European Network for Housing Research

Housing finance beyond individual mortgages – how to finance new forms of affordable housing in Eastern Europe?

Zsuzsanna Pósfai
GEOFIN Research, Department of Geography, Trinity College Dublin, Ireland
Periféria Policy and Research Center, Budapest, Hungary
e-mail: psfaiz@tcd.ie

Abstract

Crisis periods shed light on the vulnerability of conventional forms of housing finance; especially in (semi)peripheral economies such as Hungary and Eastern Europe more generally. The 2008 crisis led to dramatic housing instability in the region, especially through mortgages denominated in foreign currencies. The housing market effects of the current, Covid-19 induced economic crisis are yet to unfold, but it will surely bring a reorganization in the field of housing finance. As the pool of individuals eligible for a mortgage decreases due to income uncertainties, financial institutions may become more interested in experimenting with new forms of financing organizations engaged in the development of sustainable and affordable housing.

In my paper I will explore the potential of cooperative and collaborative housing to even out the volatility and risk of conventional forms of housing finance, and thus become a way of responding to uncertainty and displacement in urban housing markets. In the meantime, cooperative housing also allows new social groups – previously excluded from homeownership – to access stable, long-term housing through limited capital contributions. Beyond social aspects, the financial strengthening of new housing organizations will also facilitate the environmental sustainability of residential buildings.

The establishment of such forms of housing requires pioneering financial actors. I will explore under what conditions these innovative forms of housing finance can develop, and what is needed for them to scale up beyond a few pilot projects. Beyond academic evidence, I will base my discussion on experience I have gained in negotiating such innovative financial mechanisms for housing cooperatives in Hungary, as well as on the work done in MOBA Housing Network, which aspires to become a financial intermediary for new cooperative housing initiatives in the Eastern and South-Eastern European region.

Keywords: housing cooperatives, Eastern and South-Eastern Europe, social and sustainable finance

Introduction

This paper aims to be both an analysis of the limitations of the current housing finance system, and of the possibilities for the development of new forms of housing finance in the Eastern European region, and specifically in Hungary. In terms of new forms of housing I will focus on housing cooperatives, but the main arguments can be broadened to other forms of institutionally owned rental housing as well. In Eastern Europe, there is a sore lack of such organizations, which is closely linked to how the rental housing market is regulated and financed.

In the current, Covid19-pandemic induced unstable economic situation, many households will not have access to mortgages despite an ongoing credit boom in many Eastern European countries. The instability of employment and increasing risk aversion of lenders means that the pool of households eligible for a mortgage will likely narrow down, while – also as an instrument of contemporary crisis management – liquidity is abundant on financial markets. The main question I seek to answer is whether this abundant capital can be channeled into new forms of housing finance, developing affordable cooperative and rental housing.

Limits to an individual mortgage-based housing finance system

2015 was a turning point in terms of European housing finance. Until then, the effects of the 2008 crisis could be strongly felt, especially in various countries on the peripheries of Europe. As a consequence of pre-crisis lending, many families defaulted on their mortgage payments, many were evicted or went through severe financial hardships (Mikus and Rodik 2021). However, from 2015 onwards banks were called on to clean their portfolios in order to prepare the rollout of a new wave of mortgages (ECB 2015, Bródy and Pósfai 2020). This new wave of lending is stronger in some places than others. In Hungary, it is exceptionally strong, boosted by a series of government measures. These measures include a non-refundable subsidy for home purchase based on the number of children a family has, subsidized mortgages and also a free-purpose, large-sum consumer loan linked to childbirth, which in practice is used by many for housing purposes.

However, partially due to stricter post-crisis market regulations concerning household loans and partially due to the specific social targeting of the Hungarian government (higher status, childbearing, married couples), this new wave of mortgage lending is much narrower in terms of who it reaches. My hypothesis is that this rather narrow social targeting was further narrowed by the economic crisis following the pandemic, since the employment situation of many became more precarious. This narrower and safer targeting of mortgages is a reasonable development, since it can potentially avoid the financial overinclusion of the pre-crisis period.

However, in the meantime, new forms of housing provision are not being developed, which would target those who fall out of the individual mortgage-based homeownership regime. Thus, other forms of – more risky – indebtedness develop, and there is also a very large unmet housing need of all those who cannot access individual ownership (Florea, Gagyi and Jacobsson 2018). I argue that this is, to a large extent, a question of housing finance. Adequate housing finance instruments could help overcome the lack of different housing tenures and housing institutions in Eastern Europe.

New housing organizations: the need and the response through finance

In Eastern Europe, there is a nearly complete lack of institutionally owned rental housing. That is, housing associations or "social landlords" practically do not exist; there is a very small stock of social housing most often directly in the hands of municipalities, and beyond that, the rental market is dominated by small individual private landlords. This lack of institutional actors has historical roots: the drastic privatization of previously state-owned housing at the beginning of the 1990s resulted in an entirely fragmented housing stock. However, the fact that the sector of organizations owning and managing housing did not develop until today following this privatization wave, is more a question of political and legislative choice and of financial possibilities.

On the one hand, an exclusively individual mortgage-based housing finance system does not provide any incentive for financial institutions to provide loans that would be suitable for developing rental housing. Put in very practical terms, long-term corporate (non-individual) loans do not exist in the region (Pósfai 2018). Thus, corporations on the real estate market can only be financed for building new housing for immediate re-sell to individual buyers. Long-term loans only exist for individuals, and individual savings are often also channeled into real estate, thus both tendencies further strengthen the presence of small landlords on the rental housing market.

This strong financial bias towards individual homeownership is extremely difficult to break because of the fundamental risk adversity of mainstream financial (and of political) actors. However, from the perspective of organizations which are striving to develop new forms of housing tenure in Eastern Europe – such as the members of MOBA Housing Network – this financial bottleneck is key. Since the aim is to target social groups who are not able to access homeownership on the market, new tenure forms that need to be developed are clearly rental and rental-based cooperative forms. For this, however, organizations need to be able to access finance with which a slow return on affordable rents is possible. On the other hand, financial institutions see a lack of experience, a lack of a comparable market, and thus "non-financeable" actors. This situation of catch-22 can only be overcome if there is a purposeful push either by the state or by market actors – or both, in a concerted way. The forms this "push" or support could take are elaborated on in the last section.

The current historical situation could present a new opportunity for a shift on Eastern European housing markets for various reasons. On the one hand, the narrower pool of potential mortgage debtors (previously described) means that at some point financial institutions can potentially become interested in new forms of lending in order to overcome market saturation. Government subsidies promoting homeownership continuously try to broaden the pool of mortgage debtors, but this possibility of entering untapped markets through new instruments can potentially be interesting from a merely financial perspective. On the other hand, in the EU, contemporary public financial instruments are increasingly loan-based, with a general aim of achieving developmental goals through targeted and regulated lending and investment. At the same time, the absorption of these financial instruments is not straightforward. The expectations and capacities of lenders and end users have to be brought closer to each other in order to achieve the developmental (social and environmental) goals set out. Housing can be an important avenue for such, socially and environmentally focused investment because of its very high impact in both areas.

Steps for overcoming the bottlenecks

In order to be able to develop this new potential in housing finance, some important bottlenecks need to be overcome. Steps are needed from the side of government, market actors, and from the small, emerging non-profit housing sector.

Shifts in policy are important because as long as regulation is very vague concerning rental housing, corporate actors will be more reluctant to shift their practices in this direction. Cooperative housing is even more a grey zone than pure rental housing, since this tenure is in between the more conventional forms of both ownership and rental. In order to reassure different actors and to shift the risk off individuals or smaller housing organizations, the regulatory framework and legal guarantees of both rental and cooperative housing need to be clarified. Additionally, the focus of government subsidies on mortgage-backed homeownership is also counter-productive to the development of any other form of housing tenure. Thus, a fundamental shift in these housing subsidies would also be needed in many Eastern European countries.

From the side of the market (especially financial institutions), different methods of risk assessment would need to be developed in order to be able to "measure" other forms of housing than individual homeownership. Furthermore, resources need to be allocated to new product development – without which cooperative or institutionally owned rental housing can surely not be established. Attitudes of partnership and communication need to established with housing organizations and public entities.

The third party that has an important role to play in this process are housing organizations that need to be built up and strengthened in a way to be able to respond to concrete housing needs. Many such organizations exist in Eastern European countries, but are almost always relatively small and lack capacities or experience in managing larger stocks of housing. For this to change, they need support in systematic capacity building, and also a long-term perspective of room for maneuver beyond the paradigm of individual ownership. This is the experience both of MOBA Housing Network, which is a regional network of pioneering housing cooperative initiatives, and of various local housing organizations in Hungary.

A more long-termist approach would generally be direly needed on Eastern European housing markets, which are fundamentally characterized by volatility. The expectation of short-term returns in itself has an effect of increasing house prices and reducing the stability of housing perspectives for individuals. If financial instruments of patient finance and institutions of rental and cooperative housing could develop, then fundamental shifts could begin on these housing markets.

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