

Public Disclosure Authorized

A ROOF OVER OUR HEADS

Public Disclosure Authorized

Public Disclosure Authorized

Public Disclosure Authorized



HOUSING IN BULGARIA

Public

October 2017

A ROOF OVER OUR HEADS

Housing in Bulgaria

The Government of Bulgaria (GOB) is in the process of developing a new National Housing Strategy. This World Bank ASA (Advisory Services and Analytics) was requested by GOB to complement their efforts, and assist them in establishing strategic pillars to serve as the foundation of the forthcoming Strategy.

This is a short summary extracted from the full report titled “Bulgaria: Housing Sector Assessment.”

Currency: Bulgarian Lev (BGN) = 100 stotinki

Exchange Rate: BGN 1 = 0.51 EUR (as of 2017)



CONTEXT

Bulgaria's housing sector provides a window into the broader issues of the country's social, political, and economic transformation in the Europe and Central Asia (ECA) region over the last 25 years. The country's transition has been difficult, and the Government of Bulgaria (GOB) has played an active role in reforming the housing sector – starting in 2004 with a Housing Strategy, to more recent large-scale initiatives to improve energy efficiency in residential buildings. Still, many challenges remain, and while these challenges are not unique to the region, they appear to be more acute in Bulgaria.

Bulgaria consolidated its transition after most other transition economies, with the result that, unlike other reformers, sustained economic growth took hold almost a decade later than it did elsewhere. Indeed, it took 14 years for real per capita income to return to pre-transition levels. The country suffered through hyperinflation, a financial crisis, and considerable political turmoil, falling increasingly behind other reformers such as Hungary or Poland. Until the end of the century, Bulgaria remained locked in a lower income status, and its economic performance diverged from other reformers and its European Union (EU) neighbors. For example, if it had been able to stabilize in, say, 5 years rather than the 11 it took (1989-2000), and grow at the average rate, its per capita income would be 40% higher than it is now.

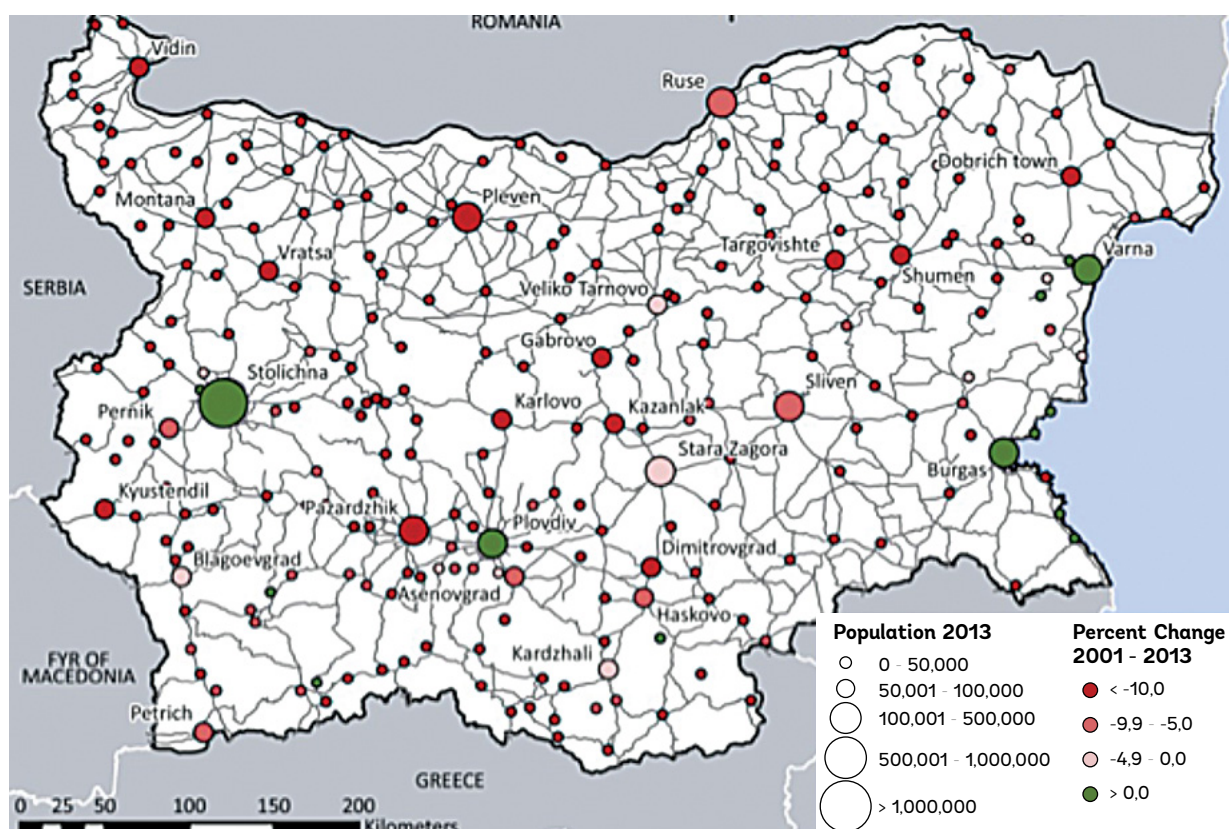
Some evidence of how different things would be if Bulgaria's transition legacy were less pronounced is offered by its performance after it achieved political and economic stability in 2000. It experienced the strongest growth record of the reforming economies for the next 6 years, just under 6% per year, made significant progress in converging with average EU income levels, and was also granted membership in the EU in 2007. Unfortunately, these more benevolent trends were disrupted by the global financial crisis of 2008 when it experienced one of the sharpest slumps among transition countries.¹

One of the main reasons Bulgaria weathered the downturn badly was the bursting of its housing bubble; it is still experiencing one of the deepest and longest persisting housing downturns among transition countries.² This downturn has been one of the main contributors to the increase in poverty that occurred post-2008 as construction employment – one of the largest employers of low-skilled workers – plummeted. Moreover, unlike the usual underlying causes of housing bubbles, in Bulgaria the bubble was not caused by too much mortgage credit; the country continues to have the lowest share of mortgage debt among transition countries. Instead, as this report will show, more fundamental housing market obstacles are at play. Sectoral distortions slow the sector, increase costs, reduce employment, and contribute to the country's inability to close the income gap with the EU-28.

Besides the strong and somewhat disruptive legacy of Bulgaria's transition, perhaps the most important and closely related aspect of the country's economic performance is its extreme age distribution. It has become one of the oldest (ageing) societies in the world and, at the same time, is experiencing one of the world's sharpest reductions in population: a decline of 20% since the transition began in 1989 – see Figure (i).

¹ Between 2008 and 2014, the global financial crisis and the subsequent Eurozone crisis led to annual growth in real per capita income of just over 1%, and today Bulgaria remains the poorest EU member state with a per capita GDP of around 47% of the EU average.

² Eurostat 2015.

Figure (i). Population growth from 2001-2013

Source: *Cities in ECA*, World Bank, 2016

Moreover, the United Nations (UN) predicts that the decline will intensify over the next generation.³ Neither of these qualities lead to an increase in housing demand; indeed, they have the opposite effect. Why then study the performance of the housing sector when it appears to be one with considerable over-supply?

One of the main reasons to do so is to achieve a better understanding of a seeming paradox: how do housing costs rise relative to incomes – to a point where the country has the second highest share of households burdened by high housing costs among all transition countries – when the total population is both declining and aging? One would think that an over-supply of units relative to the number of households would lead to a decrease, not increase, in prices. Moreover, the paradox is more perplexing considering the low employment rate among the working age population. Bulgaria has the third lowest share in employment among the working age population, i.e., those between 25 to 54 years of age, in transition economies, and a youth unemployment rate of 22%.⁴ If housing costs are high compared to income levels, the opportunity costs of not working would be considerably higher in a country where the largest household expense is so high. Similarly, the elderly tend to move less frequently and usually have lower rather than increased demands for housing. To better understand the paradox, one must also understand these following key aspects of Bulgaria's housing sector:

- **Since 2008, poverty rates have been on the rise and income gains for the bottom 40% of the population have slowed significantly.** Over 40% of the population is at-risk-of-poverty⁵ or social exclusion, and this problem is particularly prevalent among Roma families and other ethnic minorities.⁶

³ It is expected that Bulgaria's working age population will continue to shrink, by as much as by 30%, until 2050.

⁴ Eurostat 2016 (<http://www.tradingeconomics.com/bulgaria/youth-unemployment-rate>).

⁵ Eurostat definition of at-risk-of-poverty: those earning below 60% of median equalized income.

⁶ World Bank; Bulgaria National Statistics Institute; EU-SILC.

- **The country has a large stock of deteriorating multifamily residential buildings.** It has the largest share of pre-1990s housing built by a centrally planned socialist state – which is questionable in terms of its quality, design, and location. A large proportion of the population is either unable to afford basic maintenance or has little incentive to do so.
- **The 2008-2010 global financial crisis resulted in a large drop in house prices.** The drop was 30-50% since 2007 in many prime locations, which bankrupted many private developers, and resulted in many households suffering major losses in wealth and equity. The market is only now slowly recovering from the shock, but remains volatile.

All these factors – population decline, poverty, deteriorating housing stock, and the aftermath of the financial crisis – have exacerbated the housing demand-supply imbalance. As a consequence:

- **The cost of housing relative to prevailing income levels is very high,** which makes it virtually impossible for households earning less than BGN 1000 (EUR 510) per month, i.e. those in the 60th-70th income percentile, to purchase or rent any housing in the market. More than a third of young adults are unable to afford a house, and hence are continuing to live with parents or other family.⁷
- **The number of informal and illegal settlements has been on the increase,** with people living in poor quality housing and inadequate infrastructure.⁸ The situation is precarious for the Roma, more than 90% of whom are categorized as poor.
- **Job mobility and corresponding productivity is very low,⁹ and emigration is high,** particularly among the educated youth in whom the country has invested so much.

Moreover, Bulgaria's housing market may in fact be in worse shape than its aggregate numbers indicate. This is because there is no single housing market, but rather many different markets in different parts of the country. The average figures obscure the huge variability that exists across the country's cities. In some places, such as Sofia, where productivity is higher and opportunities more abundant, housing costs are very high relative to income. In other places, those with little to no opportunity, the costs are very low and the housing is deserted.

These problems, at least in part, stem from the fact that Bulgaria followed the planning approach used by the Former Soviet Union (FSU) more closely than did other transition economies outside the FSU (and Albania). This approach created one of the most over-industrialized economies among transition countries. It called for the creation and expansion of many cities that would not be so large in a more market-oriented economy. The result today is that employment prospects are dim in many locations where state-owned factories of the old regime have closed, and housing vacancies are extremely high, with some villages and towns facing complete abandonment.

Not only are many of the cities in the "wrong place", so too are many housing developments in the wrong locations within cities. Bulgaria has city density patterns in which the population appears to be dispersed to the outer parts of the city, rather than concentrated in the central city. While the Bulgarian pattern is not as extreme as some of the other countries in the region, it does exist. This distribution of the housing stock results in much longer commuting times, and also creates demand

⁷ Ibid.

⁸ National Report for Bulgaria on the Tenancy Law review, "TenLaw: Tenancy Law and Housing Policy in Multi-level Europe".

⁹ Between 2001 and 2011, only 380,000 people, or 5.1% of the total population, changed residence within Bulgaria (30% within the same town, and 70% into a different town). Nearly half of all people who migrated internally moved to Sofia or Varna.

for new infrastructure while existing infrastructure is under-utilized, thus creating urban management problems. More importantly, however, such spread-out cities reduce the agglomeration economies that underlie the incentives to urbanize in the first place. This pattern of housing investment across cities creates a situation of feast and famine. Those in desirable cities face intense competition, and correspondingly high prices for units, while those in less attractive locations are trapped in units that have little to no value and face problems with on-going maintenance and utility costs.

At the same time, public expenditure in the housing sector, and especially that targeted to lower income and vulnerable groups, is a small fraction of the overall budget.¹⁰ Public social housing, which constitutes less than 3% of the housing stock, is essentially an unfunded mandate. While the legacy of the old regime suggests good reasons for moving away from publicly-provided housing, international experiences shows that such housing can be an essential component of a city's overall development and social assistance strategy. Indeed, governments have a significant role in improving the functioning of housing markets that is quite commonly overlooked – both at the national and the local level.

¹⁰In 2013, little less than 1.5% of GDP went into government support of housing and community amenities and housing development.





KEY FINDINGS

1 High vacancy rate, surplus, and overcrowding

Massive vacancy

Bulgaria has a very high incidence of vacant or “uninhabited” housing – some 1.2 million housing units, which is more than 30% of the country’s housing stock. The incidence of vacancy is 43% in rural areas, and 25% in urban areas (see Table (i)).^{11, 12}

Some of this might be attributed to declining populations in rural areas and small towns, and hence a declining housing demand for rent or purchase. Based on data from 2001 to 2011, all but two districts – Sofia (+10.3%), and Varna (+2.8%) – have witnessed net depopulation.¹³

Table (i). Vacant dwelling units in Bulgaria, 2011

	TOTAL dwellings	# Uninhabited or “vacant” dwellings	% Uninhabited or “vacant” dwellings
TOTAL	3 887 149	1 220 416	31.4
Urban	2 566 601	653 105	25.4
Rural	1 320 548	567 311	43.0
SOFIA district	176 842	85 277	48.22
SOFIA capital	607 473	142 608	23.48

Source: 2011 Census, National Statistical Institute

Another explanation for this high vacancy rate may lie in the data itself – from two aspects: First, these data are from 2011, one of the peak years of the global financial crisis in Bulgaria, when the property market was depressed. And second, the data on “uninhabited dwellings” collected by the National Statistical Institute (NSI) includes cottages, holiday homes, apartment hotels and such – more predominant along the Black Sea coast – which are not necessarily “housing units” in the traditional sense. So, the numbers might be a bit exaggerated.

Still, while this may, in part, explain the numbers at the national level as well as in the declining towns and tourist destinations, it is puzzling to see such vacancy in otherwise growing and seemingly vibrant housing markets. For example, vacancy is 24% in Sofia capital, 48% in the surrounding Sofia district, 26% in Plovdiv district, and 30% in Varna district.

¹¹ 2011 Census, National Statistical Institute.

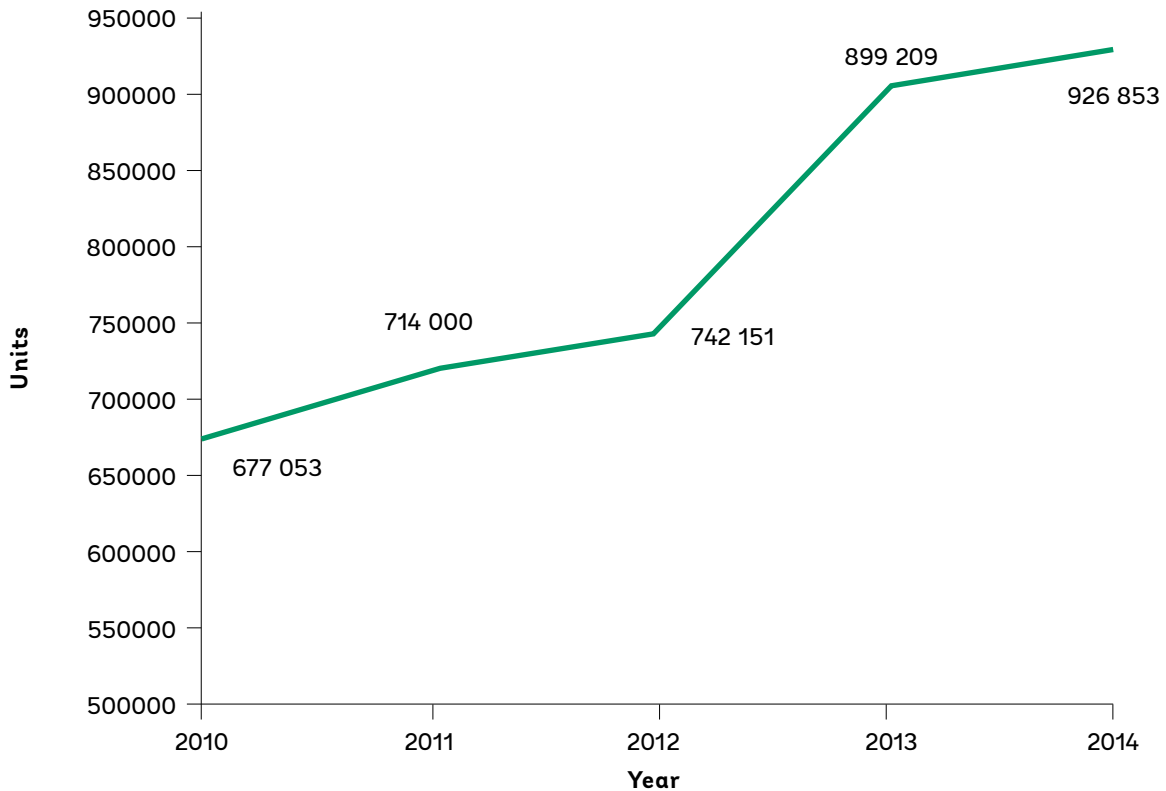
¹² “Uninhabited” houses, as defined by NSI, include vacation homes, apartment hotels etc. (more prevalent in the Black Sea coast) as well as dilapidated housing that is unfit for habitation (prevalent in rural areas and small towns).

¹³ 2011 Census, National Statistical Institute.

Housing “Surplus”

There is a housing surplus in all districts of Bulgaria, which has grown from 677,053 units in 2010 to 926,853 units in 2014 - see Figure (ii).

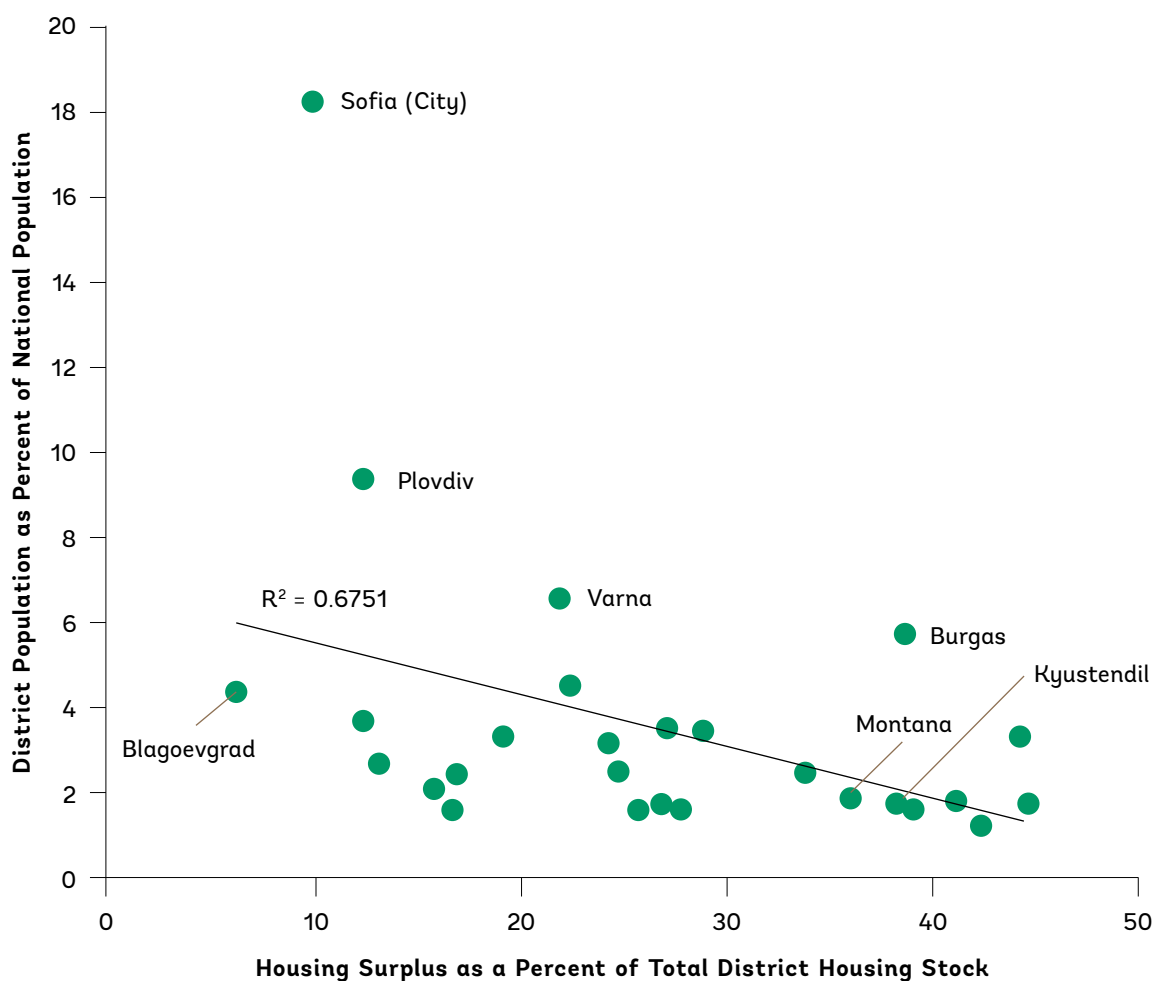
Figure (ii). National housing surplus



Source: Population and dwelling data from NSI; household size data from Eurostat

The national data for each district show that there is a weak negative correlation between housing surplus and higher district populations, meaning that the housing surpluses in less populated districts are of greater magnitude, as shown in Figure (iii). This may, at least in part, be attributed to the significant population decline in smaller towns located in less populated districts. However, even the smaller of the major cities (Varna and Burgas) have large surpluses compared to Sofia and Plovdiv, indicative of the net effects of migration on a national scale.

Figure (iii). Housing surplus as a percentage of district housing stock compared to district population as percentage of national population



Source: Population and dwelling data from NSI; household size data from Eurostat

High incidence of doubling-up and overcrowding

While the 3.9 million dwelling units for 3 million households might, at first glance, suggest a “surplus”, the fact that 1.2 million of these units are uninhabited implies that, effectively, 3 million Bulgarian households are living in 2.7 million housing units.¹⁴ About 1.05 million people, or 15% of the population, live in dwellings that are shared by more than one family.¹⁵ In other words, “doubling-up” is common, especially among lower income households in the larger urban centers: often, up to 3 generations, or some 6-8 family members, live in a small 60 m² apartment.

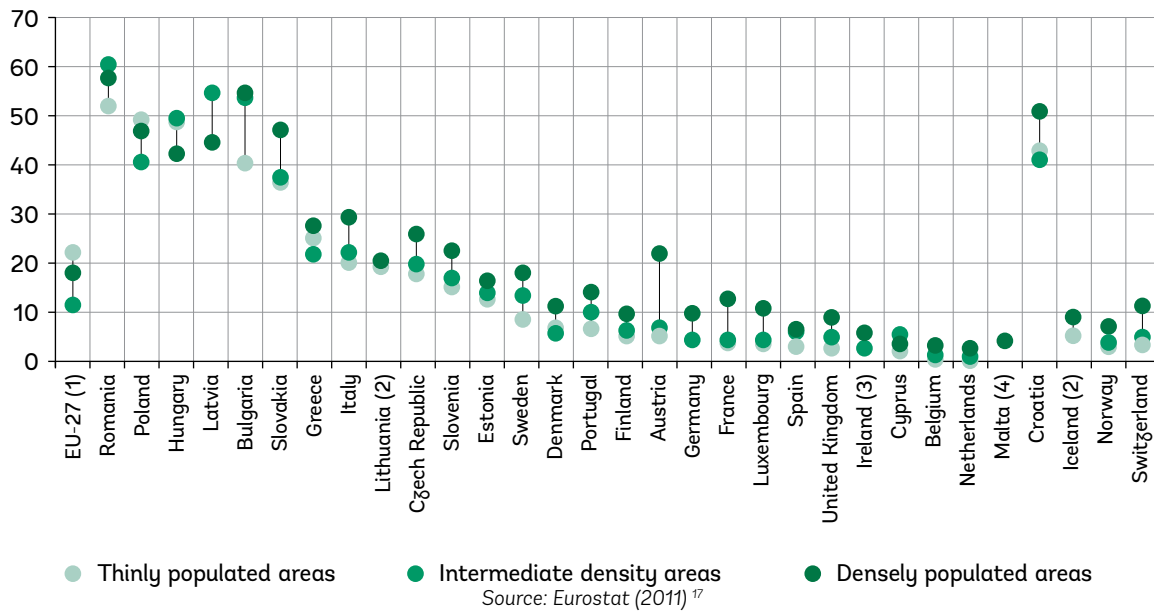
The national housing overcrowding rate is 41%. Among households at-risk-of-poverty, nearly half of all people, 80% of children below 18 years, and 59% of young adults (aged 16-29 years), live in an overcrowded house. Also, 82% of all tenants paying market-rate rent live in an overcrowded unit.¹⁶

The overcrowding rate in Bulgaria in both urban and rural areas is very high compared to the EU-27 average (see Figure (iv)).

¹⁴ 2011 Census, National Statistical Institute.

¹⁵ EU, National Report for Bulgaria, “TenLaw: Tenancy Law and Housing Policy in Multi-level Europe”, p. 40.

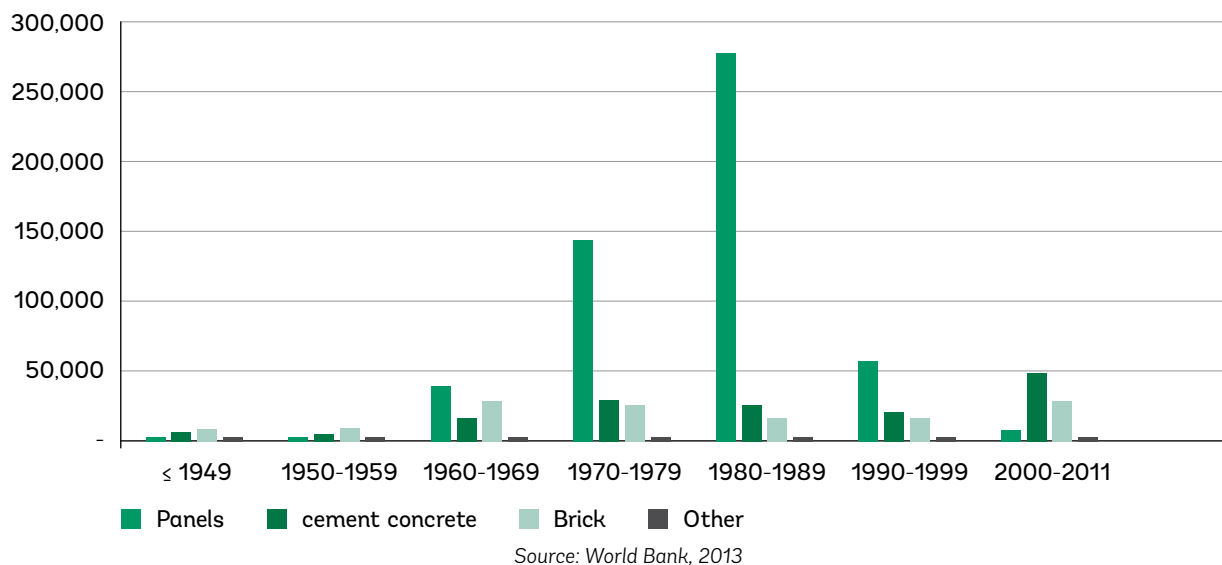
¹⁶ Eurostat, 2015. <http://ec.europa.eu/eurostat/web/income-and-living-conditions/data/main-tables>.

Figure (iv). Overcrowding rate by degree of urbanization

2 Poor quality of old stock, potential seismic risk

Age and quality

Most of Bulgaria's housing stock comprises old socialist-era multi-family buildings, many of which are made of prefabricated panels blocks. More than three-fourths of apartments in the country are in buildings that are older than 30 years – see Figure (v).¹⁸

Figure (v). Number of housing units by construction materials and period of construction¹⁹

¹⁷ Eurostat ([http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Overcrowding_rate_by_degree_of_urbanisation,_2011_\(%25\).png](http://ec.europa.eu/eurostat/statistics-explained/index.php/File:Overcrowding_rate_by_degree_of_urbanisation,_2011_(%25).png)).

¹⁸ World Bank, Bulgaria housing stock overview, 2013.

¹⁹ World Bank, Bulgaria housing stock overview, 2013.

Panel buildings, shown in Plate (i), are very prevalent, with some 11,128 of them housing 2 million Bulgarians.

Plate (i). Panel buildings

Panel buildings in Sofia (left) and Blagoevgrad (right).



Lack of maintenance

While the age of a building may not in itself be a problem per se, the lack of maintenance of these buildings over the last several decades has led to their rapid deterioration. This is attributed to a combination of several factors: a lacking sense of responsibility for common areas and elements of the building, non-payment of fees by absentee owners of vacant units and some of the poorer residents, differences in income levels among residents, dissatisfaction about the buildings' conditions and service levels, and a general apathy resulting from a sense of entitlement that the state will take care and pay for the common areas, and the absence of properly functioning Homeowners Associations (HOAs). The result is all too common: leaking roofs, damaged facades with fallen plaster, dark and ill-maintained stairwells and hallways, and leaking water and sewer pipes in the basements. Fixing these buildings will require major capital repairs and entail huge costs, which many apartment owners cannot afford.

Further, while the Condominium Law obliges HOAs to maintain their buildings, it does not 'mandate' the establishment of an HOA. The supporting legal framework or funding capacity of the public sector to intervene or enforce building management and maintenance is very limited. Management companies are increasingly coming into the fore, but they are unregulated/unlicensed, and hesitate to service older buildings given the complexity of the underlying maintenance issues and the poor level of organization of the residents.

Potential seismic risk

In addition to the above two issues, there is another reason to be concerned: the structural integrity of some of the older housing stock. Old prefabricated "panel" buildings built in the 1970s-80s constitute over 40% of the current multifamily housing stock. The "links" joining the precast panels in these buildings are believed to be at the end of their 50-year lifespan, and in some cases, could be corroding/ rusting. Although the extent of this risk is unknown, the fact that the panels are load-bearing, even a remote possibility of disintegration of the links raises

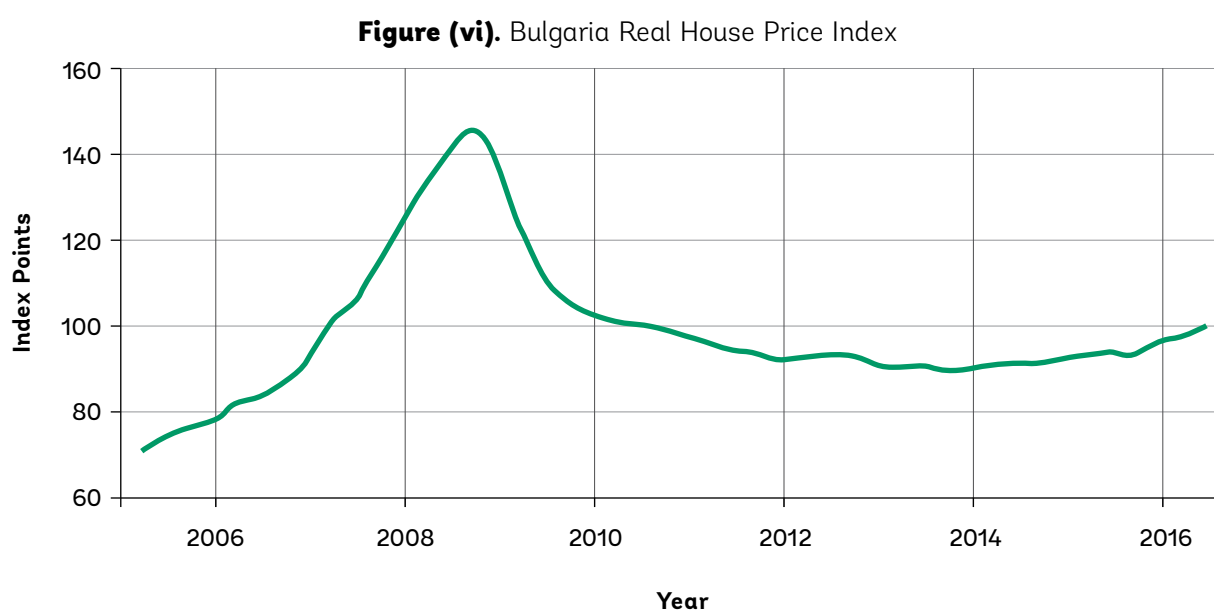
serious questions about the structural safety of these buildings. This is of particular concern given Bulgaria's propensity to seismic hazards (see Box 3.1), but there has been no comprehensive study of the seismic vulnerability of this housing stock to date. In the meanwhile, the majority of residential buildings – according to some estimates, over 95% – do not possess a “Technical Passport”, which is the technical documentation of the building's structure.²⁰

3 Housing market failures

Negative impact of the financial crisis

Not only did the 2008 financial crisis bring an end to the construction boom in Bulgaria, it also resulted in many unfinished housing projects. Banks, on their part, retracted from the market and tightened their lending. The main investors in the construction boom prior to 2008 were foreigners (Russians, Irish, English etc.) and their withdrawal was an important factor for the collapse of the construction sector. Many owners and investors saw their property values shrinking to half or a third of the original value and, in many cases, lost money to developers who filed for bankruptcy. However, since 2015 prices have begun to stabilize and, in the larger cities, housing demand now appears to be making a comeback to pre-crisis levels. Figures (vi) and (vii) show that the Bulgaria Real House Price Index as well as annual average market prices of dwellings in district centers decreased significantly after the financial crisis.

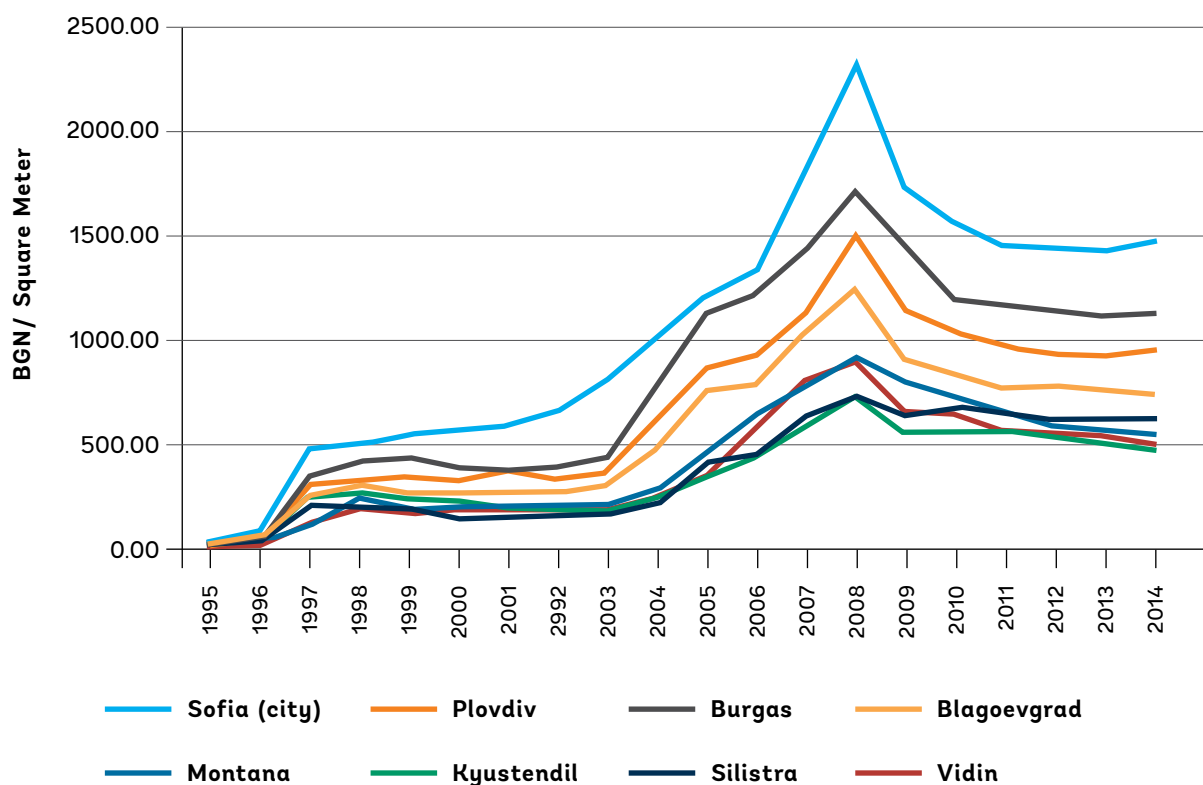
More recently, however, banks have resumed lending and housing construction has picked up in the larger urban centers. This is attributed to a combination of factors: growing incomes, low mortgage interest rates, low deposit rates, and relatively larger returns on real estate investment.



Source: NSI, Eurostat²¹

²⁰ According to a recent amendment to Ordinance No. 5 on Technical Passports, the deadline for all existing buildings to prepare their Technical Passports was moved from 2017 to 2022. Unlike the old building stock, all buildings built after 01.01.2007 have Technical Passports.

²¹ <http://www.tradingeconomics.com/bulgaria/building-permits>.

Figure (vii). Annual average market prices of dwellings in district centers²²

Source: Data from NSI Macroeconomic Statistics²³

Lack of affordability

The average housing price ranges from EUR 550-800/m² for the less desired homes in older buildings to EUR 800-1200/m² in new buildings in more desirable locations in Bulgaria's larger cities. Given the national average monthly household income of EUR 477,²⁴ this means that a large majority of the population, i.e., people below the 60th income percentile, cannot afford to buy or even rent a house in urban housing markets.²⁵

According to Eurostat, the housing cost overburden rate is 42% for single person households, 15% for households constituting two adults, 7% for households constituting three or more adults, 24% for older residents aged 65 years and over, 31% for tenants of market priced rentals, and 17% for tenants of subsidized or rent-free accommodation.²⁶ Among those who face a housing cost overburden in Bulgaria, 46% are from households below the 20th income percentile, and 66% are from households below the 40th income percentile.

²² Data only for existing stock, newly built dwellings excluded. Annual averages were calculated as an average of quarterly data for each year.

²³ https://infostat.nsi.bg/infostat/pages/module.jsf?x_2=276.

²⁴ Source: <http://www.tradingeconomics.com/bulgaria/wages> (September 2016).

²⁵ Further, with the base cost already so high compared to income levels, the closing cost of a transaction (roughly 4.5-6.0% of sale price) and a VAT of 20% imposed on new developer-built buildings has led to a common practice of underreporting the sale price on paper.

²⁶ Eurostat 2015. <http://ec.europa.eu/eurostat/web/income-and-living-conditions/data/main-tables>.

Absence of a robust rental market

According to NSI data, less than 5% of the country's housing stock is leased out in the rental market. An additional 8% of the stock constitutes "shared", "free", or subsidized rental housing; how much of this is transaction-based or formal/ informal is difficult to ascertain from the data.²⁷ Nevertheless, the high cost of rental housing suggests a constrained supply despite the housing "surplus" at the national level.

This sort of situation often occurs in housing markets in which the regulations are preventing the rental market from functioning effectively. Several reasons may be attributed to landlords keeping their properties vacant rather than renting them out. Among them, (i) the current eviction laws, which lean in favor of the tenant and make eviction difficult; (ii) the inability to enforce formal lease agreements in the court of law, even when registered by a notary; (iii) a general hesitation on part of landlords to rent out the property based on the legacy of poor maintenance by tenants;²⁸ and (iv) a flat 10% income tax which applies to rental income, which, although minimal, could be a disincentive to report rental income. From the tenant's side, it is usually the high cost of market-based rental that is problematic.

The 'informalization' of the rental market, on the other hand, has several negative impacts:

- Informal rental denies both the tenant and the landlord any legal protection associated with an official contract.
- Informal rental limits the market supply of rental housing, thereby making it more expensive, and locking out the bulk of households earning less than EUR 1,000 per month from the option to rent with a formal contract.
- The absence of an efficient rental market limits mobility and compounds the affordability dilemma by pushing many young households to purchase smaller units with limited buying power instead of renting.

Bulgaria's vacant housing stock could present a real opportunity: a ready pool of "locked" but potentially valuable rental stock that can be leveraged to address the housing problems as part of new housing sector policies.

Low penetration of housing finance

Given the problems in the functioning of the housing market itself, and the hyperinflation and financial sector collapse experienced by Bulgaria, the low penetration of the mortgage is not surprising.²⁹ Despite relatively favorable lending terms,³⁰ it is common practice for buyers to finance house purchases with cash from savings or with the slightly more expensive consumer loans³¹ as these have no mortgage lien on the property. Few banks offer products for people with incomes lower than BGN 1,000 (EUR 510) per month, and those that do, require them to pay higher interest rates due to their higher risk profile. Such systems need time to develop, and the value risks of Bulgarian real estate have shown themselves to be among the highest in the region.

²⁷ One study suggests that the social housing stock is 3% of the total housing stock, but the NSI Census data identifies 0.02% of housing as "institutional" housing. The definitions of these two terms and their respective data needs further investigation and clarification.

²⁸ EU, National Report for Bulgaria, "TenLaw: Tenancy Law and Housing Policy in Multi-level Europe", p. 21.

²⁹ The Bulgarian mortgage to GDP ratio is 8.0%.

³⁰ All major commercial banks offer mortgages, with a loan-to-value (LTV) ratio of upto 85% for newly built properties, and 50-60% for flats in old buildings. The most common product is a local currency BGN adjustable rate (4-5% plus Sofibor) mortgage for upto 30 years, with a maximum debt-to-income ratio of 50%.

³¹ @ 7% interest, for 5-7 years.

4 Inadequate housing and infrastructure for low income groups

Lack of public assistance for the poor and marginalized

Little has been done or can be done under the current legal and fiscal structure to address the increasing housing informality and marginalization of poor households. Government assistance falls far short of the prevailing need of poor and vulnerable groups. The lack of both public and private investment in low-income areas, combined with social prejudices, has resulted in self-proclaimed 'ghettos' in which low-income communities (including a high proportion of Roma households) are marginalized.

There is a lack of proactive interventions for poor and vulnerable communities with respect to the provision of better quality social housing, slum upgrading or land rights. The National Roma Integration Strategy 2012-2020 calls for the improvement of housing conditions in Roma neighborhoods including infrastructure upgrading and titling. However, it is unclear how much funding is set aside for this purpose. The two largest programs in the housing sector – National Program for Energy Efficiency in Residential Buildings (NEEP) and Regions in Growth-Priority Axis 1 – focus heavily on energy efficiency, and are aimed at serving a broad population and do not necessarily target the poor. There is some funding for social infrastructure (including social housing) and promoting social inclusion for vulnerable groups but the focus is on providing “social housing” and “social infrastructure”. In other words, infrastructure upgrading in marginalized areas, which is a very critical and much needed activity, is not an eligible activity in this program. At the same time, the public social housing program is inadequate both in terms of quality and quantity.

Growing informality and illegality

Not only do a large percentage of Roma and other ethnic minorities live in slums or illegal settlements, these minorities are also spatially concentrated, i.e., the majority population in illegal settlements constitutes ethnic minorities, primarily the Roma. In some municipalities, if a person or their family have ever squatted, they are deemed ineligible to receive social housing benefits. The same may apply if they have ever been evicted on grounds of non-payment of rent or fees, non-maintenance of the leased property or its improper use.

Plate (ii). Roma settlements in Sofia



With space already very limited in existing Roma settlements, newcomers tend to occupy the more dangerous or environmentally sensitive locations, for example, near garbage dumps, flood plains, forests etc. Local authorities are often unable to monitor – and sometimes unwilling to control – this influx. This has consequences for the municipality in terms of planning and infrastructure, as well as for the residents because many settlements that started out as “legitimate” are now largely seen as “illegal” as the original residents are vastly outnumbered by the new illegal migrants.

Absence of appropriate “legalization” or upgrading instruments

Government attempts to legalize illegal houses in informal settlements have had little success. The two amnesty programs offered by the government to legalize illegally constructed buildings – the Tolerance Certificates and the Building Legalization Document of 2012 – require that the applicant either be the owner of the land or have a legal right to build on the land. This, together with the complex and expensive procedures involved and, in some cases, the lack of awareness of the amnesty programs among the communities, has resulted in a very low uptake from Roma and other ethnic minorities.

5 Limited reach of national government initiatives

National Energy Efficiency Program

Since 2007, the government has implemented several energy efficiency programs in residential buildings, although there has been difficulty in scaling up these initiatives. Under the most recent (2015-16) NEEP, which is the largest housing program in the country – with a budget of EUR 1 Billion for 2015-16 – the criteria were changed. The subsidy element was increased to 100%, the program was opened up to everyone, not just the poor, and the original requirement to have buy-in from 100% of homeowners was reduced to 95%. All these changes in the program criteria have contributed to a more rapid expansion of the NEEP compared to previous programs.

Plate (iii). Residential buildings in Blagoevgrad retrofitted under NEEP



However, despite the many hurdles that the government has overcome in moving this program forward, some challenges remain, as is recognized by the government. These are summarized below:

1. From the perspective of improving building management, NEEP requires that an HOA be established and registered with the municipality in order to be eligible for funding under the program, and it is recommended that a capital improvement fund be set up for building repairs. However, experience indicates that while HOAs were established in buildings that participated in the program, their capacity and motivation to deliver their functions effectively remains questionable, and most beneficiary HOAs continue to operate without adequate capital reserves. Another common problem cited is the lack of participation of the HOAs in terms of decision-making or supervision or quality control of the works.
2. A technical audit is conducted as part of the NEEP package, which includes an “investigation and evaluation of the seismic security of the building.” While, on paper, this appears to be a reasonable requirement to ensure structural safety, some experts express concern that this is essentially a “visual observation” of the structural quality using X-ray technology, rather than a thorough seismic exam. In the event that a structurally unsafe building indeed manages to qualify for NEEP funding, its structural defects could get further concealed, exposing the residents to catastrophic seismic risk.
3. The 100% subsidy element also raises the issue of equity: essentially, the program offers full government funding for energy efficiency measures to every household in an eligible building, regardless of need, and without form of targeted assistance to the poor. This applies to both, the poorest households within participating buildings, as well as buildings that have a large majority of poor households (including social housing). While recognizing the need for such a subsidy to mobilize this challenging program, and the value in getting it off the ground first with the “low-hanging fruit”, there is potential to improve the design in the medium and long term by gradually introducing user contributions over time.

Municipal Social Housing

The public social housing program is inadequate both in terms of quality and quantity.³² Local governments are required to provide social housing for those in need, but it appears to be an unfunded mandate. In the few municipalities where new social housing is being constructed with funding from the EU operational program (Regions in Growth), the target group is not necessarily low income households. This is perhaps a function of the ideology that housing is not an essential service that the state is obliged to provide. There is also a lack of technical capacity at the local level to plan for or implement social housing projects.³³ This is exacerbated by the spatial legacy of fixed capital investments inherited from the old regime that restricts the ability of municipal governments to adjust to changing housing demand.

Further, municipalities are at liberty to establish their own eligibility criteria for social housing. These criteria typically include income, employment, current living conditions, domicile with a registered address, household size, and so on. In most cases, regular income is required to be able to apply for social housing. Based on this, many of those with the most needs get relegated to the bottom of the long waiting lists for social housing. While it is clear that the

³² National Centre for Regional Development: Monitoring and Analysis of the State of Housing Fund and Housing Market, 2012.

³³ For instance, the capacity to estimate the demand for social housing at the local level, i.e., which population groups to cater to, and therefore, which types of units to build. (Source: OSI Europe Foundation, Housing in Bulgaria: Challenges and Perspectives, 2003.)

problems facing local authorities vary widely so that there is need for greater flexibility in how they address their somewhat unique problems, it is not clear that allowing them to establish their own terms (tenure etc.) and eligibility criteria for social housing allocation is an effective policy.

Finally, in some municipalities, sitting tenants of social housing units have the right to buy the unit after a certain period of time, while in others, there is no term limit for the lease. This policy puts an even bigger strain on the already limited pool of public housing stock.





RECOMMENDATIONS

As findings suggest, the Bulgarian housing market faces many constraints. This situation is costly for the broader economy in terms of employment opportunities and productivity, but it also makes it very difficult for municipalities to function effectively. When market responders are unable to respond as easily as they could if the market worked effectively, the costs of housing assistance are considerably higher and the ability of local authorities to carry out their functions are impaired. As a result, besides the difficulties faced by younger families who want to move to locations with job opportunities, it is very difficult to assist lower-income households in such a system.

Creating a better functioning housing market is thus an important step as well as one that will improve the efficacy of housing and municipal programs. Consequently, attention to the sector's broader reform agenda is at least as important as improving the functioning of specific programs. It is worth noting that the existing housing stock provides the bulk of housing services at any time so even minor improvements in the functioning of this stock can convey enormous benefits, far in excess of those offered by programs that affect the supply of new units. Hence, the following section presents some of the key recommendations for the government to consider for their forthcoming Strategy.

1 Housing Policy

An overarching approach or strategy to housing is required to enable the government to better target scarce public resources to those who need them most, and to facilitate the development of a better functioning housing market. The core tenet of a good housing policy is to target public assistance to those most in need, as defined by income or vulnerability. More specifically, public investments need to be targeted first at the poorest households in the 20th income percentile before being directed to people higher up in the income spectrum.

At the same time, it is critical to make the market work better. Subsidy programs, however well-designed and well-targeted, cannot work effectively in a dysfunctional housing market where the vast majority of the population (including middle income households) cannot afford adequate, decent, and safe housing. In such a situation, the subsidies intended for the poor inevitably get "hijacked" by the middle income segment. Here, the role of government as a "facilitator" of a well-functioning housing market – while effectively targeting scarce public resources to the poor – cannot be overstated. This involves a proactive role of the government in creating the right environment through appropriate incentives and tools for the private sector to play its role in housing delivery more effectively.

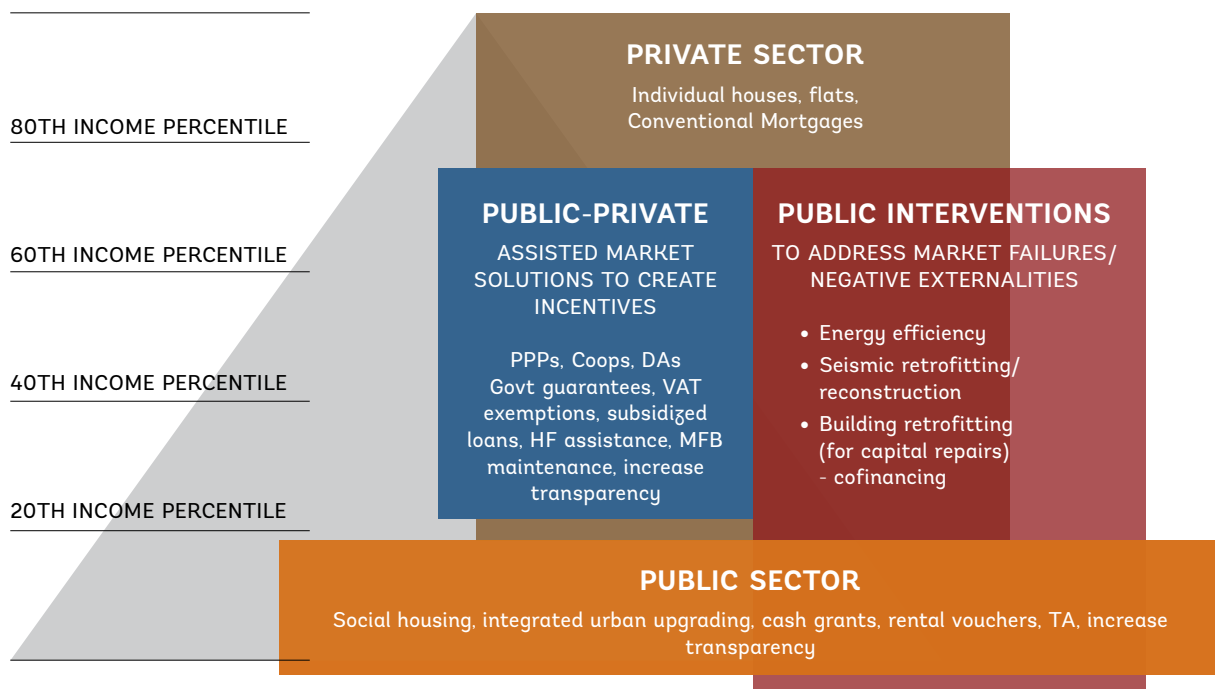
Accordingly, the underlying strategic vision should outline the types of interventions most appropriate at different income levels. For instance, the poorest households might need purely public assistance, other low income households might be targeted with a mix of public and private "hard" investments, while middle income households might require "soft" assistance in the form of affordable mortgages and tax breaks.

Finally, given the many different markets in different parts of the country, geographical segmentation will be important – for example, customizing and differentiating solutions between urban versus rural areas, growing cities with increasing housing demand versus smaller towns with declining populations, and so on.

At a more general level, as illustrated in Figure (viii), a national strategy for housing should aim for an environment where:

- The public sector plays a key role in providing direct housing assistance to the poorest and most vulnerable groups;
- The public sector actively intervenes in specific themes or sectors facing market failure or negative externalities;
- The public sector creates incentives to change behavior and leverage private investments for affordable housing through “assisted” market solutions; and
- The private sector is enabled to serve the housing needs of middle and upper income groups.

Figure (viii). Functional housing market: Roles of public and private sector stakeholders



2 Institutional Framework

The condition of Bulgaria’s housing stock and the legacy of the way it was located and designed clearly have enormous and highly variable implications for the functioning of Bulgaria’s municipalities. Further, the management and control of the housing stock have important spill-over effects on the labor market and social integration. The role of municipalities in implementing a more effective policy cannot be overstated. At present, it appears that cities are burdened with more responsibilities than resources for addressing these problems.

Thus, an analysis of how housing policy affects municipal functioning and how the central government policy affects municipal operations is an important next step in understanding this complex problem. In principle, the following is recommended:

National government

A much stronger Housing Policy Directorate with responsibility for all government programs spanning the housing sector (e.g., energy efficiency, HOAs and maintenance, accessing finance, monitoring, evaluation, and data collection) is highly recommended for Bulgaria. Such a

strengthened housing department can provide training to specialists at the district level, who can then provide support to local authorities.

Local authorities

The way a city's housing stock and its management affects the functioning and responsibilities of local governments is an important part of the country's fiscal system. It is very evident that technical and financial capacity of municipalities with respect to the housing sector needs to be strengthened, in particular in the delivery of social housing, and in collecting and maintaining housing data at the local level.

3 Government programs

Social housing program

The loss of the educated young population is of enormous consequence for Bulgaria, and efforts to ameliorate this situation need to be further investigated. In this context, it is essential that local authorities maintain a database of the many dimensions of the housing sector, including social housing in terms of available stock, prevailing demand from different population sub-groups (not only low-income households, but also youth, young starter families, professionals, students, etc.). Accordingly, housing assistance may be considered for young families so that they are able to move to another location in the country if the city in which they live has very limited job opportunities. Similarly, municipalities of declining towns might consider providing social rental housing for their youth and young professionals as an incentive to retain them in their hometowns. At the same time, it will be important to streamline the eligibility criteria set by municipalities for social housing to make them more equitable, transparent, and well-targeted.

Further, some portion of the large pool of vacant housing units could be used as social housing. This would be a much more cost-effective option for the government rather than building new social housing, and at the same time, contribute to the upkeep of otherwise unused or under-utilized houses. However, this will require the appropriate legislation to be in place that provides landlords the necessary protections and incentives to rent their houses to people who need housing, with the guarantees necessary to ensure that their properties are maintained adequately. Rental vouchers could be particularly relevant under such a scheme, whereby an eligible household could find a private rental house and receive a subsidy in the form of a voucher from the government to cover the rent (partial or whole).

Finally, the government may reconsider the current practice of some municipalities offering social housing units for sale to sitting tenants, because this effectively removes stock from the already tiny pool of public sector housing. It is also important that municipalities conduct a regular review of whether or not the residing tenant continues to meet the eligibility requirements rather than allowing occupancy for an indefinite period: this will make more houses available to people who have real housing needs.

National Energy Efficiency Program

Recognizing the significant challenges faced in the design of the NEEP, and the need to make compromises to roll out the program, some suggestions to improve program design may be considered for the medium and long term. One among them is that the government consider introducing a sunset clause for the 100% co-financing subsidy. Such a clause could come into effect, say, in 5 years, after which an owner contribution would be required and the government co-financing element gradually reduced over time. Other include aspects related to better targeting, and linking EE improvements to a more robust structural retrofitting.

4 Old housing stock

Maintenance and management

One way to improve the maintenance of multifamily housing stock may be better enforcing the Condominium Law, by introducing incentives rather than penalties. This could include, for example, granting certification to HOAs/ condominiums that have adopted certain standards for management of the condominium – such as registering the HOA, having adequate reserves in a capital improvement fund, purchasing condominium/ hazard insurance, and so on – to be eligible for tax concessions and other benefits.

Second, the current 100% subsidy element in the NEEP – while it lasts – could be used as a strong lever to make HOAs contribute into their capital repairs fund. What would otherwise have been expected as an HOA contribution – 5% or 10% or 20% of total project cost – could be required of the HOAs to put into a capital repair fund for the building, to be maintained at a certain minimum threshold at all times. Poor households who are unable to make this contribution may be supported through a Housing Allowance, discussed below (which could essentially be viewed as the equivalent of a rental voucher for eligible home-owners).

Seismic risk assessment and mitigation

It is a well-known fact that panel buildings (and all other buildings in Bulgaria) have high exposure to seismic activity. It is also a fact that the structural integrity of panel buildings relies on the metal “links” that hold the panels together. However, it is unclear whether or not those links continue to retain their structural integrity after 50+ years. This as an issue with high risk exposure and potentially catastrophic consequences. There is thus an urgent need for this matter to be investigated further; a comprehensive study of the seismic vulnerability of this housing stock is strongly recommended.

5 Housing assistance to low income groups

Informal and illegal settlements

It is in the interest of the government to facilitate the legalization of informal/ illegal settlements, where viable,³⁴ for several reasons: this will encourage private investment into these areas; it will also improve the health and productivity of poorer communities; and most importantly, once these areas are legalized and upgraded, they can be a potential source of revenue for local authorities (through property taxes). However, unlike the previous legalization window that was opened, any such new program should ensure that: (i) the process is simple and inexpensive, and residents receive all the technical and financial assistance necessary to facilitate the process; (ii) building and planning standards are relaxed; and, (iii) clear and legal ownership of the land underlying the house is provided.

Also, rezoning some of the illegal/ informal settlements as “Improvement Areas” within which a different set of more relaxed infrastructure standards may be applied could potentially save the government the time and money to build social housing, and work as a much more effective solution for the residents.

Housing Allowance

The poorest households (bottom 20th income percentile) typically should not use more than 10-15% of their incomes on housing and related utility expenses combined. Similarly, those in the 20-40th income percentile should not spend more than 20-25% of their income on housing and utilities. Subsidies for both housing and energy would be more effective and equitable if they were structured around a voucher framework, as is done in many EU countries. This Allowance could be used to assist poor households rent a social house, or pay for improvements or management/ maintenance fees in multifamily buildings. That said, such an Allowance program for rentals will only work if the housing supply is responsive.

6 Housing market

Vacant housing

An essential first step to address the high vacancy rate is to establish a better understanding of its underlying causes, particularly in otherwise growing, vibrant housing markets. The data being collected by NSI could serve this purpose better by differentiating between the different types of vacant housing – and shed more light on what portion of the vacant stock could be potentially “unlocked” - for use as social housing, rental housing, and so on.

³⁴ i.e. where the settlements are not located on environmentally sensitive or otherwise hazardous lands which are unfit for inhabitation, and they do not amount to an illegal “taking” of another person’s property. In cases with disputed ownership traditional legal processes should be followed.

Rental housing

The lack of rental housing and particular dearth of formal rental housing in Bulgaria acts as a major deterrent to labor mobility, causes difficulties for newly-weds, and inflates the rents of the limited stock available. Increasing the supply of rental housing will help increase affordability, especially for young families, and lower income groups, and help make rental a viable alternative to purchasing a house.

As mentioned earlier, the large pool of vacant housing – at least the share of it that is “usable” – presents a massive opportunity in this regard. However, this will require the appropriate legislation to be in place. Existing rental policy may accordingly be reviewed and amended to ensure that an equitable balance is achieved between the rights and duties of the tenant and those of the landlord. Examples of ways in which the legislation can be adapted to facilitate renting include the following:

- Introduction of a tax deduction on rental expenditure for tenants. This will induce people to rent rather than buy homes, and also provide an incentive to formalize rental agreements;
- Introduction of a rental income tax exemption for small landlords (with less than, say, five units) to encourage the “formalization” and mainstreaming of the rental market;
- Establishment of a quick and low cost system to resolve disputes between tenants and landlords.

Building permits

Developing a modern, effective and efficient planning and development review system is crucial for streamlining the permitting process. It is recommended that the Spatial Development Act accordingly be reformed to develop a planning and development review system that is faster, better, concurrent, more predictable, simplified where possible, customer-focused, and transparent, and one that maintains high-quality community standards, and protects the public interest.



An aerial, high-angle photograph of a city, likely Denver, Colorado, showing a dense urban landscape with numerous buildings and a prominent rock formation on the left. The image is faded and serves as a background for the text.

CONCLUDING NOTE

While the poor suffer the most from a dysfunctional market, and require additional and better-targeted assistance, the most effective way to improve such assistance is to improve the functioning of the overall housing market. Such reforms can have significant beneficial effects on the economy, the labor market, and the performance of municipal governments. Moreover, there are significant, low cost ways to improve the functioning of the housing market that would reduce the burden of what appears to be an unfunded mandate for the cities.

Accordingly, the more general market-oriented policies may be seen as a prerequisite to policies that only improve the situation of the poor. With this caveat in mind, there is also a strong need for both social policies that address the needs of the poor, as well as promote a better understanding of the way that housing policy affects the functioning of local governments. Ultimately, it is local governments who are responsible for implementing both housing regulations and programs. At present, it appears that these obligations vary considerably across cities and are not fully understood. As the above recommendations make clear, creating the basis for a well-functioning market is of highest priority. An important dimension of that basis is how well local governments fulfill their essential role ■



For an electronic copy of the full report, please contact Ashna Mathema (amathema@worldbank.org)
or visit www.worldbank.bg.