



Trnovski pristan 2, p.p. 4717, 1127 Ljubljana, SLOVENIA
Phone: +386 1 420 13 00, fax: +386 1 420 13 30
E-mail: info@uirs.si, web: <http://www.uirs.si>



Workshop 17 - Housing Renewal and Maintenance

**Housing Privatization and Management of Privatized
Dwellings in the Czech Republic**

Martin Lux
lux@soc.cas.cz

Paper presented at the ENHR conference
"Housing in an expanding Europe:
theory, policy, participation and implementation"
Ljubljana, Slovenia
2 - 5 July 2006

Housing Privatization and Management of Privatized Dwellings in the Czech Republic

Martin Lux

*Institute of Sociology, Academy of Sciences
Jilská 1, Prague 1, Czech Republic*

*e-mail: lux@soc.cas.cz
phone: +420 22222 1655*

Introduction

Under the communist regime, housing in the Czech Republic was subject to tight state control. With the exception of family houses, the entire privately owned housing stock was nationalised; subsequently the creation of new housing cooperatives was allowed. All rents were controlled by the state. The housing production was mostly shaped by the state. As a result of the extensive housing construction programme financed from the state budget, the share of state rental flats in the total housing stock grew rapidly. The physical and aesthetic quality of these new flats was however very poor with large concrete housing estates creating a new urban landscape. The state housing policy in this period was based on the principle that a flat is such an important good in the life of a person that the increase in construction, maintenance and management costs should be not reflected in household expenditures or else in rent increases. This necessarily resulted in the continually growing volumes of state subsidies for housing construction as well as for the management and maintenance of the existing housing stock. State dwellings were allocated on local level. Despite the officially declared proclamation about the responsibility of society for ensuring housing for each single citizen, the allocation process was characterized by injustices, bribery and protectionism. In the case of state dwellings, the rent was fixed at the level of 1964 prices through a legal regulation.

The extensive, state-funded construction, management and maintenance of state rental flats were increasingly more confronted with limited resources, and therefore other types of housing construction (mainly co-operative and individual) were allowed. The “stabilisation co-operative housing construction” was organised by housing co-operatives, and the construction costs were covered using co-operative membership fees (on average approximately 18% of the total construction costs), state subsidies (on average approximately 56% of the total construction costs) and low-interest state bank credits with a 3% interest rate and 30-year maturity (on average approximately 26% of the total construction costs). However the housing cooperative system during the period of “the development of socialism” acquired an altogether different character: pre-war housing cooperatives were merged together into cooperative “giants”; the regulatory influence of the state and central authorities grew immensely; the statutes of the cooperatives became uniform by law. Differences were not tolerated, the original democratic behaviour and actions of members was, in view of the very high number of members, replaced by the actions of “delegates”. The “nationalisation” of the cooperative system resulted predominantly in the total disappearance of the original meaning of the cooperative system as “self-help” independent entities.

Individual housing construction included primarily the construction of family houses, their extensions and outbuildings and, to a limited extent, also the construction of residential

houses with individually owned flats. Individual construction was mostly funded using the resources of the constructors themselves, and was supplemented with loans provided by state banks with up to 30-year maturity and 2.7% interest rate.

Housing Conditions and Housing Policy during Transition (1990 – 2006)

Housing Construction and Housing Conditions

The revenue subsidies for existing state rental dwellings and capital subsidies for new state rental housing construction practically disappeared soon after the change of the regime; prices of construction materials were liberalized and quickly increased. Both factors led to the sharp decrease in housing construction volumes; housing construction output started to grow again since 1994, and especially since 1996 (Table 1). In the first period of transition „the market could not react in an environment of huge disparities between housing need and demand and the government was not willing to bridge the gap between the high need (but low purchasing power) of households and the sharply increased costs of housing production.“ (Sýkora 2003). This situation changed in the most developed regions (especially in the capital Prague) after 2000 when real household incomes started to rapidly grow and the ratio of prices for existing dwellings to construction prices decreased (new housing supply started to compete with the existing housing stock). The private capital became dominant in new housing supply and the share of municipal housing construction on total housing starts steadily decreased (Table 2).

Table 1: Housing construction in the Czech Republic (number of dwellings), 1990-2001

<i>Year</i>	<i>Number of dwellings</i>		
	<i>Started</i>	<i>under construction</i>	<i>Completed</i>
1990	61,004	158,840	44,594
1991	10,899	128,228	41,719
1992	8,429	97,768	36,397
1993	7,454	72,356	31,509
1994	10,964	62,117	18,162
1995	16,548	66,172	12,662
1996	22,680	74,726	14,482
1997	33,152	90,552	16,757
1998	35,027	103,191	22,183
1999	32,900	112,530	23,734
2000	32,377	118,785	25,207
2001	28,983	121,705	24,759
2002	33,606	129,609	27,292
2003	36,496	139,132	27,127
2004	39,037	146,801	32,268
2005	40,381	155,202	32,863

Note: Apartments in extensions of existing buildings, houses for the elderly with social services and those adapted from non-residential premises have been included since 1996.

Source: *Czech Statistical Office*

Table 2: The number and share of started and completed municipal housing from the total number of new dwellings in 1990-2001

<i>Year</i>	<i>Started total</i>	<i>Started municipal</i>	<i>Share of started municipal (%)</i>	<i>Finished total</i>	<i>Finished municipal</i>	<i>Share of finished municipal (%)</i>
1990	61,004	10,411	17.1	44,594	8,516	19.1
1991	10,899	1,524	14.0	41,719	9,610	23.0
1992	8,429	1,864	22.1	36,397	7,086	19.5
1993	7,454	192	2.6	31,509	6,213	19.7
1994	10,964	1,477	13.5	18,162	4,224	23.3
1995	16,548	3,015	18.2	12,662	1,689	13.3
1996	22,680	3,165	14.0	14,482	2,727	18.8
1997	33,152	4,123	12.4	16,757	2,835	16.9
1998	35,027	3,407	9.7	22,183	3,216	14.5
1999	32,900	3,246	9.9	23,734	2,925	12.3
2000	32,377	3,679	11.4	25,207	2,897	11.5
2001	28,983	2,585	8.9	24,759	2,686	10.8
2002	33,606	4,393	13.1	27,292	2,612	9.6
2003	36,496	3,782	10.4	27,127	2,605	9.6
2004	39,037	2,012	5.1	32,268	3,641	11.3
2005	40,381	1,968	5.4	32,863	2,430	8.4

Source: Czech Statistical Office

In spite of the moderate scale of house construction, due to the profound demographic changes (extremely low fertility rate) the number of permanently inhabited dwellings per 1,000 inhabitants increased from 360 in 1991 to 372 in 2001 (Table 3). There are other dwellings that serve residential purposes, but their inhabitants do not have permanent residency there. If we take all habitable dwellings (and only those that are registered as dwellings for permanent habitation without cottages or other secondary homes), the Czech Republic had 424 dwellings per 1,000 inhabitants in 2001. In comparison with other developed and transitional countries (Figure 1) this result leads to the conclusion on relative housing sufficiency; the ratio is even higher than in some “old” EU member states.

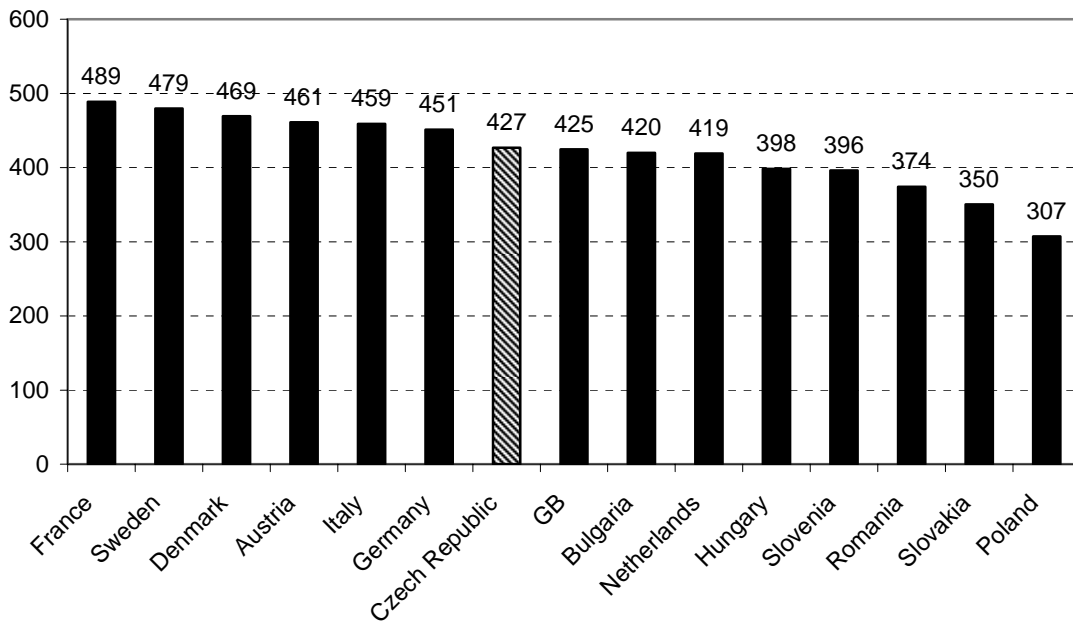
Table 3: Number of dwellings in 1991 and 2001

	<i>Number of dwellings 1991</i>	<i>Dwellings per 1000 population</i>	<i>Number of dwellings 2001</i>	<i>Dwellings per 1000 population</i>
Permanently inhabited	3,705,681	360	3,828,912	372
Inhabited (incl. temporary)	N/A.	N/A.	3,951,345	384
Habitable	4,039,738	392	4,304,084	418
Total	4,077,193	396	4,369,239	424

Note: Population in 1991 – 10,302,215, population in 2001 – 10,292,933.

Source: Czech Statistical Office, Census 1991 and Census 2001

Figure 1: Number of dwellings per 1,000 inhabitants, around 2000*



*) Note.: The majority of figures refer to the situation in 2000, for some countries they refer to the situation in 2001, for Slovenia to the situation in 2002 and for France to the situation in 1999
 Source: *Housing statistics in the European Union 2002*. CR, Slovakia, Hungary, Slovenia, Bulgaria, Romania: *www pages of national statistical offices*.

Tenure Structure Changes

The fundamental objective of the Transformation Act in the field of the cooperative housing was to increase the proprietary rights of cooperative members. Unlike municipal housing occupants, members of a cooperatives using a cooperative flats acquired the right “to sell” their flat on the open market (in fact to sell their share in housing cooperative) for a market price and particularly the right to a free transfer of a cooperative flat to their full ownership. Cooperative housing gradually became virtually part of the home-ownership sector but formally remained part of rental sector. Housing cooperative members are not considered to be full homeowners by the legislative framework and housing cooperatives are not working as Homeowners Associations (only when some flats in buildings owned by cooperatives are transferred to the exclusive ownership of members, the Homeowners Association is established).

The transitional period in the Czech Republic was and still is characterized, among others, by decentralization of power from central to local (and later on also to regional) level of public administration. The decentralization in housing policy started in 1991 with a massive transfer of 877,000 dwellings (23.5% of the dwelling stock) from state to municipal ownership. It was expected that the local governments would become the major administrators of housing policy. However, the transfer of properties was not accompanied by adequate financial means. The management and maintenance costs were, in most local governments, higher than revenues and housing became a heavy financial burden for the municipal budgets.

Many blocks of flats that had been expropriated by the communist regime have been also returned to their previous owners or their descendants by so called property restitution (mainly in the centres of the towns). Most of these transfers were accomplished by the end of 1993. There is no exact statistical data available; however, estimates say that around 7% of

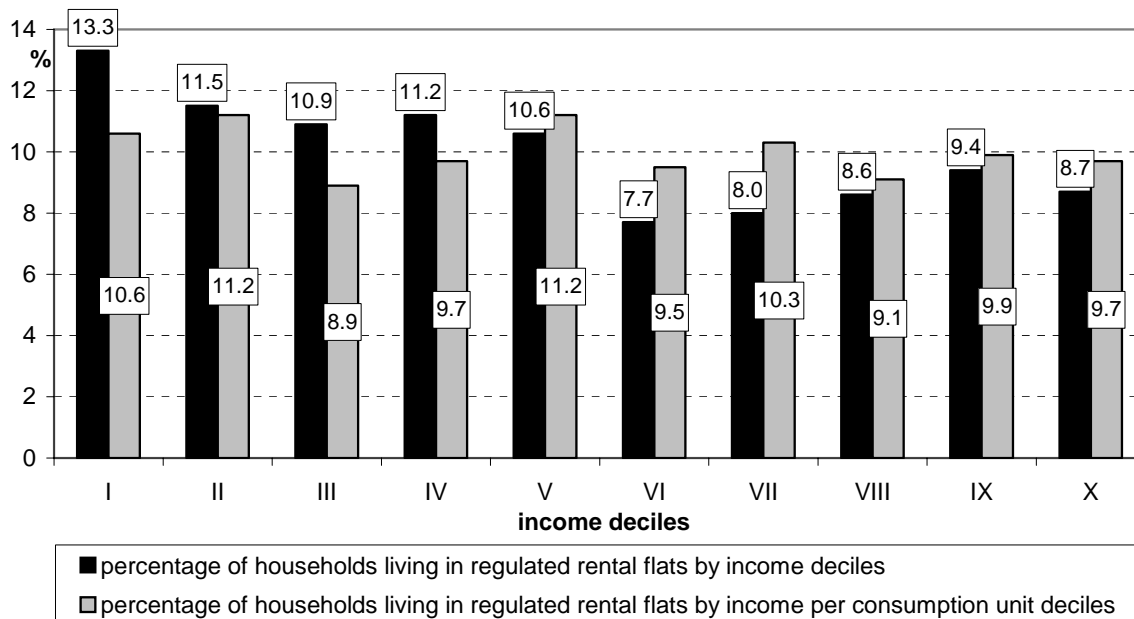
the dwelling stock was restituted to previous owners. Restitution has mostly impacted the central parts of towns and cities. For instance, in central Prague 70-75% of all houses were returned (Sýkora, Šimoničková 1994). Re-privatized houses could immediately be marketed and the process was the most important impetus for the development of a real estate market in the Czech Republic.

The central government decided to maintain the system of “old-styled” (or “first-generation”) state regulation of rents. This was applied for all running tenancies both in transferred municipal rental dwellings but also in private rental flats in houses restituted to the previous owners or their descendants. Despite of the rent regulation no revenue subsidies were introduced to cover the difference between low regulated rents and costs of maintenance. In practice a paradoxical situation arose when private owners could not even increase the rent by at least to a level sufficient for covering the necessary maintenance costs. The legislature (1993) allowed charging a market rent if the tenant was not a citizen of the Czech Republic, if the flat had been vacant before renting (new tenancy) or if a privately owned family house was rented.

The first phase of graduate rent deregulation in the Czech Republic was launched at the beginning of the 1990s. The maximum price of a monthly rent has been gradually increased in view of the quality of a flat (four categories), size of a municipality and inflation coefficient. As a result, the limits of maximum rent per m² of dwelling floor space in a 1st category flat per month increased from the original CZK 2.50 in 1991 to CZK 37.07 in 2006 in Prague, CZK 24.76 in cities with a population over 100,000, CZK 18.31 in cities with a population of more than 50,000 and less than 99,999, CZK 16.42 in towns with a population between 10,000 and 49,999 people and CZK 15.23 in towns and municipalities with a population below 10,000. In 1999 the populist government policy led to the freeze of the real rent values (rents were increased only with inflation) and after 2002 the rents were frozen both in nominal and real values. The difference between regulated and market rents remained very high even after 2002, especially in prospering cities; in Prague, regulated rents are still about three times lower than their market counterpart for the same dwelling. In most of the cities the rent revenue is still not high enough to ensure the effective management and, mainly, needed refurbishment of housing stock.

Just like other housing policy instruments, the existence of rent regulation could be justified by two reasons: inefficient functioning of a market (low housing supply and housing shortage) and/or redistribution of means toward low-income households. The existing rent regulation in the Czech Republic is, however, completely unfounded. There is no reason for such a form of state intervention for the purpose of increasing the efficiency of the housing market functioning - when we compare the values of the usually used indicators of housing stock penetration, the Czech Republic does not suffer from a housing shortage compared to the old EU countries, and the suspicion of an existence of a monopoly in private rental housing is also unjustified. Moreover, the effectiveness of the rent regulation is also very poor. Figure 2 shows the percentage of households living in the rent regulated housing sector in the total number of households in individual income deciles according to the total household income, or alternatively, household income per consumption unit.

Figure 2: The percentage of households “profiting” from regulated rent



Source: FBS 2001. N = 3,291, n = 857.

As is clear from Figure 2, rent regulation is almost equally applied to “rich” and “poor” households. As many as 10% of the wealthiest Czech households (according to income per consumption unit ranking in the 10th decile of the income distribution) live in a flat with regulated rent and this percentage is not significantly lower than among the poorest households (according to the household income per consumption unit in the 1st decile of the income distribution – 10.6 %).

The ‘possession of decree’ on a rent regulated flat has remained transferable to family members, exchangeable with some other ‘owners of the decree’ and tradable on the black market. The amendments of the Civil Code in 1991, 1992 and 1994 did not decrease the inappropriate tenant protection in the extent that would allow more efficient functioning of the sector. The judicial procedures are slow and the eviction of tenant refusing to pay the rent takes several years. Current market rents (applied for new tenancies) are above their equilibrium levels mainly due to the rent regulation itself (Lux, Sunega 2003). Thus rent regulation paradoxically decreases the financial affordability of rental housing for those that are really in social need (new households). Rent regulation is also an important factor behind the black market practices which are common and widespread in the country. Generally, many tenants who do not need their rental flats rent them out on the open market for market rents without the consent of the landlord (mostly municipality). The other form is “to sell” the right for regulated rent and protected tenancy on the open market and such “price” may be between half and two thirds of the price of the comparable dwelling in legal home-ownership.

In 2000 the Constitutional Court decided that Decree No. 176/1993 Coll. regulating the level of rent in regulated rental housing contradicts certain articles of the Charter of Basic Human Rights and Freedoms, Article 1 of the Constitution of the Czech Republic and some other superior legal regulations. It justified its decision, among other things, by the fact that the equality of entities (the landlords on the one side and the tenants on the other) had been breached and the proprietary rights of certain groups of owners had also been limited. By the Court’s decision, the Decree should have become null and void by the end of 2001 and new terms and conditions when negotiating the level of rent should have come into force as of the

beginning of 2002. However, no new Act was accepted by the Parliament up to the end of 2001 and the new Edict of the Ministry of Finance has been introduced that was again null and void by the Constitutional Court in November 2002. Since 2002 the rents are nominally frozen (depreciate in real values!) as there was no further legislation passed in the Parliament and rents could not be increased unilaterally by landlords (without the consent of the tenant). In the late months of 2005 the Parliament passed the Rent Act allowing for graduate increases in regulated rents since the beginning of 2007 (the start of the second phase of deregulation was postponed due to the elections). The goal of the Act is to increase the regulated rents to their market values till the end of 2012; however there is a justified fear that under the conditions incorporated in the Act the regulated rents will not reach their market values in that time. The private landlords and also many representatives of municipalities turned with several hundreds of charges to the European Court for Human Rights in Strasbourg and ask for the state compensation of the loss caused by the regulations. In 2006 the Constitutional Court of the Czech Republic decided that the state should compensate the losses made by regulations to landlords because it prolonged the solution of the problem for so long time.

The municipalities acquired the right to manage, rent and sell the public housing. No law gave unlimited purchase right to tenants as well as it did not set forth any method of price calculation for which the municipal council was to offer the sale of flats to the tenants (unlike the "Right to Buy" policy used in United Kingdom or in most of the CEE countries). It was entirely left to the consideration of the municipal council to determine the price and the dwelling stock for privatisation. Thanks to the chaotic course of privatisation, many municipal rental flats were, in initial stage, paradoxically "saved" from privatisation (unlike the situation in Hungary or Bulgaria) and rental housing still formed a substantial part of the Czech housing stock in 2001.

The insufficient fiscal decentralization, large inherited debt on housing maintenance, unfounded rent regulation and strong legislative tenant protection created incentives for privatization of municipal housing. Unlike in other CEE countries municipalities in the Czech Republic were not asked by the state to sell the stock but above mentioned incentives (together with the fact that privatization is generally popular among tenants and may assure better local election results) led to the acceleration of housing privatization after 2000. However, there are no figures monitoring the scale of privatization and only census results may show the difference in tenure structure. It is very probable that in few years the private rental housing will have higher share on total housing stock than municipal rental housing, due to the privatization of municipal housing. Table 4 shows the tenure structure change between census in 1991 and census in 2001.

Table 2: Changes in tenure structure, 1991-2001

<i>Tenure</i>	<i>1991¹⁾</i>	<i>1994²⁾</i>	<i>2001³⁾</i>
<i>Homeownership</i>	43,25	42,0	46,8
in own family house	40,57	40,0	35,8
in own apartment dwelling	0,80	2,0	11,0
other homeownership	1,88	-	-
<i>Rental housing</i>	56,59	57,0	46,0
cooperative housing	19,83	19,4	14,3
municipal and state housing	35,65	27,0	16,9
private rental housing	-	10,0	11,7
cooperatives of tenants	-	0,4	3,1
other rental housing (enterprise housing)	1,11	-	-
<i>Other tenure</i>	0,11	1,0	6,7
Total	100	100	100

¹⁾ Czech Statistical Office, census 3.3. 1991 (Statistical Yearbook 1993)

²⁾ Czech Statistical Office, the Survey on Housing Stock Structure (web sides of the Ministry for Regional Development, www.mmr.cz)

³⁾ Czech Statistical Office, census 3.3. 2001 (web sides of the Czech Statistical Office, www.czso.cz)

⁴⁾ The figure shows the common share of municipal/state and private rental housing on total housing stock. The more detailed tenure structure is not, however, available.

Housing Policy Changes

The Czech housing policy is institutionally based at the housing policy section of the Ministry of Regional Development (MMR). Some measures are implemented by the Ministry of Labor and Social Affairs (housing allowances) and the Ministry of Finance (rent regulation/deregulation). From the end of 2000 some programs of the state housing policy prepared by the Ministry are operated by the State Fund for Housing Development.

The state support of housing has been substantially restructured during the 1990s. The former system of housing subsidies ceased to exist and new programs have been introduced. These include the indirect financial support for housing production/purchase (support for housing savings schemes and tax relief for interests from mortgage loans) as well as the direct support for the housing production. The state subsidizes construction of new municipal rental housing, housing for the elderly and gives provisions for technical infrastructure for all kinds of housing construction. Furthermore, a number of programs aimed at the repair and modernization of prefabricated housing stock were introduced. Almost half of the state housing expenditures were directed to support the system of housing savings. Following is the brief description of some programs that may be important for financial management of privatized dwellings.

Support for housing savings is based on an Austrian and German model (*Bausparkasse*) and it was introduced in 1993 in the Czech Republic. Each citizen can deposit a certain amount to housing savings banks. On top of the interest on the savings given by the banks, the State gives a premium equal to 15% (for agreements concluded till the end of 2003 25%) of the annually deposited sum. However, the premium is given at a maximum of CZK 3,000 (for agreements concluded till the end of 2003 CZK 4,500) per year (equal to EUR 110). If someone wants to use the housing savings system only for the purpose of savings, he/she must keep saving for the minimum period of six years to have a right for the state support. However, he/she may continue to save even after this minimum saving period and has still the right for the originally applied state premium. If someone wants to take a loan, he/she must save for the minimum period of two years and became qualified (according to the internal rules of the bank) for the loan; the main condition is to save 90% (sometimes 100%) of the loan value. The interest on savings (including

state premium) is tax-free, the credit (which may be equal in value to the savings amount) is available at low interest and the interest can be deducted from income tax base under same conditions as the interest on mortgage loans. Loans can be used for the purchase, construction or reconstruction of housing. If the person does not apply for the loan the savings (together with the state premiums) could be used for any purpose.

The system of housing savings played very important role at the beginning of transition when mortgages were not introduced and/or unaffordable for most of the population. The annual inflation was high and the standard fixed interest rate on housing loan from the scheme equal to 6% p.a. in that time was very advantageous. However, in current days (2006) several banks provide the mortgage loans and the average nominal mortgage interest rate is around 4% p.a. (for five years fixed rate). The support for housing savings became the most expensive program of state housing policy: in 2005 the state (via the Ministry of Finance) spent CZK 15 bln. (EUR 550 mil.) on savings premiums (more than half of all state housing expenditures). The program was reformed in 2003 but its generosity and inefficient targeting is still criticized. The generous state premium that does not reflect current low inflation rate makes housing savings scheme one of the most profitable almost zero-risk deposit. It is sometimes argued that the whole program is not a part of housing policy but it is more a general state support for household savings.

Program for the housing stock modernization (loans to municipal housing funds) was introduced in 1994 to support the reconstruction and modernization of dilapidated housing stock. Another program objective is to initiate the foundation of local funds aimed at the modernization of housing stock within towns. To be eligible for subsidy, the local authority must establish a municipal housing fund to which the Fund may contribute a low-interest loan (with maturity of 10 years). Aside from the modernization of local authority apartment buildings, this fund must provide loans on housing modernization to private owners of housing stock. A minimum of 20% has to be allocated to private owners. This form of state support is usually perceived as very efficient as it allows for a combination of several sources and creates incentives to pass the local housing policy strategies (one of conditions to receive low-interest loan). From 2001, the State Fund for Housing Development has managed this program and the loans are provided at a 3% interest rate.

Program for repairs of housing stock (prefabricated housing defects) intended to help with necessary repairs of the most urgent technical defects that may cause emergencies in houses built with the use of prefabricated panel technology. Support may be provided to all owners of prefabricated buildings, i.e. local authorities, housing cooperatives, homeowners associations, private firms and individuals. The program was announced in 1997 and first subsidies were allocated from the state budget in 1999. It is implemented in the form of a grant, which may not exceed 40% of the budgeted costs and the amount of CZK 45,000 (EUR 1,600) per dwelling in the building. In average, the subsidy covered around 32% of expected repair costs.

Program for repairs of prefabricated housing (modernization and reconstruction, PANEL) should help owners of prefabricated buildings (municipalities, housing cooperatives, homeowners associations, private landlords) with access to financial sources from commercial banks for repair, reconstruction and modernization needs. The support is provided in the form of an interest subsidy and/or state guarantee to commercial mortgage loans. The interest subsidy is equal to 4 percentage points with maximum of real loan interest rate (e.g. if interest on mortgage loan is 3.5%, the interest subsidy is equal to 3.5 percentage points). Due to the low interest rates this subsidy allows to eligible persons to take, in fact, interest-free loan. The

subsidy is allocated only on the loan value (or its part) with maximum of CZK 4,800 (EUR 170) per m² floor area of dwelling in the house designated for refurbishment. The state guarantee on commercial mortgage loans is offered for 70% of outstanding loan value. The support is administered by the State Fund for Housing Development, the guarantee is provided by the Czech Guarantee and Development Bank.

Program for regeneration of housing estates started in 2000. It provides subsidies to municipalities with prefab housing estates (minimum of 150 dwellings) and can cover (in the form of grant) up to 70% of the costs in the field of transport and technical infrastructure and the regeneration of public spaces in housing estates. The necessary condition for the allocation of such subsidies is a prepared project of housing estate regeneration and the tenant opinion survey.

All subsidies for refurbishment of prefab housing and regeneration of prefab housing estates were allocated as “subsidies *de minimis*” in 2005 as they might breach the rule on free access to public subsidies to all entities (for subsidies *de minimis* there is a ceiling for maximum amount of subsidy – EUR 100,000). This limit was quite restrictive, mainly for large housing owners. The consultations with the European Commission and decision of the European Parliament led to the conclusion that these subsidies may be increased and will not be viewed as subsidies *de minimis* further on.

Neither social housing nor non-for-profit housing associations were legally defined in the Czech Republic. The government however started to **support new municipal rental housing construction** since 1995 through total subsidies amounting, a bit later on, to CZK 400.000 per new dwelling (EUR 14,200 in current value; about one third to one quarter of average dwelling construction costs). The housing output following from this program equals to total of about 62,000 housing starts between 1995 and 2002. Due to the fact that there were no bidding cost or income ceilings (targeting) for dwelling allocation and mainly the fact that the program has been transformed in a way that allowed speculation and abuse, it was highly criticized and, finally, largely amended in 2003. The original program allowed for creation of housing cooperatives (some form of PPP) between municipality and participants (future “tenants”): a municipality, with the help of commercial developer, often only secured the state subsidies and remaining costs of house development were covered from down-payments of future “tenants” and commercial mortgage loans. Though the right to buy was allowed only after 20 years from the year of completion, the share in housing cooperatives could be liquidated under valid legislation immediately. Many cooperative flats constructed from this PPP were therefore soon sold or rented out by participants profiting from state subsidies; moreover, some of flats were constructed only as a secondary homes and some as luxurious dwellings. Since 2003 the cooperative form is forbidden, cost and income ceilings were introduced; on the second side the subsidy was increased to the maximum of CZK 630.000 (EUR 22,500) per dwelling. The abuse of the original system was criticized by the National Control Office in 2005 and it went out that also high political representatives were engaged in the program.

Housing Privatization

The Act on Ownership of Apartments and Non-Residential Premises, approved by the Parliament in 1994 (Act 72/1994), offered the possibility of division of apartment house into separate housing units and common area (condominium) and thus allowed for selling individual dwellings in an apartment building. According to the legislation applied until 1994 (based on the Civil Code and the Act 52/1966 passed in 1996) the apartment houses could be

privatized to the ownership of tenants only if all the dwellings in the house are sold. The new Act defined the shared ownership of the apartment house with separate ownership of apartments (or non-residential premises), often called as condominium form, and included, though only vague, shared responsibilities of home-owners for management of communally used functions and spaces of the building, such as the roof, stairs or elevator. Private and public rental housing, as well as cooperative housing, could be transformed into homeowners associations (condominiums) since then.

Before the approval of the new Act it was only possible to sell the whole residential buildings; in the case of privatization of municipal housing the building was sold usually to a housing cooperative formed by tenants. When some tenants in the building were not interested in buying their flats, the sale could be difficult as those willing to buy had to pay also for those who were not interested in a purchase. Since 1994, municipalities can thus also privatize individual apartments and if tenant decided not to buy a flat, he/she may continue to live in municipal rental tenure. Thus “mixed ownership” (municipality together with individual home-owners) became common in many cities.

This Act gave municipalities also a possibility to hold non-residential commercial premises in privatized building. As the rent for commercial premises is not regulated by the state (unlike rent in residential housing for running tenancies), the municipalities often tried to keep the commercial premises for themselves. This is a rational policy from the point of view of municipality but this also means that new homeowners associations could not use the rent from commercial premises in their buildings by themselves.

The Czech municipalities can freely decide on the scale, price conditions and form of privatization of municipal housing. Therefore, different models of privatization have been applied with various outcomes. Most towns prefer sales of individual flats, however, large cities, such as Prague and Brno prefer sales of entire residential buildings. There are municipalities that have sold most of their housing and, on the other hand, municipalities that have not privatized at all.

The decentralization of power in this field was substantial. For example the capital Prague (with population of 1,169,000 of inhabitants) is divided into 22 administrative districts and 57 independent municipalities. Each of 57 municipalities has its own elected council, board and mayor. The Act 172/1991 transferred the original state housing stock free-of-charge to the ownership of the capital City of Prague. But based on the Act on the Capital City of Prague and Status of the Capital City of Prague, the overwhelming majority of the housing stock is managed independently by „municipalities” (they decide on privatization, rent setting, allocation criteria, etc.). There are, therefore, a wide variety of privatization approaches within the city. Some municipalities (e.g. Prague – Řepy) decided not to privatize even one dwelling, others (Prague 1) decided to privatize almost all public housing stock.

Privatization of municipal housing is an important strategy in local housing policy. Some municipalities intend to stimulate the development of a local housing market. “Selling part of the housing stock owned by the Brno municipality can help the creation of a market” is, for instance, stated in the General Housing Plan of Brno (Lahoda, et al. 1999). Some towns expect better care for property that is under owner-occupation that would contribute to an overall urban revitalization. While municipalities do not have sufficient financial sources for reconstruction, through privatization they can transfer this responsibility, as well as privilege, to new owners whom are expected to be better owners than the public administrators.

Through privatization, municipalities obtain funds that may be used for the reconstruction of the housing that remains in municipal ownership. They usually set the amount and structure of apartments for sale and/or apartments that should be kept in municipal hands. However, the regular research of ÚÚR (see below) shows that probably larger part of the funds gained in privatization is used for other than housing purposes. As a part of decentralization policy, there is no central rule on how to use the income from housing privatization.

Municipalities usually privatize housing only by offering it to sitting tenants. There are also local governments that offer dwellings for sale to third parties, provided that the current tenants are not interested in the privatization. The housing is usually offered for a discounted price. At the beginning of transition the flats were sold for extremely low prices (often for 1/10 of market price). In the course of transition the bid prices generally increased. However, the flats are still sold deeply under their market values, often for no more than half of market values. The discount can vary between different types of housing. In Prague, for instance, higher discounts are given for prefabricated housing and lower ones for brick buildings (Eskinasi 1995). In some cities the bid price did not increase in time and remained very low (for example Ústí n. Labem), while in other it did increase substantially (for example in Prague).

However, the total precise statistics on scale, forms of privatization or price discounts is missing. The municipalities are not obliged to provide any information to the central administration or to the Czech Statistical Office. The surveys represent thus the only source of information. The Institute for Land Development (UÚR) realizes the regular surveys among selected 50 Czech cities and in large cities (Prague, Brno, Ostrava, Plzeň and Ústí n. Labem) they survey additionally several small municipalities that are free to dispose with municipal housing (quarters); altogether they send the questionnaire to 114 municipalities. The respondents are informed representatives of municipalities. According to the results from this non-representative survey, 39.5% of original municipal dwellings was privatized till 2000, 45.2% till 2001 and 51.2% till 2002. The municipalities very probably own less than half of housing transferred from the state ownership into their hands at the beginning of transition now. When comparing the speed and scale of privatization in selected large cities, the highest speed of privatization was in the West and North of Bohemia (cities like Ústí n. Labem, Plzeň), while in the Central Bohemia (Prague) and in Moravia (Eastern part of the Czech Republic with cities like Brno and Ostrava) the scale and speed of privatization were significantly lower. According to the results from the survey the municipalities intend to keep only 29.5% of original municipal housing (transferred in 1991) and therefore the privatization of municipal housing should continue in the future.

Another source may be the Local Government and Housing Survey (LGHS) conducted by the Department of Social Geography of the Charles University among all municipalities with population above 5,000 inhabitants in 2001 (currently the results could be different). From the respondents of the survey, nearly all municipalities have been involved in privatization of municipal housing. Nearly one quarter of the municipalities had already finished with their sales while over 70% of the local governments intend to continue with privatization in the future. Nearly half of the Czech municipalities used both ways of privatization: selling whole buildings to cooperative of tenants and selling individual dwellings and establishing homeowners association. As the sale of individual dwellings could be realized only since the mid-1990s there may be municipalities that started earlier with sales of whole buildings and later continued with the sales of individual flats. On average, municipalities have sold 41.5% of their original housing stock in 2001. However, there are huge differences between local governments: 6.8% of the municipalities have not privatized a single unit yet. Larger towns

and cities usually privatized a substantial share of their housing but at the same time keep a sizable part in their ownership.

Housing Management

According to LGHS, two thirds of municipalities managed housing in their ownership by themselves or through public organizations or private firms established, owned and fully controlled by municipal office. The housing stock in 22.5 % of municipalities is managed only by private firms. Usually it is just one firm (16.9 %) and in 5.6 % of cases more firms. In 12.4 % of municipalities, housing management is divided between two or more types of organizations. This is namely the case of large cities, where the responsibility for the management is decentralized to a number of small municipalities and each of them has its own structure for housing management (especially Prague and Brno). The share of dwellings managed by private firms was much higher than the share of municipalities that use private firms for municipal housing management – in total 67 % of municipal dwellings were managed by private firms.

The property management is by many municipalities realized in an *ad hoc* manner of day-to-day care solving emergency issues. Some municipalities attempt to organize certain regular and structured base for property management that would involve for instance, regular inspection of the physical state of buildings. More advanced methods, such as a strategic portfolio management, usually are not known, not spoken about and not practiced.

The Act on Ownership of Apartments and Non-Residential Premises (Act No. 72/1994), that allowed creating a condominium form (homeowners association) in privatized apartment houses, was amended several times (in 1994, 1996, 1999, 2000, twice in 2001, 2003 and 2005). The amendments in 2000 and 2001 were substantial ones. The number of amendments shows how fragile the legislative framework that deals with the management of condominiums was. The main reason for legislative changes was the inappropriate framework for the effective management of newly established Homeowners Associations. The original Act in 1994 did not even include a duty to establish a separate legal person after the privatization of individual housing units. The form of management of building and even the fact whether any kind of management of the house will appear was completely left on the will of new homeowners. The Act lacked the regulations how to make a common decisions among homeowners, regulations specifying who will represent them with the third parties and what are the possibilities when full consensus among homeowners concerning management or modernization of the house may not be achieved. The Act did not presuppose that municipalities would start to use it as a main legislative framework for further public housing privatization and that condominium form would expand. The authors of the Act assumed that municipalities will continue in privatization in the original way – by selling the whole buildings into the ownership of the cooperative of tenants. The consequences of the incomplete legislative framework to the management of houses after the privatization were really significant – the management of many privatized houses was missing, the achievement of the agreement among homeowners was very difficult, there were no legal ways how to act against “free-riders” or those who breach the effective management or are in arrears. There was therefore a need for substantial amendment of the Act.

This amendment came with the Act No. 103/2000 (passed in 2000) that firstly defined a duty to establish (by a notary deed) a separate legal person – the Homeowners Association – and register it in the Business Register, if there are more than five housing units in the building

and if there are more than two different homeowners in the building. The Homeowners Association is not, however, established by its registration but automatically *ex lege* when the third different homeowner in the privatized house is registered as a new dwelling owner in the Cadastre Register. Though in such case (registration of the third different homeowner in one building in the Cadastre Register) the homeowners were obliged to establish the Association also formally, the Act did not state any term or sanctions if this does not happen. The Act also did not specify the duty of previous house (building) owner to effectively help with the establishment of the Association. Thus, new homeowners remained often inactive for several years and the problem with the lack of effective house management remained. Moreover, by registration in the Business Register the Associations started to be perceived as business firms and therefore had to register in the Tax Office and pay income taxes. Another unintended consequence of the registration was that homeowners started to be responsible for the liabilities of the Association by their full wealth (and not only in a limit of the value of the dwelling together with the value of ideal share on common areas of the house), and therefore homeowners could lose not only the owned dwellings, but also other households' wealth and properties in case of the Association insolvency. The next amendment of the Act in 2001 removed the problem with tax registration and income tax payment but it did not set forth other needed amendments concerning a duty to establish the Association formally in a due time or obligatory participation of original house owner on the establishment of the Association.

After homeowners establish the association formally (by notary deed, approval of the Charter, election of the Board and registration in the Business Register) they should conclude new agreements with service, utility and energy companies, insurance agreement, select the form of house management, establish the banking account and decide on the level of contribution made by all home-owners regularly to the fund for repairs and modernization. According to the Act No. 103/2000 the Assembly of Homeowners is the main body of the Association and it consists of all homeowners in the building. Each homeowner has the right to vote on the meetings of the Assembly according to his/her ownership share on the house – the size of share is generally computed as a portion of the total floor area of his/her dwelling on the sum of total floor areas of all homeowners (or owners of commercial premises) in the building. In general, the Assembly may pass the resolutions if half of homeowners is present on the meeting (more exactly, homeowners having more than half of shares) and for the approval of resolution the simple majority of present homeowners is needed (if the Charter of the Associations does not state something else). However, the Act explicitly defined that in the case of change of some parts of the Association Charter the $\frac{3}{4}$ quorum of all homeowners would be needed and in the case of resolution on actions connected with modernization, refurbishment, and reconstruction (mostly interpreted as “substantial” ones) and/or in the case of taking a loan the full consensus among all homeowners must be achieved. As this has shown to be a too restrictive and ineffective regulation (many homeowners were not permanently living in their flats and/or one homeowner could block the actions agreed by all other homeowners in the Association), the full consensus in the case of modernization and/or reconstruction of the house was replaced by $\frac{3}{4}$ quorum of all homeowners in the last amendment of the Act in 2000 (the Act No. 171/2005). The problem that new homeowners often hesitate to establish the Association formally though it was *de iure* already established however remained up to now. The parts in the Act that deals with the power of homeowners to act against free-riders and homeowners in arrears remained unclear and inconsistent.

The government prepared a new Act that should replace completely the original Act No. 72/1994 and all its later amendments. The proposal of this new Act is currently discussed in

the Parliament but it is expected that it will not be passed before new parliamentary elections in June 2006. This proposal already clearly states that the Association is established by the registration in the Business Register (and not *ex lege*, as it is now) and the Cadastre Office will refuse to register the third different homeowner in one building as a new owner if the Homeowners Association is not already established (i.e. registered in the Business Register). The Act provides also a duty that the Association has to be formally established (by registration) in the term of 60 days from the registration of the second different homeowner in the Cadastre Register. The original house (building) owner will get a duty to provide effective help with the establishment of the Association. The powers and management commitments of the Association and its Board are more clearly specified and thus provide a direct instructions what and how should be defined and stated in the Association Charter. The new proposal strengthens the legal power of the Association in the actions against homeowners in arrears as well as the legal powers of homeowners against illegal actions of the Board or illegal decisions of the Assembly. The proposal also clearly defines that homeowners are responsible for liabilities of the Association only to the limit of the value of the owned dwelling and value of their share on common areas of the house.

However, even the new proposed Act does not explicitly state that homeowners are personally responsible for the management of common areas and therefore many of them may continue “to behave as tenants” and use the current “tricks” how to avoid any prosecution (for example, by saying that they were not well informed). Moreover, any judicial process in the Czech Republic is very long (often criticized by international human rights organizations and the European Court on Human Rights in Strasburg) and costly. Though the Association has the right to prosecute those homeowners that are in arrears with payments of contribution to the fund for repairs and modernization or for utilities (and, in extreme case, to ask the court to seize the dwelling), there are different legal possibilities how to drag out the whole process and avoid from the responsibilities. According to some comments, the Act should explicitly state that people must regularly study notices on notice boards in the building and all information presented there should be perceived as accessible to all homeowners.

On the second side, the instability may arise (though we do not have any particular knowledge about its occurrence in practice), when big investors (with high share in the association) want to proceed some action that is against the interest of other homeowners in the building. As the Assembly votes by simple majority on the level of the contribution to the fund for repairs and modernization, the big investor may vote out other homeowners with unrealistically high contributions. In this way he may get the control under the sale conditions of other dwellings in the building. In such a case the homeowners may turn to the court but the decision of the court may not be estimated (the law does not state any reference for the court in this case).

Though the management of the house is often realized by the special private management company hired by the association (according to the resolution of the Assembly), many decisions and activities remain on the members of the Board and especially of the chairman of the Board. Such work assumes quite a lot of time, professionalism (at least to know well a legal framework) and enthusiasm. In many cases to find such a person in the house is very difficult and even if there is someone willing to do it, he/she stops after some time. The “condominium” structure therefore remains unstable (in both directions) and this instability is more general and not only the consequence of not appropriate legal framework. The final result therefore very much depends on the fact whether there are or not problematic households among new homeowners. Due to the fact that dwellings were privatized for low prices, many households, who would not become homeowners under standard market

conditions, are homeowners now. This is a real challenge for the management of condos in the Czech Republic.

Case study – Homeowners Association in Prague

The building used in this case study is situated in the historical centre of Prague and consists of 20 apartments and 3 commercial premises with total floor area (without common areas) of 2,218 m². It was constructed in 1780s as a building to house poorer people; original average floor area of flats was about 30 m² with shared bath and toilets on the back porches. Though it reflected the standards of 18th and 19th century, it did not correspond to the norms and standards of 20th century. However, the modernization of the house, especially during the communism, went very slowly – during 40 years of communistic rule when the building was in state ownership there were only three bigger investment actions: repair and modernization of electricity distribution, installation of gas distribution and complete repair of the roof. As it was common during this regime, the quality of provided work was very low and the roof is in a need of further repair again. Though the house is placed in the attractive part of Prague, the quality of living (often with separate bathroom in the corridor and local heating) was not, in that time, attractive for the most of the people who preferred to live in reconstructed houses further from the town center or in new prefab housing on housing estates. The originally low attractiveness of the house predetermined the structure of its inhabitants.

Some inhabitants of the house (tenants of state flats in that time) made several construction improvements and changes in used dwelling by themselves and many such actions were done without the permission of the state management company and building office (so called “black constructions”). Whether legally or not, by merging several flats some dwellings became larger (some of them has a total floor area even 100 m² now), the tenants constructed and installed new bathrooms and toilets inside of their dwellings (or linked the existing bathrooms exclusively to their dwellings) and they converged former local heating (separate in each room) into central gas heating (some of them into electricity heating). Though some flats were in this way well modernized and reconstructed, there was a huge debt on maintenance of common areas (including windows, façade, etc.) in 1989 when the former regime collapsed. Moreover, the former open court inside of the building was covered with ugly roof to serve as a store for the provider of the shop in one of the commercial premises.

Even after the change of the regime the new owner – the city of Prague or, more precisely, the quarter of Prague 1 with exclusive rights to dispose with the house – invested only marginal amount of the sources to the upgrading of the house; the most of the expenditures went only to adjust the statics of the house eroded by the tram transport. The housing preferences started to change in that time and the town centre became much more attractive than before. The exclusive address in the centre of the capital made possible to charge higher rents for commercial premises in the house and there was also some, though slow, rent deregulation for residential housing during 1990s. None of this fact helped to better house maintenance and the municipality used the increased income from the house in “not-known” areas. The attractive location made possible to provide under-roof space for new house construction to those people, who would promise to spend additional sources on house repairs – two new rental flats were finally constructed in the under-roof space of the house during the second part of 1990s and basic repair of corridors (plastering and painting) was realized - both actions (construction of flats and repair of common areas) were, however, again not financed by municipality but by future tenants of the flats (who could discount their costs from their future rents). Finally, the municipality promised to built the lift in the house in late 1990s but flood

in 2002 and the start of house privatization caused that this promise remained only as a promise (though the building office issued a building permission already).

The municipality of Prague 1 decided to sell almost all municipal dwellings to tenants in 1998 and to use exclusively the privatization form of selling of individual apartments (Act 72/1994 with later amendments). The reason was that in this way they could keep the commercial premises for themselves and thus save the rental income stream from commercial premises for municipal budgets. However, future homeowners were cut off from very attractive rental incomes. This way of privatization opened also the possibility of “mixed house ownership” or, more precisely, allowed staying as a municipal tenant, if the household was not interested in purchasing the flat (up to now, three tenants in the house decided not to purchase their flats). The price for dwellings was determined as a “market” price based on the decree of Ministry of Finance in 1998. In fact, in the time when privatization of the house started (2003) the real market price of dwellings was twice or even four times higher than the price tenants had to pay. Moreover, tenants received a discount of 10 % from this price if the full price was paid immediately and not in the installments. The income from house privatization was grinded in different areas and nothing came back from municipality to new homeowners in the house (unlike in some other cities there was no special municipal fund where the income from privatization would be concentrated and used, for example, also as qualified loans or grants to the new Homeowners Associations). The privatization was accompanied by several scandals, non-transparency and black market practices.

The Homeowners Association in this house was *ex lege* established already in 2003 but the formal establishment of the Association (its registration) took place two years later – in 2005. The municipality provided the help with the establishment of the Association by calling of new homeowners, preparing the proposal of the Charter and arrangement of notary deed for the first meeting of the Assembly where the Board was elected. Due to the high ownership share of municipality, the representative of the municipality was also elected as a member of the Board. The Board then arranged for the registration of the Association in the Business Register, new agreements with service companies, the insurance agreement and due to the negative past experience concluded an agreement with new management company that should mainly secure the accounting of the Association and allocation of payments on utilities among individual homeowners. This all was a subject to the voting on the first regular meeting of the Association.

From the very beginning it became clear that many new homeowners are low-income households (tenants from periods when the center of Prague was due to low housing quality unattractive) and in old age. One problematic household that was in rent arrears staid as a municipal tenant and in this way the Association was “saved” from at least on significant problem and the arrears remained the problem of municipality as a landlord. However, former tenants were accustomed to pay a low regulated rent (reflecting original low housing quality) and effective contributions to the fund for repairs would have to be higher than this rent. Due to the fact that the tenants paid the privatization price (for low-income households it might be a high price) and that about half of new homeowners were already retired the will to set the contributions to the repair fund on higher levels than previous regulated rents was low. On the second side there was a huge debt on maintenance of the common areas and the acute need for the repairs and house modernization. This was a real challenge for the members of the Board but the chairman of the Board did not have any past experience with house management.

The chairman and the Board therefore decided for the strategy that it is known from politics as the strategy of “sugar and whip”. In close cooperation with municipality they started to arrange for the possible grants on house modernization in the future (mainly he renewed the discussion on the possible grant to finance the lift in the house from the Municipal Housing Fund) and the chairman asked the municipality for the payment of the lost rental income from the store located in the house court that was also transferred to the Homeowners Association as common area (for the period from the establishment of the Association *ex lege* to the time of its formal establishment). In the same time the chairman of the Association concluded a new rental agreement on this court, but already on higher “market” rent. These actions finished with the first significant financial contribution to the newly established fund for repairs and modernization and somewhat more real chance to obtain a municipal grant for the installation of the lift in the house. There were not many other possibilities to find additional income or grant for the Association because state grants and loans for refurbishment of pre-fab housing could not be used in this case. Moreover, it was clear, that at this point, when the Association was just established, it is not realistic to expect that people will agree with the proposal to take a commercial loan on house refurbishment.

The chairman then organized a pre-meeting with all existing and future homeowners where he presented the outcome of up-to-date work and where could show that he is able to find financial sources for house modernization next to the regular contributions from new homeowners – this increased his ability and prestige in the eyes of existing or future homeowners endangered originally by its lack of experience. Next to it he opened the discussion on the house quality problems and, as expected, the participants started to enumerate many problems connected with the insufficient house management in the past. The chairman used the increased prestige and following discussion as the tools how to convince the participants that the contributions to the repair fund have to be substantial (i.e. higher than the original regulated rent for their dwellings) to finalize all the needed changes. He suggested the relatively high level of contribution (that is, according to the law, computed from the floor area of each dwelling) and though the strong opposition to this level of contribution from some participants appeared in that time the meeting was already at a stage when even those in opposition could not simply reject it. The following long discussion did not finish in the full consensus and mostly retired older people went home unsatisfied. The chairman offered everyone to visit him and discuss this problem further on and set the date for the official meeting of the Assembly.

During the next several weeks the people unsatisfied with the proposed level of contribution visited the chairman in his flat to express their dissatisfaction. The chairman listened to them carefully and then explained them the difference between regulated and market rents, showed them planned investment actions in the house and their planned costs as well as profits that such changes could give them and he tried to explain them that such actions have to be made to protect the value of their dwellings. These long face-to-face individual discussions have shown to be crucial. When such discussions proceed on common meetings, there is always a danger of “mass behaviour” and/or winners from such discussions are often those with loud voice than those with the best argument. To open a possibility to discuss this “hot” issue separately with all committed home-owners has shown to be a major condition of final success. During the later official meeting of the Assembly the proposed high level of contribution to the fund was agreed by all present homeowners (by full consensus) without any further discussion or comments. Though at least in one case other family members must help the poorer older women with the payment of her contribution, the experience was that

even low-income households can find a consensus on the payment of efficiently high contribution to the fund for repairs and maintenance.

The “mixed ownership” of the house (some inhabitants remained as municipal tenants and municipality has, together with commercial premises, still the highest ownership share in the house) has shown to be as an advantage for the Association as it does not have to solve the problem with arrears of the problematic tenant and may have some preferential access to potential municipal grants in the future. At least it has up-to-date reliable information stream from the representative of municipality who is the member of the Board. The Association started to collect the contribution from new homeowners in October 2005 and the first larger investment actions (agreed on the second meeting of the Assembly in January 2006) will take place already in 2006. According to the plan, the house should be completely refurbished in the next five years and the Association will not need to take a commercial loan for this purpose.

The aim of this case study was to show how careful management behaviour of the chairman of the Board may solve the problems that other homeowners association face – a low willingness of low-income home-owners to pay an efficient contribution for the refurbishment of the house. Many gaps in legislative framework and seemingly unsolvable problems may be overcome by committed work of the chairman. However, the slow judicial proceedings and many possibilities how to obstruct the effective house management remain a real problem everywhere where some homeowners do not understand the ownership title as the responsibility to the owned property.

References

- Sýkora, L. 2003. *Between the State and the Market: Local Government and Housing in the Czech Republic*. In Lux, M. (ed.) *Housing Policy: an End or a New Beginning*. Budapest: LGI-OSI.
- Sýkora, L., Šimoničková I. 1994. *From totalitarian urban managerialism to a liberalized real estate market: Prague transformation in the early 1990s*. In Barlow, M., Dostál, P., Hampl, M. (eds.) *Development and Administration of Prague*. Amsterdam: University of Amsterdam.
- Lux, M., Sunega, P. 2003. Modelování rovnovážné úrovně nájemného a důsledků aplikace vybraných nástrojů bytové politiky (Modelling of equilibrium rent and consequences of housing policy tools introduction), *Finance a úvěr* 53: 31 – 59.
- Lahoda et al. 1999. *General města Brna* (General of the City of Brno). Brno: City of Brno.
- Eskinasi, M. 1995. Changing housing policy and its consequences: the Prague case, *Housing Studies* 10: 553-548.