

**REPORT ON PRELIMINARY ASSESSMENT
OF MORTGAGE FINANCE AND PRIVATIZED HOUSING MANAGEMENT
IN THE FEDERATION OF BOSNIA-HERZEGOVINA**

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EXECUTIVE SUMMARY

A preliminary assessment of certain aspects of the housing sector in the Federation of Bosnia-Herzegovina (FBiH) was conducted December 3-12, 1997. The assessment focused on two areas, mortgage finance and housing management.

This report is divided into three sections. Section I includes principal findings on the areas of mortgage finance and housing management, including legal and institutional impediments to effective market-based transition, and a discussion of certain issues in the implementation of privatization of apartments. Section II sets out recommendations for legal and policy changes. Section III makes suggestions for further study or technical assistance activities that might be considered by USAID. Comparisons with other countries in Central and Eastern Europe (CEE) and experiences from USAID programs in those countries are incorporated throughout the report where appropriate. Annex A presents additional information on the housing sector in FBiH, and Annex B lists the meetings conducted for this assessment.

Principal Findings

Mortgage Finance. The assessment found the following impediments to development of market-based mortgage lending in FBiH: the legal framework is inadequate to support institutional mortgage lending; ownership rights are often unclear and usually unregistered; housing production and purchase traditionally have been financed outside the banking system; and banks currently lack capital and liquidity to make mortgage loans. Experience in other CEE countries, including Croatia, indicates that legal and institutional reform should begin now so that a supporting framework is in place when the economy is sufficiently recovered to improve the ability of banks to lend and housing consumers to borrow.

Management of Privatized Housing. The Law on Privatization of Apartments provides no guidance on organization or management of apartment buildings after privatization. It is necessary to promulgate regulations on establishment of owners' associations as legal entities, and to clarify the rights and responsibilities of owners. Condominium programs in other countries in the region have demonstrated the importance of establishing owners' associations as soon as possible after privatization, to increase the likelihood of success of the privatization program in terms of owner satisfaction, preservation and improvement of the housing stock, and establishment of private entrepreneurial services to the housing sector.

Implementation of the Law on Privatization of Apartments. The expectation that apartment privatization will be complete by early 1999 is unrealistic. There are no official application or contract forms or instructions on procedures, and there is substantial uncertainty about what entity is responsible for implementing privatization of apartments,

how residents will document the right to privatize, how contracts will be notarized, and how transfers of ownership will be registered in the land registry.

Recommendations for Legal and Policy Changes

Mortgage Finance. Recommendations include adoption of new laws on Mortgage, Enforcement of Judgments, and Real Property Registration, along with administrative and regulatory efforts to clarify and improve procedures for administering registration of ownership rights and liens. Adoption of policies and programs to provide incentives for savings and to encourage private housing expenditures is recommended for the medium range. Programs to increase capital and liquidity for mortgage lending are longer term recommendations.

Management of Privatized Housing. Preparation of model condominium regulations for consideration by cantons is recommended. It is also advisable to proceed with clarification of the tax status of owners' associations, privatization of public housing companies, and adoption of policies to encourage the development of private sector services to privatized buildings.

Implementation of the Law on Privatization of Apartments. Recommendations include clarifying responsibility for implementation of the law, including the role of the municipality, preparing sample applications and contract forms, and preparing instructions for administering privatization procedures, such as receiving and processing applications, pricing, installment sales management, and registration of title and liens. Designing programs to make best use of proceeds, such as revolving loan funds, is also recommended.

Suggestions for USAID Technical Assistance

Several specific technical assistance approaches are suggested in Section III, based on the recommendations for legal and policy changes in Section II. It appears that the time is right for USAID to consider programs for development of a market-based housing sector in FBiH. On the eve of a program of mass privatization of socially owned housing, the Federation is at an important crossroads not only in the allocation of housing to its citizens but also in the role housing might play in overall post-war stabilization and normalization of economic activities. Donor activity here has been concentrated on resolving the problems of pervasive damage to the housing stock and displacement of the population as a result of war, but as FBiH enters a third year of peacetime recovery and reconstruction, international agencies are shifting emphasis from humanitarian assistance to economic development.

The fact is that in the post-socialist period in FBiH, housing must be financed, produced, allocated, and managed in ways that are completely different from the past.

USAID is in a unique position to facilitate the successful implementation of housing privatization and the beginning of a housing finance system that operates on market economic principles. For the past seven years, USAID has taken the lead in post-socialist CEE and NIS in providing technical assistance to the housing sector, particularly in the areas of housing finance and organization and management of condominiums in privatized housing. By applying lessons learned in other countries, carefully targeted efforts could yield substantial benefits in FBiH.

I. PRINCIPAL FINDINGS

Time constraints on this assessment prevented the kind of thorough examination and familiarity with the sector that would be necessary before technical assistance programs aimed at solving the problems identified could be successfully implemented. Nevertheless, the study yielded findings with regard to mortgage finance, housing management, and implementation of the apartment privatization law that the author believes are sufficient to begin to design efforts directed at facilitating successful transformation and providing assistance with those aspects of the housing sector. Legal and institutional impediments to transition are discussed throughout Section I. Specific recommendations for legal and policy changes and for further study and technical assistance are discussed in Sections II and III of the report.

A. Mortgage Finance

Residential mortgage lending is virtually unknown in Bosnia-Herzegovina. There are a number of institutional and legal reasons for this, including the following:

The Legal Framework Is Not Adequate to Support Mortgage Lending

There is no mortgage law *per se* in FBiH. To the extent that loans are secured by real property by agreement between the parties, the controlling law is the Law on Obligations.¹ For such loans, the obligation usually is registered with the court. As a result of the historic and pervasive disuse for land registration for ownership rights (as discussed below), it is not the practice to register a lien in the land records, even in cases where current ownership for the property used as collateral is registered and a mortgage lien could be registered.

The Law on Enforcement Procedures² provides for enforcement of court orders. It includes procedures for foreclosure or sale of immovable and movable property used to secure a loan. In order for a creditor to receive a court order allowing foreclosure of real property, the creditor must submit to the court a registered land certificate as proof of registration of the property in the ownership of the debtor. If ownership is registered in the land registry in the name of a person other than the debtor (as will often be the case, if there are any ownership rights registered at all), the creditor must submit to the court a document sufficient to register the debtor's ownership rights. If it is not possible to produce a document sufficient to register title, the creditor must initiate a separate legal proceeding

¹ The Law on Obligations, SFRY 29/78-1181, as amended, is a general law that regulates the rights and duties arising from contractual and other obligations in the exchange of goods and services. It includes provisions for collateralization with immovable and movable property.

² SFRY 20/78-673, as amended.

seeking a court decision that the debtor is entitled to register ownership. In other words, it is the responsibility of the creditor to resolve any issues of unregistered title before it can proceed with execution against the debtor. Even if the creditor is ultimately successful, such procedures could take many years and cost more than the value of the property at stake.

Once the debtor's ownership rights are established, the creditor faces several other problems. Assuming the property is sold, certain other claims must be settled from the proceeds before the creditor can be paid. If there are other creditors, the residual proceeds must be shared. Finally, and most importantly, in residential property the debtor has a right to remain in residence indefinitely, as a tenant of the purchaser. This may prevent a lender or a purchaser in foreclosure from ever taking possession of the collateral. Needless to say, this single provision makes market-based residential mortgage lending a practical impossibility.

Comparison with Other CEE Countries. Throughout CEE during the socialist period, mortgage lending was legally possible but rarely used as the sole security for housing loans. Lenders were usually state-owned banks and most borrowers were employed by the state, so access to employee wages was considered both an adequate and the most efficient means of achieving loan recovery in cases of default. Mortgage liens were required, however, and were routinely registered in the land records. If nothing else, they served to assure payment eventually, when the property was sold.

Throughout the region, substantial improvements in the legal framework have been accomplished to permit market-oriented mortgage lending. Western European laws serve as the models for legal reform, even in USAID-sponsored programs, because of the dissimilarities between the European and American systems of mortgage finance, and to facilitate eventual admission to the EU and cross-border lending and mortgage banking activity. Mortgage banking laws have been passed in Poland and Hungary, and are under consideration in Slovakia and the Czech Republic.

Reform of loan recovery laws has been successfully accomplished in most countries. In Hungary, Poland, Slovakia, Czech Republic, and Croatia, foreclosure can be accomplished without a court proceeding and restrictions on eviction have been eased, providing the lender complies with certain requirements in preparing the loan documents. Priorities in order of payment from proceeds of execution have been altered to improve the position of the mortgage lender in Slovakia, Poland, and Hungary.

This is not to say that there is a substantial amount of mortgage lending without other forms of security. Third-party guarantees are still required in almost all cases, and the preferred procedure for recovery of loans in default is wage attachment rather than foreclosure. Foreclosures do take place, however, even if only as a last resort, and the expedited legal procedures are regarded as an effective deterrent to default.

Ownership Rights Are Often Unclear and Usually Unregistered

Since World War I, ownership rights or changes in title have not routinely been registered in the land records. This is almost always the case for the socially owned apartment buildings, which are owned by enterprises or municipalities, and for the parcels of land upon which the apartment buildings were built, which are owned by the municipality. Registration records are more common but far from complete for privately owned single family houses and the small parcels of land upon which they are built. Ownership status for any real property is likely to be unclear and difficult to prove from a legal standpoint.

Recent efforts to resolve conflicting claims to socially owned housing by the Commission for Real Property Claims have resulted in the registration of tenure rights for thousands of socially owned housing units, in both enterprise and municipality-owned housing. These tenure rights have been registered at the court, not in the land registry, since the holder of tenure rights is not the owner of the land or the building. Estimates are that 50 percent of the socially owned apartments in Sarajevo now have court-registered tenure rights. This will facilitate registration in the land registry of changes in ownership resulting from privatization of the socially owned housing, as required by the Law on Privatization of Apartments with Existing Tenure Rights, and thus indirectly will contribute to development of institutional mortgage finance.

Comparison with Other CEE Countries. In most countries, land registries are regarded as reliable repositories of records on ownership rights and interests in real property. Croatia is an exception, probably for reasons similar to those in FBiH. For the most part, problems with land registries are administrative in nature, primarily in that registration procedures are cumbersome and very slow³, but recently adopted laws and computerization are gradually eliminating administrative problems.

Banks Lack Sufficient Capital to Make Housing Loans

Severe liquidity and capital problems limit the ability of banks in FBiH to make loans, even to the most creditworthy customers. Under prevailing circumstances, medium or long-term housing loans are simply not a feasible option. Banks are heavily dependent on international agency transfers and deposit accounts; 70 percent of their income comes

³ For example, in Poland registration is administered by regional courts, with filings handled by judges rather than administrative personnel. Ownership does not transfer until registration is complete, which may take six months or more. Banks making loans for purchase of property incur risk during that period that the borrower does not have good title. Efforts are now underway to amend the controlling law and introduce the position of registration clerk, following the German model.

from fees for international transfers.⁴ The primary source of liquid funds is deposits for working capital made by international donor agencies and contractors. The ability of banks to invest these funds is limited by law and by the requirement to have sufficient cash on hand to meet depositors' needs. Some banks do invest in short-term German bonds.

Eighty percent of current bank assets are in the form of foreign currency accounts that were held by the National Bank of Yugoslavia and which were frozen when the war began;⁵ 10 to 15 percent are essentially uncollectible loans to state enterprises.⁶ As a result of the freezing of foreign currency accounts, many citizens lost their savings and remain reluctant to deposit their cash in a bank.

On the positive side, there are a few banks that are now making commercial loans available for housing purposes, often at concessional rates. They are usually small private banks with foreign partners. These banks have indicated interest in more conventional mortgage lending. Loans currently made for housing purposes are usually in the range of 5,000 to 7,000 DM, with interest at 10 percent and terms ranging from 90 days to two years. Ordinary commercial loans are made for 90 days to one year, at about 25 to 40 percent interest. Borrowers are required to open deposit accounts or buy shares in the bank as a qualification for taking a loan. Deposit accounts, usually in an amount equivalent to one third or more of the loan, must be maintained while the loan is outstanding. There is no market for bank shares, so the borrower who is required to buy them must maintain an interest in the bank indefinitely.

The Federal Banking Agency, which receives advice under the USAID Economic Restructuring Project, has 50 member banks, including 30 in Sarajevo. Advisors to that project believe that a number of banks would be interested in making mortgage loans if their capital and liquidity problems were eased, and would be capable of managing them.

Comparison with other CEE Countries. In no other country in the region do banks experience the extreme capitalization and liquidity problems of banks in FBiH. Croatia, with similar (if less severe) problems resulting from freezing of foreign currency accounts and reluctance of citizens to save, and with a similar history of financing housing, has made substantial progress toward recovery and may provide some useful indicators for the

⁴ It is interesting to note that competition has had the expected impact on these fees, which in Sarajevo have gone from 6 percent in early 1996 to about 1 percent at the present time. Some larger agencies have negotiated fees of 0 percent for transfers and .5 percent on withdrawals. In other cities, where there is less competition, fees are higher. In Tuzla, for example, fees currently run 4 to 5 percent.

⁵ It is estimated that there are 10 billion dinars in frozen assets in the entire banking system, and 750 to 800 million dinars of non-frozen assets in the system. (100 dinars = 1 DM.)

⁶ Loans to state enterprises did not have to be paid during the war. Now they must be paid, but there is no way to enforce this requirement without bankrupting all the enterprises.

banking sector and housing loan activity in FBiH in the near future. Housing lending in Croatia was estimated to amount to DM 150 million in 1996,⁷ similar on a per capita scale to housing lending in Hungary. Demand for loans for purchase, renovation, and improvement of housing is estimated to be 10 times greater than current lending activity, and Central Bank of Croatia data show that banks there are steadily increasing their lending to households relative to lending for commercial activity. Three major lenders⁸ account for most of the housing loan activity, but a number of other banks have expressed strong interest in housing lending.

In other countries in the region, despite recent changes in the legal framework for loan recovery, housing loans are regarded as more risky and difficult to administer than other types of loans, and less profitable than other uses of funds, such as purchase of government bonds. Among potential borrowers, high interest rates and reluctance to incur debt are strong disincentives to borrowing. In Hungary in 1994, for example, only 14 percent of housing investments came from loans; 75 percent came from the owners' own funds and 11 percent from government subsidies.

Government policies and programs encourage savings to increase available funds for housing loans. Hungary, Slovakia, and Poland have instituted contract savings plans with generous government subsidies, based on the German (*Bausparkassen*), Austrian, and French (*Epargne Logement*) models, respectively. In addition, a legal framework for mortgage banking and issuance of mortgage bonds has been adopted in Hungary, Poland, Slovakia, and Czech Republic.

Housing Was Produced and Purchased without Institutional Finance

Privately Owned Housing. Housing ownership, primarily in the form of single-family homes, has long been a predominant feature of the shelter sector in the former republics of the former Socialist Federal Republics of Yugoslavia (SFRY). At the present time, it is estimated that 81 percent of the housing units in FBiH are privately owned single family homes. While such housing is particularly prevalent in rural areas and small towns, it also comprises about 40 percent of the housing in the Sarajevo canton and half of the housing units in the seven largest cities.

Institutional lending played no discernible role in the financing of production or purchase of single family housing. Housing was paid for by the owner out of savings or financed by a loan from the enterprise employing the owner. Enterprise housing loans usually had long terms and low rates; terms could be adjusted to reflect the employee's status with the enterprise. Loans were secured with personal guarantees and the wages of

⁷ DM 100 million net of required deposit accounts equal to 1/3 of loan amounts.

⁸ Zagrebaska Banka, Privredna Banka Zagreb, and Splitska Banka.

the borrower, not by the property itself. There is no reliable data on the number or terms of such loans that have been made or their current status, but such loans were regarded as secure and reliable; presumably, if the borrower failed to pay, his wages were attached.

Socially Owned Housing. Nineteen percent of the total housing stock in FBiH is comprised of socially owned housing, consisting primarily of apartment buildings located in larger cities. In 1991, there were about 260,000 socially owned apartment units in FBiH. In Sarajevo, socially owned housing accounts for 56 percent of the total housing stock; in the seven largest urban areas of FBiH, it accounts for about 50 percent.

The production of socially-owned housing was financed by enterprises and municipalities. Since the 1960s, construction of multifamily housing usually was organized and carried out by a public enterprise operating under the authority of the municipal governments, Javno Stambeno Preduzece (Public Housing Company). A tender would be issued, to which various enterprises or municipalities could respond by contracting for purchase of the number of units they could afford and needed for their employees. Construction costs were paid in advance, and could be increased during the construction period to keep pace with inflation. After completion of the building, occupancy or tenure rights were assigned to families. The enterprises or municipalities who paid for construction of the building remained the owners. Javno Stambeno Preduzece managed and maintained the buildings under contracts with the owners. Maintenance was financed from rent collected from the residents, as discussed below.

There were no direct central or local government subsidies for construction or management of housing. Enterprises funded construction of housing for their employees from their own income or profits. A central Housing Solidarity Fund was used to finance construction of apartments for persons who had no other access to housing, or for employees of enterprises in "nonproductive" sectors (government, education, research) or enterprises with insufficient income to house their employees. The Housing Solidarity Fund was made up of payroll deductions of 6 percent from all enterprise employees.

Comparison with Other CEE Countries. In other countries with comparable rates of privately owned single family housing (Hungary and Romania, for example), construction or purchase ordinarily was accomplished by self-construction over a number of years out of current income, with family savings, or with a central-government subsidized loan from a state-owned bank. During the socialist period, most multifamily housing construction throughout the region was carried out by state-owned and subsidized enterprises, with the state remaining the owner and the occupants being tenants of the state.

A substantial portion of the multifamily stock (ranging from 20 in Hungary up to 50 percent in Poland) was constructed by state-subsidized cooperatives. The cooperatives would remain the owner of the property; members of the cooperative resided in the

buildings under occupancy agreements, with limited rights to dispose of their interests.⁹

Throughout the region, the former state-owned rental housing units have been privatized and cooperative housing interests have been converted to true ownership rights, with the housing now in the condominium form of ownership.

B. Housing Management

Management of Socially Owned Apartment Buildings

The public enterprises Javno Stambeno Preduzece (Public Housing Company) which organized and constructed socially owned housing are also responsible for its management and maintenance.

The Javno Stambeno Preduzece for the canton of Sarajevo is called Sarajevostan. It has constructed 35,000 apartment units since it was established in 1968. It now manages 60,000 units out of a total of 75,000 socially owned apartments in the canton. (The rest are military and other kinds of government-maintained housing.) Since the breakup of SFRY, there has been no new construction of apartments in Sarajevo. In the last few years, Sarajevostan has been a contractor under programs funded by the World Bank, EU, and other agencies for reconstruction of housing in Sarajevo.

Other larger cities have equivalent public housing companies, but Sarajevostan is the only one that covers an entire canton. It became cantonal property two months ago; before that, it belonged to the city of Sarajevo. The director of Sarajevostan said it wants to become privatized, but as a public enterprise it expects to be among the last to be able to do so. Sarajevostan hopes to continue maintaining the housing after privatization, under contract with the resident owners.

As discussed above in the section on financing of housing production, Sarajevostan constructed housing by pre-selling units to enterprises and municipalities, which then allocated the apartments and assigned tenure rights to the residents. After construction, the owners (the enterprises or the municipality) contracted with Sarajevostan to maintain the housing. Right now, Sarajevostan has contracts with 50 enterprises. It operates under the control of a managing board with representatives of the larger enterprises.

Sarajevostan finances maintenance activities out of rent collected from each tenant. Rents are set by local governments by a point system regulated by the central

⁹ There does not seem to have a system for construction of cooperative housing in FBiH. Between the breakup of SFRY and the onset of war, some groups of citizens formed "unions" through which they would pool their resources and construct apartments that they would then own. Whether or not the apartments were owned in the form of condominiums or cooperatives, this system is fundamentally dissimilar from the subsidized cooperatives common in other countries under socialism.

government. Points are calculated on the basis of such factors as the quality of the building and apartment, size of apartment, and location of the building and apartment. Rent is now an average of 35 pfennigs per square meter -- about 20 to 25 DM per apartment. Rent covers not only routine maintenance, but also capital repairs, insurance, and administrative costs. According to regulations, a very small amortization fee for the cost of construction of the apartment is to be collected as part of the rent and turned over to the owner, but this is rarely done, according to Sarajevostan. Sarajevostan expects the cost of maintenance after privatization to be substantially higher than rent has been until now, which should be an incentive to privatize.

Separate accounts are not maintained for individual buildings, and all income goes into a central account for all Sarajevo. Expenditures are determined by priority of need, not by income from a building. Nevertheless, Sarajevostan says that the costs of operating a particular building can be determined. Technical records and buildings plans, both as-built and from alternations to the original structure, are kept for each building Sarajevostan maintains.

Each building is given 10 percent of the rent collected there for its own maintenance account. Expenditures from the account are within the discretion of a Housing Council, a group in each building that is elected by the tenants. A president, elected for a two-year term, has access to the funds in this account, which are used for such things as hiring someone to sweep the halls or for minor repairs. The residents hold meetings and vote on how to allocate discretionary funds. The Housing Council is also responsible for collecting sums from each resident to pay for common area utility services or for services to the apartments that are not individually metered. The Housing Council is not a legal person.

As was true of public maintenance enterprises throughout the region, maintenance services by the Javno Stambeno Preduzece ranged from minimal to nonexistent. It seems that most routine maintenance tasks are in fact carried out and funded by the Housing Council. Capital repairs were made only in cases of extreme necessity, and even before the war most of the socially owned housing stock was in poor condition and in need of renovation and improvement.

Comparison with Other CEE Countries. As discussed above, most multifamily housing in CEE was constructed and managed by state-owned enterprises and was maintained in ownership of the state. Rent was regulated by state law and was lower relative to family income (often 5 percent or less) than in FBiH. Costs of maintenance were subsidized by the state budget, but the quality of service was very low. Capital improvements were rare, and preventive maintenance was virtually unknown.

The only country with an organization analogous to the Housing Council was Romania, where Tenants' Associations had authority to collect payments for certain common expenses, such as utility services, and to undertake and pay for maintenance and repairs.

The Tenants' Associations had strong connections to the local Communist party hierarchy (the president was required to be approved by the party), however, and were regarded with deep mistrust by the residents. The Housing Councils in FBiH, on the other hand, seem to have no political significance and serve a useful function in their buildings.

Management of Privatized Housing

The apartment privatization law provides no guidance on management of the buildings after privatization. Rather, it provides that regulations regarding the management of the common property of the building are to be promulgated by cantons within two years of the effective date of the law. This provision leaves an unfortunate gap in time during which new owners will have only two alternatives: they can struggle on their own to try to organize and manage their buildings, or they can enter into contracts with the public housing companies, which are likely to continue to provide the same poor quality of services as they have in the past but will be free to raise their prices.

Since the existing Housing Councils are not legal persons and therefore cannot enter into contracts, presumably each owner will have to arrange a separate contract with the maintenance company. And even assuming cantons promulgate the required regulations in two years, there is no guidance available to them to help assure that the results will be sufficient or even useful to the owners, or that there will be consistency from place to place.

In addition to allowing the owners' association to decide how the property will be managed, including the option of managing the property itself, legal status facilitates the ability of owners' associations to contract for services on the competitive open market. This encourages the formation of small private enterprises offering services such as property management, maintenance, accounting, renovation consulting, and the like.

Technical assistance efforts could serve to ameliorate many problems created by this gap in the law. Particularly applicable experience has been gained in Romania and Slovakia. In Romania, like FBiH, housing was privatized without a condominium law.¹⁰ Demonstration projects designed ways for owners to organize and register an association as a legal entity in the absence of a condominium law, and training programs and public information campaigns were mounted to explain to the new owners their rights and responsibilities and teach them how to operate their properties. In Slovakia, condominium regulations were promulgated as part of the privatization law. The law permitted but did not require the establishment of owners' associations. Privatization was implemented by the public maintenance companies (as it probably will be here) who believed it was in their interest not to organize a legal owners' association but to enter into individual maintenance

¹⁰ Apartment housing in Romania was privatized between 1990 and 1992. A Condominium Law, prepared with USAID technical assistance, was passed in 1996.

contracts with each of the owners. This system proved to be unworkable for the maintenance companies as well as the owners. Technical assistance projects have been directed both toward the establishment and operation of owners' associations and the privatization of maintenance companies. These projects have had significant benefits in the development of the small private enterprise sector as well as the private housing sector itself.

The following are the most significant lessons learned from technical assistance programs in condominium management in other CEE Countries:

Requirement of an Owners' Association. Policy makers, legislators, and residents themselves have come to realize that condominiums in privatized housing have a better chance of succeeding, both in terms of owner satisfaction and improvement in housing conditions, if owners' associations are required by law and put into place at the time privatization sales begin. An organization of owners is needed as a mechanism for making decisions and for enforcing rules and obligations of ownership. This is particularly important in former socialist countries, where tenants had no expectation of owning their own homes and little experience with making decisions about the management of their own buildings.

Legal Status of the Owners' Association. Another vital element of the legal framework for successful privatized condominiums is the power of the owners' association to act as a legal entity. This is particularly important in the context of management or renovation of the property, where the association must be able to enter into binding contracts with service providers and contractors, enforce the financial obligations of the owners, and use association assets to secure credit.¹¹

The laws in Hungary and Poland provide only partial legal authority to owners' associations, which has constrained efforts to make common property repairs or renovations in those countries. A new condominium law, now in the Parliament of Hungary, will correct this problem. In Poland, limits on the legal authority of the association were placed in the law to protect creditors by assuring that individual owners could be held liable for debts of the association. Knowledgeable Poles regard it as unlikely that the law will be amended in the near future.

Tax Status of Owners' Associations. It is important that owners' associations be treated as non-profit associations for tax purposes, so that they are not required to pay taxes on ordinary income such as maintenance or other operating fees collected from

¹¹ If the association is not a legal entity, it has no authority to borrow on its own behalf. In order to obtain bank financing, individual loan agreements must be negotiated with each owner in a building, and all owners must agree to have a mortgage placed on their property.

owners. This status is granted under condominium laws throughout the region. Owners' associations are required to keep books and records under applicable accounting laws, and to pay taxes on income from sources other than fees from owners, such as leasing of spaces in the common property.

Delineation of Owners' Rights and Responsibilities. When people share ownership and use of property, they must establish rules to facilitate decision making and to protect the value of the property. Guidelines for this purpose should be set out not only in the condominium law itself; the law should also require a contract among the owners, usually called an association agreement. Such a contract serves to provide more detailed rules about the rights and responsibilities of ownership -- how the owners will share the common property, make decisions about and pay for common expenses, and make and enforce rules of the association.

Aside from the ordinary problems of operating the property, many privatized condominiums must wrestle with the additional problem of mixed public and private ownership resulting from the sale of fewer than 100 percent of the units in a given building. Condominium laws usually provide inadequate guidelines regarding the voting rights of the non-private owners and what financial responsibilities those owners have in the operation and management of the building. In many cases, there is confusion about when the non-private owners must pay the monthly condominium fee and whether it must contribute to a renovation fund. Some local regulations require the association to collect fees directly from tenants in non-privatized units, despite the fact that under the law it is the owner's obligation to pay such fees.

C. Implementation of the Law on Privatization of Apartments

The Law on Privatization of Apartments with Existing Tenure Rights was passed in November 1997. It was "Gazetted" (officially published) November 28 and took effect December 6. Implementation will begin March 6, 1998. Persons with tenure rights have one year thereafter to submit an application for purchase. The "holder of handling rights" (seller) has three months after submission of the application to complete the sale,¹² after which the new ownership rights are to be registered in the land registry. Thus, the law contemplates that housing privatization could be complete as early as June 1999. Experience in other countries in the region, even where an implementation infrastructure was well established and there was little problem with documenting the right to privatize, shows that it is likely to take much longer.

Responsibility for Implementation. The law does not specify what entity will actually implement the law, that is, accept and decide on applications, calculate prices, issue

¹² Otherwise, the tenant has to right to initiate a court procedure against the seller. The verdict of the court overrides the contract.

contracts, and register new ownership rights. For example, if the seller is an enterprise, can it delegate its responsibility to another entity, such as the public housing company? Since the municipality owns the land upon which the housing is built, and a proportionate share of the land is included in each privatization contract, the implication is that the municipality will have to be involved in each sale, even if all apartments in a given building are owned by one or more enterprises.

Sarajevostan is preparing for apartment privatization, even though it has not been delegated the authority to administer the process by any of the owners with which it contracts or by the canton privatization agency. It has prepared a short handbook on privatization procedures, which includes application and contract forms, and will offer its services to the owners of the buildings it manages. It expects some enterprises will want to administer privatization on their own. In that case, Sarajevostan will still have to cooperate with the owner, for example, by providing the records of tenure rights it maintains for all apartments under its management.

Sarajevostan expects most eligible tenants to privatize, which will place a tremendous strain on administrative services. Even though the average purchase price of 7,000 - 10,000 DM is high for most families, many families have certificates that can be used to pay part or all of the price. Others will use the option of making installment payments over time.¹³ The law allows payments over a 25 year term at 1 percent interest. The cost of paying the average purchase price under these terms is only about 40 DM a month, substantially less than rent is expected to be after privatization (at least 100 DM a month).

The law presents a number of other issues that are relevant to successful implementation of privatization and the start of a stable housing market, including the following:

Right to Privatize. The fundamental premise of the law is that all persons with tenure rights in apartments (except for several narrow exceptions¹⁴) are entitled to buy their apartments under a price scheme provided in the law. Persons with tenure rights are those persons (or members of their family, as defined in the Law on Housing Relations, in

¹³ The price for a privatized apartment here is substantially higher than in other countries in CEE, which on average ranged from several hundred dollars (Romania) to several thousand dollars (Hungary). The option of making installment payments over many years at low interest was a common feature of privatization schemes, but surprisingly few people took advantage of these extremely favorable terms.

¹⁴ Premises are not considered apartments under this law if they are in buildings for individual lodging, for temporary lodging or in administration and business buildings. Apartments in buildings for which demolition procedures have been initiated, buildings intended for lodging during official activities, and buildings used for activities of state administration, federal administration, courts, health facilities, and for traffic and communication purposes.

cases of assignment or death) who are owners of an apartment, those who have a legal contract for use of an apartment, those who have rights pursuant to a court decree, and persons assigned an apartment under authorized entities under the Law on Housing Relations.

Article 28 of the law deals implicitly with the issue of conflicting claims for apartments with tenure rights issued before the war which are now occupied by other persons. After privatization, refugees, soldiers, or family members of soldiers who are deceased or invalids and are currently occupying an apartment on a “legal” basis (presumably, through some kind of official assignment but without tenure rights) can remain in the apartment for a maximum of three years under a lease arrangement with the owner, with lease terms determined by a separate law on leasing apartments. As a result, a holder of tenure rights who abandoned a socially owned apartment during the war and who elects to privatize will become the landlord of the family that occupied the apartment after the holder of tenure rights left. This provision, the results of a political compromise, could be a substantial impediment to the ability of the new owners to organize and take on cooperative responsibility for the management of the building after privatization.

Recent efforts have been made to resolve conflicting claims to tenure as a result of abandonment of apartments during the war and allocation of those apartments to subsequent occupants.¹⁵ After claims are resolved, tenure rights are registered at the court, not in the land registry, since the holder of tenure rights is not the owner of the land or the building. Regardless of one's perspective on the political issues underlying such conflicts and their implications for post-privatization management, registration of resolved tenure rights should help speed the privatization of affected apartments. Forty to 50 percent of the apartments in Sarajevo have newly registered tenure rights.

Exception to Time for Completion of Contracts. Article 7 of the law provides that the one-year term for concluding a contract is extended in cases where “all relevant facts” for selling the apartment are not known when the request is submitted. In such cases, the three month period for concluding the contract begins at the time when all the relevant facts are known.

Persons responsible for developing procedures to implement the law should be as clear and specific as possible on the definition of “all relevant facts” and what documentation or other evidence is necessary to establish them. Apparently, “relevant facts” can include matters related to pricing, such as evidence of pre- or post-war investment in the apartment, as well as establishment of tenure rights. This provision could

¹⁵ These claims are determined by the Commission for Real Property Claims of Displaced Persons and Refugees, reportedly a highly respected body which is made up of Bosnian, Serbian, and Croatian judges with jurisdiction to resolve claims for tenure rights through 2002. The Commission also resolves claims for ownership rights.

greatly complicate transactions for the seller or its agent, as well as delay completion of sales.

Pricing. The scheme for pricing the apartments is quite complex, but the law probably provides adequate guidance on calculation of base prices, credits, and discounts. Payments can be made in cash or by certificates issued on the basis of various “citizen claims” including foreign currency savings accounts. Many complications in determining price and verifying documentation of claims for reduction in price can be expected, which will slow down the privatization process.

A buyer can opt to make installment payments over a period of 25 years at 1 percent interest (or a shorter period at a lower interest rate, if the cantonal authority so decides). In such cases, the buyer must allow the seller to register a mortgage on the apartment until the installments are paid. The apartment cannot be re-sold until all installments are paid.

Clear instructions and examples of how the credits and discounts work, and how mortgages are to be registered if sales are made in installments, should be made available to the public by the privatization implementation offices.

Notarization and Registration. The contract must be submitted by the seller to an authorized “legal officer” (presumably, a public notary) for validation within 30 days of signature. The contract becomes final upon approval by the notary. If the notary disagrees with the sales price, he must inform the parties within 30 days that the contract should be changed. If the parties do not comply with the decision of the notary, he can apply to the court to invalidate the contract.

Ownership rights attach upon registration in the land register. Cantonal regulations are to be promulgated on registration of ownership rights upon completion of sales. In cases where apartments were not previously registered, new registration documents are to be issued by the court in the jurisdiction where the relevant land registry is located.

Again, clear instructions and sample forms will be necessary to accomplish these procedures within a reasonable time frame. Even then a great deal of confusion and a backlog of paperwork can be expected because the land registry was rarely used to register ownership interests in socially owned housing, and because the condominium form of ownership will be unfamiliar to notaries and registrars as well as prospective owners.

Allocation of Proceeds. The law provides a rather complicated scheme for allocation of proceeds of the privatization sales. Proceeds of sales of government-owned apartments are allocated 80 percent to the cantons and 20 percent to the Federation. Proceeds of sales of enterprise-owned apartments go to the enterprise, until the enterprise itself is privatized, to be used as follows: 90 percent for concessional loans to employees

who wish to purchase apartments and 10 percent for the administrative costs of privatization. After the enterprise is approved for privatization by the privatization agency, proceeds go to municipal and city budgets of the jurisdiction where the enterprise is located, to be used for development of utility infrastructure. In all cases, 30 percent of the proceeds are to be used for construction of apartments for categories of persons affected by the war.

Management of Housing after Privatization. The law fails to provide for a structure or rules for managing and operating the housing after privatization. It requires regulations for this purpose to be adopted on the cantonal level within two years of the law's effective date. This is a significant problem that is discussed above, in the section on Management of Privatized Housing.

II. RECOMMENDATIONS FOR LEGAL AND POLICY CHANGES

A. Mortgage Finance

Basic Legal Framework

- Adopt a mortgage law
- Adopt a new law on enforcement of judgments
- Foreclosure procedures
- Priorities of payment from proceeds
- Eviction
- Adopt a new law on real property registration

Registration of Real Property Ownership Rights and Liens

- Clarify procedures for registration of ownership interests and liens
- Develop procedures for administration of real property registration

Capitalization of Banks

- Consider policies and programs to encourage savings
- Long range: Consider mortgage finance mechanisms (mortgage banks and mortgage bonds)

Housing Production and Purchase

- Consider incentives for private housing expenditures, including development, renovation, and reconstruction (such as short term tax incentives)

B. Management of Privatized Housing

- Prepare model regulations for adoption by cantons
- Organization of owners' association
- Legal status of owners' association

- Clarification of owners' rights and responsibilities
- Prepare model association agreement
- Clarify tax status of owners' association as non-profit organization
- Privatization of public housing companies
- Encourage establishment of other private housing management enterprises, through short-term tax or other incentives

C. Implementation of the Law on Privatization of Apartments

- Clarify responsibility for implementation or options for delegation
- Clarify role of municipality with regard to land
- Prepare and disseminate sample application forms and contracts
- Prepare instructions for implementation:
 - Responsibilities of owners
 - Responsibilities of public housing companies
 - How to receive and process applications
 - Clarification of who is entitled to purchase
 - Clarification of acceptable evidence of entitlement to purchase
 - How to evaluate evidence of entitlement to purchase
 - How to calculating prices
 - Preparation of procedures for installment payments
 - Procedures for notarization of contracts and registration of title
 - Instructions for allocation of proceeds
- Design programs for local governments to make best use of proceeds (e.g., revolving loan funds for infrastructure improvements for privatized buildings)

III. SUGGESTIONS FOR FURTHER STUDY AND TECHNICAL ASSISTANCE

Introduction

Why should USAID-sponsored programs in the housing sector in FBiH be appropriate at this time and valuable for future economic development?

The war placed extraordinary stress on economic and political systems and has delayed the transition to a market economy in the post-socialist period. With diminished resources, FBiH is now facing the same daunting institutional and legal transformation that began in most other CEE countries in the early 1990s.

Several factors might help ease the way, particularly in the transformation of the housing sector. As part of the former SFRY, FBiH had experience with a relatively open and less centralized economic system compared to elsewhere in CEE. There has been a strong tradition of decentralized housing production and private housing ownership here, as opposed to the monolithic role played by the state in other countries in the region. In addition, experience gained in tackling similar problems is available to provide models and to help avoid time-consuming and costly mistakes. Programs under USAID sponsorship have resulted in substantial progress in institutional development and legal reform of mortgage finance systems, several housing privatization and condominium programs in the region are nearing completion and have had a high degree of success in terms of improvements to the housing stock, contribution to small enterprise activity, and citizen satisfaction.

In order to design some of the suggested technical assistance programs, it may be necessary to develop a more thorough understanding of the relevant sectors than was possible was for this report. It should be possible to design other programs, such as assistance with housing privatization and establishment and operation of condominiums, on the basis of findings to date.

Some of these programs might best be carried out in coordination with those of other donors and international agencies, most of whom are in the process of shifting emphasis from humanitarian and emergency assistance to economic development. In November 1997, the European Commission and the World Bank identified priorities in the housing sector for the next two years that are consistent with recommendations made in this report: (1) clarification of property rights; (2) introduction of cost recovery on donor-financed housing investments, moving away from grant-based programs; (3) development of a sustainable housing finance system through local banks; (4) rationalization of rental charges, and organization of building maintenance and administration systems for public housing; and (5) privatization of housing stock.¹⁶

¹⁶ "Status Report to the Donor Community on Implementation of the Priority Reconstruction Program."

Mortgage Finance

Legal Reform. Preparation of laws on mortgage, enforcement of judgments, and real property registration should be undertaken now to prepare a legal framework conducive to market-based mortgage lending.

Policy and Implementation Dialogues with Relevant Actors. Working groups comprised of representatives of banks, courts, relevant ministries, and legislators have been established in several countries to provide an ongoing vehicle for discussion of new policies, laws, and implementation procedures. This has been a valuable adjunct to legal reform by increasing consensus and practical knowledge about lending issues.

Increasing Capital and Liquidity for Mortgage Loans. Programs are underway to increase mortgage finance mechanism (such as mortgage banks and mortgage bonds), and to encourage savings. These should provide not only useful models for design of programs, but also indicators of appropriate timing.

Introduction of Cost Recovery Principles in Donor-Funded Reconstruction or Renovation Loan Programs. Technical assistance could be providing in conjunction with loans, such as the planned EU grant of a 20 million DM credit line in mid-1998 for housing purchase, reconstruction, or renovation loans, in amounts up to 50,000 DM for terms up to 15 years. The funds will come through local banks to individual borrowers.

Management of Privatized Housing

Condominium Law, Model Condominium Regulations, and Owners' Association Documents. USAID programs have contributed to preparation of condominium laws, regulations, and owners' association documents throughout CEE and NIS, making good models readily available. There has been substantial experience with explaining underlying concepts and building consensus to assure legislative success.

Privatization of Maintenance. A number of program have assisted with privatization of former public housing maintenance companies, and establishment of condominium management services in the private sector.

Training in Condominium Operations and Property Management. Handbooks, training manuals, and curricula for training owners' associations and property managers have been used successfully throughout the region.

Financing and Implementing Condominium Renovation. Programs in a number of countries, including Slovakia, Romania, and Hungary, have worked with new owners in privatized housing to design, finance, and implement renovation and major repair projects.

Creative approaches to cost recovery have been emphasized, such as increasing efficiency of heat systems and constructing new apartment units in common area attic spaces under the roof that can be rented or sold. When bank financing is used, advisors have worked with lenders to design loan products and documents appropriate for condominiums, as well as working with owners to increase their understanding of the benefits of using banks loans to improve their property.

Implementation of the Law on Privatization of Apartments

Assistance with Administration of Privatization. Very valuable short term assistance could be provided to coordinate the preparation of forms, instructions, and procedures for housing privatization. National dissemination of models and a public information campaign could be useful in clarifying requirements under the law.

Use of Proceeds of Privatization. In housing privatization and condominium programs in other countries, including Hungary and Slovakia, USAID has designed revolving loan programs for privatized apartment renovation with funds from the proceeds of privatization and from local government budgetary allocations. If cash proceeds from apartment sales prove to be substantial here, these programs would provide useful models.

ANNEX A

ADDITIONAL INFORMATION ON THE HOUSING SECTOR

Socially Owned Housing Production. A trend toward rapid urbanization, which began in the mid-1970s and continued until the outbreak of war, resulted in 86.9 percent of the population living in larger cities and towns. In Sarajevo, 56 percent of the housing stock is socially owned apartments. In the seven largest urban areas of BiH, some 50 percent of families lived in socially-owned apartments.

A quantitative shortage of housing in BiH after World War II had been overcome by the early 1980s. In fact, in the 1991 census, there were some 91,000 more housing units (counting weekend or vacation houses) than there were number of households. Of 1.3 million apartment units in 1991, over 800,000 had been built after World War II.

Despite the collapse of production after 1991 and damage and destruction as a result of war, there is no statistical evidence of a shortage of housing.

Quality and Condition of the Socially Owned Housing Stock. Estimates are that 57 percent of housing units in BiH were destroyed or substantially damaged in the war. Of 1.3 million apartments registered in the 1991 census, as many as 51 percent or 600,000 units have been damaged. Estimates are that 100,000 units were damaged to an extent exceeding 60 percent, 110,000 units between 40 and 60 percent, 150,000 units between 15 and 40 percent, and 300,000 units up to 15 percent.¹⁷

Although it is difficult to assess with any precision, the quality of construction of the socially-owned housing stock appears to be comparable to that of other CEE countries. While the pervasiveness of war damage may be unique to BiH, the vast majority of privatized buildings throughout CEE share the need for substantial rehabilitation to bring them into good condition, let alone up to modern standards. Since the 1960s, prefabricated panel construction has been the norm, often with poor quality of materials and workmanship. More importantly, housing maintenance was for the most part a notion rather than a reality. It is recognized that in BiH, as elsewhere in the region, funds designated for housing were directed toward construction and not maintenance.¹⁸

As elsewhere in the region, the most pressing needs to be addressed in apartment

¹⁷ Study by Dr. Mehmed Bublin, Institute of Architecture, Urbanism, and Spatial Planning, Sarajevo (1997).

¹⁸ During some periods, as much as 10 percent of the state budget was directed toward housing construction, compared to 4-5 percent in Hungary, 3.7 percent in Poland, and an EU average of 2-4 percent for all types of housing expenditures, including loan subsidies.

reconstruction are: roof repairs or replacements, inadequate thermal insulation, leaking panel joints, obsolete or low quality mechanical systems, inadequate connections to infrastructure (particularly water and sewage lines).

Socially Owned Housing Consumption. In 1991, the floor space of the average apartment in FBiH was 55.16 square meters, an improvement of about 21 percent over 1971 (45.65), but smaller than some other CEE countries (Hungary: 69.2 square meters; Poland: 60.3 square meters).¹⁹ The average apartment had 15.17 square meters per person, well below the CEE average of 20 square meters per person, and less than half the Western European average of 32 square meters per person.

Forms of Tenure

Privately Owned Housing. Housing ownership, primarily in the form of single-family homes, has long been a predominant feature of the shelter sector in the former republics of the former Socialist Federal Republics of Yugoslavia. Private housing has been characterized by a system of free-standing construction, usually with a ground floor and one upper floor, and relatively low population density. In general, the population occupying private homes had lower income than those in socially-owned apartments. Construction costs were usually financed by loans on favorable terms from the enterprise employing the owner.

A significant number (up to 30 percent) of private homes were constructed illegally, that is, without official construction or occupancy permits; this figure can be expected to increase as dislocated families rebuilt their former houses or build new ones during the post-war period, when local authorities may have little capacity or inclination to enforce construction regulations.

Rights of ownership frequently have not been registered in the land registry. Nevertheless, ownership is recognized informally.

Tenure Rights in Socially Owned Housing. Since the 1970s, FBiH has had a system of housing tenure rights to apartments under social ownership. Tenure rights are of Constitutional stature and are regulated under the Law on Housing Relations, No. 14/84, 12/87, and 13/89. The law provides that tenure rights exist from the date of legal occupancy of the apartment until a stated termination date, under a contract granted by the Administrative Body for Housing. Disputes over tenure rights are resolved by the courts. Tenure rights grant an exclusive right to use the apartment, including the right to sublease it. They can be terminated or exchanged by the bearer, or by the grantor if the bearer breaches the contract for occupancy, such as by failing to pay rent, using the apartment for

¹⁹ Current BiH figures are more than one-third less than in Western Europe and more than one half less than US norms.

commercial purposes, or disturbing other occupants of the building.

Tenure rights are similar to occupancy rights granted in other CEE countries, where the state constructed most multifamily housing and allocated it through more traditional rental arrangements. The tenant usually had the right to remain in the apartment indefinitely, and the state was required to provide a substitute dwelling in the few cases when eviction was possible. Tenure rights in FBiH do confer certain additional rights, such as the right to sublease or exchange apartments, which did not exist elsewhere.

Rental Housing. A small private rental market exists in Sarajevo at the present time, although this is not quantified in any published data.²⁰ Despite the fact that there are many people in the city who have no tenancy rights from before the war, most of the rental activity is geared toward housing foreigners. With rents averaging 300 to 600 DM a month, most local families would be able to buy or build a house for an equivalent amount.

Rentals have occurred in the past, however, in all forms of housing, including family houses which were subdivided and in privately and socially owned flats. This activity probably reflected the former system's greater tolerance for private economic activity than in most other CEE countries. With the substantial increase in rates of apartment ownership expected to result from privatization, these factors suggest a future expansion in the private, small-scale rental market.

²⁰ One estimate made prior to the breakup of Yugoslavia was that 5 percent of all households rented from private parties.

ANNEX B

LIST OF ORGANIZATIONS AND INDIVIDUALS INTERVIEWED FOR PRELIMINARY ASSESSMENT

USAID PROGRAMS

USAID

Michael Kerst
Emir Mehmedbašić
James O. Watson

East-West Management Institute (EWMI), Center for Law Reform

Stephanie McPhail, Director of Law Reform
Charles A. Schwartz, Director of Business Reform and Commercial Law

USAID Economic Restructuring Project

C. Dale Wilson, Financial Institutions Advisor, Barents Group/KPMG

:

USAID Business Development Program:

Business Consulting (BC)

Guy Sommers, Deputy Director

Business Finance (BF)

Bruce Spake, Chief of Party
Roger Bird, Credit Manager

OTHER INTERNATIONAL AGENCIES AND DONORS

Office of the High Representative

Andreas Herdina, Refugee and Humanitarian Affairs
Peggy L. Hicks, Human Rights Advisor

Commission for Real Property Claims of Displaced Persons and Refugees

Steven Segal, Executive Officer

Amb. Brunson McKinley, Bosnia Humanitarian Coordinator for the US

International Management Group

Kevin Mannion, Deputy General Manager and Chair of Housing Task Force

Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ)

Eduard Hoffman
Werner F. Gronwald

CLAS - City Link Amsterdam Sarajevo

Felix de Vries, Head of Mission

FBIH AGENCIES

Ministry of Physical Planning and Environment

Fatima Hadjibegic, Chief of Law Department
Muris Hadjic, Director of PIU Housing

Sarajevostan Javno Stambeno Preduzece (Public Housing Company)

Dzvad Kadribegovic, Director
Fevzija Karahasanovic, Deputy Director

League of Communities and Cities of BiH

Anton Štitić, Secretary
Mehmedalija Huremovic, Chair, Housing Committee