



Introducing Social Rental Agencies in Hungary

An innovative housing programme

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The project “Introducing Social Rental Agencies in Hungary”, implemented by the Metropolitan Research Institute and Habitat for Humanity Hungary and funded by Open Society Institute, aims at developing a model for an affordable rental sector by utilising vacant private housing in social housing provision.

Housing privatization

The privatisation process began in the late 1980s, and accelerated after the transition, when firstly the state housing stock (19% of the total stock in 1990) was transferred to local municipalities, and secondly the sitting tenants were offered a preferential right to buy, allowing them to purchase their home for a fraction of its market price. By 2012, the number of municipal rental units shrunk to 119 thousand, of which about 103 thousand were habitable (accounting for less than 3% of the total housing stock); while people in need of, and technically qualifying for, social housing is estimated at around 400-500 thousand. (Hegedüs-Horváth, 2013)

The Great Financial Crisis and need for new approaches in housing

The need for affordable housing has only become graver in recent years due to the economic downturn following the 2008 crisis. The depreciation of the Hungarian forint increased the mortgage repayment for borrowers. The variable rate foreign currency loans accounted for 65% of the total mortgage loans; on average such loan repayments grew by 30–40%. The payment burden increased not just because of HUF’s depreciation, but also because the banks increased variable interest rates. These two developments inevitably increased the likelihood of payment arrears. (Hegedüs, 2013)

Today, according to our estimation, 25-35% of households may face serious difficulties in covering their housing related spending; and for most of these households, it is a long term and systemic issue. This phenomenon goes beyond the poorest groups, and is reaching the lower middle classes; as they are an important voter basis, addressing their problems is becoming inevitable even for popular (or populist) political forces.

Households have been losing their security of tenure due to their financial instability ever since the crisis hit in. Mortgage debts and the growth of loan payments is only one reason for this; although many of the mortgage rescue programmes were only available to middle class mortgagors, which left

the least well-off unaided. The crisis also led to a massive loss of stable jobs in Hungary and to the indebtedness of households.

Private rental sector – a missed opportunity

In the research we showed that one possibility for the government to move away from this critical point is ***the use of the private rental sector for social purposes***, which is a sustainable and cost-efficient solution for expanding the social housing sector, and over time it could even become a model for other public housing programmes.

In Hungary, a rational consumer would move into owner occupation rather than into the rental sector, because they would realize higher individual 'profit' in owner occupation. The three key reasons for this are the lack of imputed rent in Hungary's taxation system; the lack of tax incentives for potential landlords; and centrally funded subventions towards owner occupation. The housing related tax and subsidy system possibly lacks tenure neutrality in favour of ownership as a manifestation of public policy efforts aiming at developing market economy and encouraging the culture of private property. This, however, results in a heavy financial burden to lower income groups, who cannot afford home ownership, and who are not provided with a well-functioning rental sector.

The private sector is underregulated, and the legal conflict resolution system is slow, expensive and inefficient; as a result, many landlords will be discouraged from letting out their property. When private landlords rent out their apartment, they face a few major risks: (1) tenants could leave without paying the rent; (2) tenants could accumulate massive utility payment arrears; (3) the unit will be run down or damaged. Economic constraints, stemming from these legal insecurities, will drive up the rent levels in the whole sector. Based on interviews with landlords and real estate agents, we estimated the price of the risk, and we concluded that to cover their expected costs, landlords have to raise the rent level by 23% on average. Consequently, the market rent has to cover the expected return on equity (53% of the full market rent could be sufficient for this purpose only), the management cost (accounting for roughly 8% of the full market rent), the Personal Income Tax rate (16% on the rental income), and the cost of the risks (23%). We came to the conclusion that, because of the risk and the tax/subsidy disincentives, market rents are hardly affordable for the average or lower income households.

While market rent is high due to legal uncertainties and the tax/subsidy environment, the number of vacant housing units has been increasing in the last decades. The 2011 National Census found nearly half a million residential housing units. According to Census data, 6% of the total stock was vacant in 1990; this proportion increased to 9% by 2001, and then 11% by 2011, indicating a slow but constant growth. (CSO Census 1990, 2001, 2011) These facts indicate both a market failure and a state (regulation) failure, where a strong demand is unable to meet a large supply, resulting in the under-utilization of national asset. In our research we concluded that – while some of these units may be uninhabitable, remote from the job market and basic services, or simply unreported private rentals – an important part, ***up to around 150 thousand apartments***, are located in an accessible area, near the job markets, are in a decent state of repair; and with the right conditions, they could be very well utilised for rental purposes.

Proposal for Social Rental Agencies

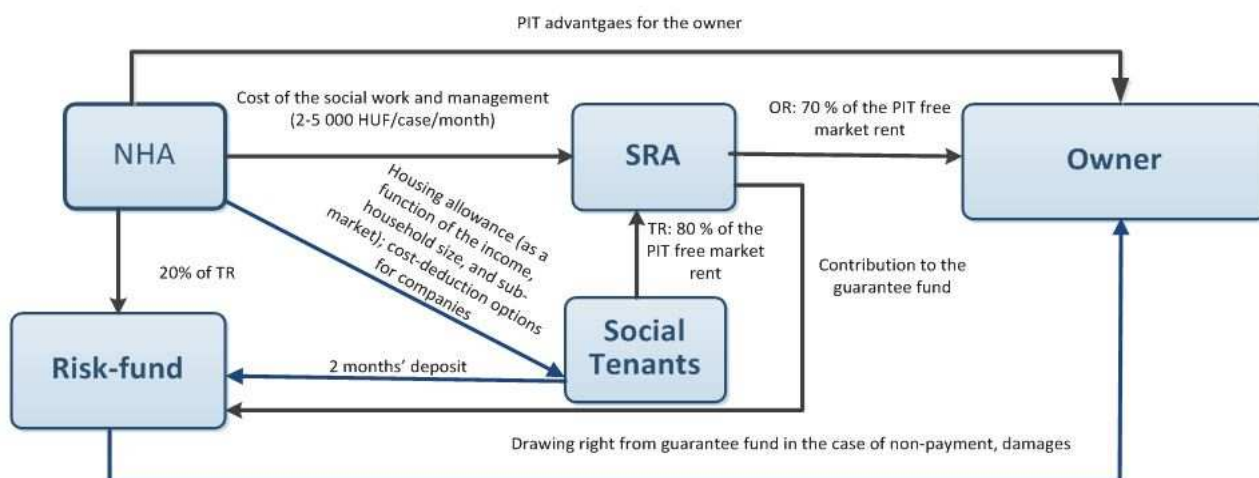
Our key idea is to propose Social Rental Agencies (SRAs) which intermediate between the potential landlords and the social renters. SRAs – functioning under the central coordination of a National Housing Agency (NHA) – offer a guaranteed, low risk arrangement to landlords. SRAs contact potential landlords who are willing to commit to a long term contract (3, 5 or 7 years, tentatively), for a rent level approximately equal to the 70% of the net rent (market rent minus PIT). In this arrangement the SRA guarantees regular rental income to the landlord, manages potential risks and amortisation in a way that the landlord's rate of return over the contractual period is still about 10% higher than it would be under individual market renting, and guarantees the preservation of the condition of the property. It is necessary, though, that the landlords contracted by the NHA are granted PIT exemption (which figures as tax expenditure in the national budget); furthermore, an amount equal to 20% of the rent level has to be provided from the national budget as a contribution to the NHA's Risk Fund (which is accounted as an outlay from the budget). The rent level to be paid by the tenant is 80% of the net market rent level. This includes the rent to be paid to the landlord, and part of the cost of the risks. On top of the 20% rent discount, the tenant will receive a housing (rent) allowance from the NHA (again, outlay from the budget) to make this rental option affordable. The tenant and the SRA have to contribute to the Risk Fund with an amount of 2 months' rent (this corresponds to the deposit). Moreover, the SRAs will be eligible for a special grant to support the social work related to the sub-groups of the tenants who require this kind of assistance. This is a special risk-sharing financial model, where the cost and risk of social housing is shared between the landlord, the local SRA, the NHA (Risk Fund) and the tenants. (See Figure .)

The financial risk-sharing model was based on the private market risk analysis. Our goal was to present all costs related to social housing in a transparent way, in order to guarantee the sustainability of the model. The costs to be covered by the central of the budget are (1) 20% of the net rent per SRA rental unit, per month; (2) social work compensation; (3) housing allowance (direct outlay from the budget); and PIT allowance (tax expenditure). Due to tax avoidance, the latter has largely been missing from state tax revenues, therefore providing PIT exemption means no real loss for the central budget; while it gives a convenient opportunity to landlords to turn their leasing activity legal without profit loss. Housing allowance depends on the income of the households, and their total housing cost (rent and utility). The main model's goal is to provide housing to households for a maximum of 40% of their total household income, where at least a modest disposable income remains with the household after covering all housing costs. Based on a model considering three income groups and three submarkets, we came to the conclusion that the average housing allowance would be 25-30% of the total housing cost (around 20 thousand HUF/month/household).

Local SRAs will be approved by the NHA; the maximum eligible rent will also be centrally set by the NHA. The operational cost of SRAs are covered by 10% of the rental income (the difference between the rent paid by the tenant and the rent paid to the landlord); and the grant for cases requiring social work input has to be covered by the central budget through the NHA. The two months' contribution to the Risk Fund has to be paid by the SRA's own sources, which gives an incentive for efficient management. The Risk Fund is managed by the NHA, and approves payments only when an SRA

proved that it has done everything that can be expected to manage the properties in order (rent collection, property control, etc.).

Figure . Financial model of the Social Rental Agencies, coordinated by a National Housing Agency (NHA)



Financial sustainability is guaranteed by the realistic cost estimates and the proper incentive structure in the model. A number of measures need to be taken to ensure organisational sustainability, namely ensuring tenant cooperation, and the appropriate protection of the property managed by the SRA. Unless the tenant is facing *force majeure* – which they should immediately indicate to the SRA – uncooperative behaviour will have to be sanctioned with a swift reaction in the form of social work and/or the intervention of a mediating agency on behalf of the SRA; and if no satisfactory agreement is reached, the SRA will have to provide a way out for the tenant, either towards the homeless provision system, or to lower quality social housing (if available).

Finally, we proposed a pilot project to test the sustainability of the model. Different institutions already expressed their interest in the program, including NGOs, and local governments. One municipality, the city of Szombathely, has already made a decision on the municipal level to introduce a pilot project following a similar model, but without the state subsidy, and only on a smaller scale (local level). Private landlords contacted by us during the research or by our project partners were open to the idea of an organisation that could take over some of their risks for a slightly reduced rental income. Furthermore, even some actors of the economic environment – financial institutions, state agencies – have expressed their support; and the introduction of Social Rental Agencies could unite these fragmented interests under a single framework. Policy makers occupying key positions have not been committed yet, but they have already realized the need for new solutions in order to create an affordable housing sector with a reliable, stable tenure form. The key question of the future role of the model is that what kind of institutional political interest can be mobilized for the introduction and for leveraging the activities of Social Rental Agencies.

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