which helped to overcome the shortage of funds in the NHF, such as:

- taking loans by BGK in order to transfer it directly to NHF (i.e. preferential loans from international financial institutions such as European Investment Bank or Council of Europe Development Bank were taken in 2001 and 2002),
- selling credit liabilities of NHF to mortgage banks,
- participating in interest repayment of commercial credits granted to municipalities for technical infrastructure related to housing purposes by another bank than BGK.

Beside social rental housing development program, there are other housing policy tools such as:

- relieves in taxation for individuals:
  - taxpayer's right to deduct part of the expenditures for renovation and modernisation of dwellings and single-family houses from tax due,
  - taxpayer's right to deduct interest paid on a housing loan from taxable income,
- preferential rates of value added tax for selling dwellings as well as for construction services and construction materials,
- thermal modernisation program,
- system of assistance for tenants with lower incomes (housing allowances),
- preferential credit for municipalities, granted from National Housing Fund resources. The purpose of the credit is financing municipal infrastructure related to housing construction,
- assistance for those repaying the so-called cooperative "old-portfolio credits",
- guaranteed bonuses for owners of saving-for-housing booklets,
- preferential housing credit for natural disasters victims,
- contract saving system,

In 29th January 2002 the government approved the strategy of economic development called "Enterprise - Development - Labour. Economic Strategy of Government". According to the above mentioned document the expansion of housing construction, including social rental housing is a priority of state economic policy. Within the strategy, the government accepted the program called "Infrastructure - the key to development". The program envisages an increase in financial support for low-profit rental sector. It also anticipates an introduction of the low-interest (fixed rate) long-term credit for housing purposes.

The project of low-interest long-term credit for housing purposes is currently under consideration of the Polish Parliament. The program will cover loans for construction and purchase of dwellings as well as renovations of houses. Preferential credit duration will be up to 25 years. The role of the state is to subsidise the part of interest above fixed rate. The latter is determined at 8% now, whilst the market-driven interest rates on credits for housing purposes are between 8.5% to 12%. There is a chance to lower the interest rate on preferential credit to 7% for subsequent loans if market-driven interest rates fall. The state subsidy will lower cost of credit to the final beneficiary and make it affordable to a broader group of investors including individuals, communes, housing co-operatives and private investors. The whole program of granting preferential long-term loans will last up to 2005.

IV. Mortgage Loans

Before the transition lending for housing purposes was performed by selected state-owned or state-controlled banks, among which PKO BP (state savings bank) played a dominant role. The terms of loan agreements were stipulated in government ordinances. The last of these ordinances was adopted in 1988. The most popular product under this ordinance was a construction loan for housing co-operatives. Its term was 40 years and the interest rate was fixed at 3 or 6% (depending on the type of tenure). No downpayment was required (10 or 20% of the loan value had to be repaid in lump sum and 30% was paid by the budget). Yearly repayments were set at the level of 1 or 2% of the value of the flat. The difference between the costs to banks (plus some margin) and the interest due was covered by the budget.

One of the first transition decisions was the Act of 1989 on Restructuring Loan Agreements. It repealed administrative restrictions on loan agreements, especially with respect to interest rates. Under high inflation the banks instantly applied adjustable rates to the existing agreements. In order to make these loans repayable the state provided a mechanism of buying down part of the interest on housing loans from the budgetary resources. The support is being continued up to the present moment and constitutes a considerable burden within the housing budget (see Table 15 for budget allocations).

However, the above model of subsidised lending was not repealed completely. The government ordinances of the early 1990s introduced the system of support, in which the budget covered part of the interest on the newly granted loans. This time, however, the loans had to be collateralized by a mortgage, the amount of the loan could not exceed 80% of the property value and the effort ratio on the part of the borrower could not be less than 25% of the borrower's household's income. The policy was finally given up in 1995.

The transition brought about a great change in the way the banking sector operated. Existing banks were transformed into commercial institutions and a great number of new banks were established. The housing loan market has developed over years and now almost all commercial bank has its own credit product related to financing the housing purposes.

First mortgage loans granted on fully commercial basis (i.e. offered at market rates with no state support to the borrower) appeared as early as 1994. These were mostly dual indexed mortgages disbursed within the framework of the Mortgage Fund program. In 1992 a series of international agreements were closed between the Government of Poland and institutions like the World Bank and the US Agency for International Development, which concerned the support for the Polish housing sector. One outcome of these agreements was establishing the Mortgage Fund as a liquidity facility to fund inflation-proof mortgage loans. The objective of the Mortgage Fund program was to encourage the development of the market-based housing finance system in Poland through the implementation of suitable mortgage products, training loan officers, the setting up of a network of banks offering mortgage loans, as well as provide the banks with loan financing. The basic type of mortgage offered within the program was so called dual-indexed mortgage (DIM), a product specially designed for inflationary economies. The DIM mortgage is an adjustable mortgage built around two variable indexes; the interest due on the remaining loan balance moves with shifts in market interest rates, and the borrower's monthly payment fluctuates with wage changes. DIM is generally hard to administer and requires professional bank personnel. It also carries a considerable amount of risk for the lender, as its amortisation period is not known at the moment of origination. On the borrower side, it may prove much more expensive than mortgages of other types. The Mortgage Fund program was successful in the promotion of mortgage loans (especially DIMs, which dominated in the market for most of the 1990s) and also helped the banking sector with training the personnel.

In 1997 there was over 700 million zloty worth of housing loans offered at market rates in banks' portfolios. The majority (about 85%) were mortgage loans granted to home-buyers. Since then the sector has experienced a very dynamic growth (see Chart 4). The growth for housing loans in 2001 was primarily fuelled by demand for credits denominated in foreign currencies, which at the end of December 2001 totalled 7.0 billion zloty, having risen more than threefold over the year.

In the years 1997 – 1998 interest rates on mortgage loans remained fairly stable at the level of 25%. They have declined significantly in 1999 due to very steep decreases of central bank rates and growing competition in the market. Average rates at that time varied between 16 and 18%. In 2000 The Council of Monetary Policy raised basic interest rates twice, which implied the growth of real interest rates in capital market. Because of inflation rate fall in 2001, Central Bank decreased interest rates by 750 basis points which pulled mortgage rates down by average 500 bp. At present the market-driven interest rates on mortgage loans are between 8.5% to 12%

In 1997 the Act on Mortgage Bonds and Mortgage Banks was adopted. It introduced a German model of mortgage securitization - *Pfandbriefe*. Mortgage banks are specialised financial institutions with the right to issue mortgage bonds (*Pfandbriefe*) against the mortgages in their portfolio. Mortgage bonds, which are long-term safe capital market instruments, are supposed to provide suitable long-term financing for mortgage loans originated by mortgage banks and have positive impact on their interest and maturity.
There are currently three mortgage banks in Poland:

- HypoVereinsbank,
- Rheinhyp - BRE Bank Hipoteczny,
- Slaski Bank Hipoteczny.

Danish bank Nykredit has submitted an application to operate a mortgage bank in Poland, and PKO BP and Bank Gospodarstwa Krajowego would like to jointly open one.

In 2002 Parliament approved some legislative changes which are expected to spur the development of mortgage banks. They broadened the scope of the allowed operations as well as relaxed the parameters for credit offered by mortgage banks.

The majority of the housing loans currently offered by Polish banks are still funded with short-term deposits. It should be noted, however, that securitization will not instantly improve the affordability of mortgage financing. The spreads between rates on loans and deposits in commercial banks are still high enough to make alternative funding techniques non-competitive in final price of credit terms.

The recent development of lending for housing purposes is slowly reshaping the pattern of housing financing for individuals. Until recently housing construction was financed almost exclusively with cash (excluding subsidised loans of pre-transition years and early 1990s). In 1998 the share of credit in housing financing accounted for about 10%. In 1999 the figure has risen to 15% while in 2000 amounted to 17%. Last year the respective figure reached almost 21%.

V. Other Housing Finance Systems

Apart from the already mentioned depository and mortgage bank models of funding housing loans, there is also contract savings model functioning in Poland. Till 2001 there were two different contract savings systems established by separate legal acts. First one is the Act of October 1995, which introduced the institution of *kasa mieszkaniowa* (KM). The other was the Act of June 1997, which regulates the operation of *kasa oszczednosciowo-budowlana* (KOB), modelled on contract savings systems existing in Germany and Austria (*bausparkassen*). The KOB system did not come in operation, due to the government's initiative (supported by the central bank) to stop the licensing process until the Law of 1997 is amended. In 2001 the system of kasa oszczędnościowo-budowlana was abolished.

The KM institutions which started operations in late 1996 and in 1997, have granted insignificant numbers of loans to date. Total amount of indebtedness as of the end of September 2002 amounted to 306.5 million zlotych. At present the system of kasa mieszkaniowa tends to a gradual decline. Recent changes in tax relieves made saving for housing purposes less beneficial to users. Therefore the regulation on contractual system requires revision to make it more attractive for clients and to ensure continuity of the system as well as liquidity of banks offering this financing measure. The Ministry of Infrastructure intends to put forward a draft law which will define a new long-term savings conditions for housing purposes. It envisages that the support for savers in the new system will rely on exemption from capital gain taxation.

VI. Land and Mortgage Register

A key legal institution for the property trade in Poland is the land and mortgage books. Land and mortgage books are registers kept for each individual property by regional courts. They consist of information on the property itself (plot number, address, area, etc.) and on its legal status (i.e. its present owner, mortgages and other encumbrances or third parties rights).

The Ministry of Justice has been preparing a fundamental reform for a few years now with the main objective being to implement a modern electronic system of real property information, similar to those in Germany, Austria and Norway. The implementation of the project would include a series of coherent legislative steps as well as re-organisation of the courts and the computer system.

The new system should dramatically cut down on the time needed to register title or mortgage, thus making the market safer and accelerating property transactions. Investors and creditors will have basic property data available from the central information office without needing to obtain them from local courts. As changes will be entered promptly, the contents of electronic land and mortgage books will be more up to date and reliable than now.