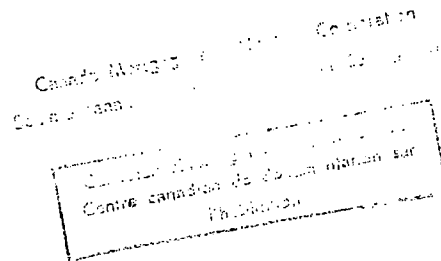


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COMMERCIAL OPPORTUNITIES FOR CANADA'S HOUSING SECTOR IN CENTRAL AND EASTERN EUROPE



Report Prepared by
Canadian Urban Institute
for
International Relations Division
Canada Mortgage and Housing Corporation

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Canada

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PREFACE

The Canadian Urban Institute was commissioned by the Canada Mortgage and Housing Corporation to assess the potential for the involvement of Canada's housing sector in addressing Central and Eastern Europe's (CEE) housing needs.

The study was conducted between September 1992 and March 1993. Most of the information and data was collected through primary research, such as interviews and fact-finding missions.

A large number of individuals and institutions from across Canada, the United States, and Western and Eastern Europe participated in the conduct of this study. The creation of an extensive database and network was made possible through the Canadian Urban Institute's technical aid programs in Eastern Europe, which are primarily funded by External Affairs and International Trade Canada.

The study identifies and assists in the assessment of potential commercial housing opportunities in the CEE region. It also identifies possible future areas for research. The authors trust that the study will prove useful to potential entrepreneurs and substantially contribute to the general understanding of the housing market conditions in the CEE region and Canada's capacity to respond to these conditions.

The study's preliminary findings were condensed into a Summary Report that was presented as the Background Papers for CMHC's *Workshop on Housing Opportunities in Central and Eastern Europe* in Montebello, Quebec on April 19-20, 1993. The outcome of this workshop has been incorporated into the study.

The authors would like to thank all of the individuals, firms and institutions which were willing to share some of their experiences and strategic information, and on doing so, contributed to the preparation of this report. Further, we would like to thank the staff of CMHC, who provided key information and greatly contributed to the writing of this document.

Tibor Frank, April 1993

EXECUTIVE SUMMARY

Significant housing opportunities have materialized since the twenty-seven countries of Central and Eastern Europe (CEE) began to restructure their respective housing sectors in 1989. It has been estimated that over fifty percent of the existing housing stock requires major renovations and that there will be a regional need for over 15 million new housing units by the year 2000. This need is being exacerbated by the fact that housing production has dropped to its lowest levels in over 40 years. CEE housing sectors will not be able to respond to this potential demand without foreign participation.

The potential long-term market in the CEE region will be shaped by the purchasing power of over 400 million people. However, since this purchasing power will depend on the success of economic and political reforms, it will take time for effective demand to develop on any appreciable scale. Poland, Hungary and the Czech Republic have the most immediate prospects for developing viable mass markets in the foreseeable future.

In the short-term there will be a great need, though only limited effective demand, for foreign housing products, technologies and services. Even in the long-term, it is expected that the market potential for the importation of foreign products into the CEE region will be limited and the opportunities that exist will mainly involve the local production of building materials and fixtures through joint ventures with Western partners.

Opportunities in the short-term are likely to be strongly associated with government assistance projects and addressing particular niche markets such as: building luxury housing and hotels for representatives of Western firms doing business in CEE countries, expatriates and other clients; providing housing in remote resource communities; and converting, rehabilitating and refurbishing centrally-located commercial or mixed-use properties.

Opportunities in the longer term will be both more numerous and varied and will be strongly linked to the mass market for new housing or the renewal, rehabilitation, renovation, conversion or retrofitting of the existing housing stock. Nevertheless, many Canadian firms are likely to remain highly specialized and continue to serve either localized markets in particular countries or specific market niches regardless of where these occur in the CEE region.

Very special circumstances have resulted from decades of totalitarian regimes and the restriction of decision-making in both the personal and economic spheres. Consequently, the foreign investor must identify and implement creative solutions to the challenges that will be encountered. This requires an understanding of how the current state of affairs came to be in different CEE countries, the nature and scope of the present economic and social disorder throughout the CEE region as well as the main characteristics of the emerging CEE marketplace.

The economic principles which guide decision-making in a market-driven system will not necessarily work in the CEE region. The emerging housing markets are unique and will not necessarily respond to conventional Western economic approaches. The ability to provide a

product or service of the highest quality at the best price does not guarantee success in the CEE region. Real estate and housing markets are only now in the process of being created and therefore Canadian firms entering the CEE marketplace at the present time should participate in the creation of these markets. This participation might entail additional initial costs and some delay in achieving profitability.

Canadian organizations wanting to benefit from existing opportunities must approach CEE markets cautiously and with creative solutions. Due to the fluidity of the situation in the CEE region, the risks associated with conducting business are great. Comprehensive market, political, and financial feasibility analyses must be performed by individuals with an in-depth understanding of the local environment and marketplace. The Canadian investor must also be very patient and cautious.

Currently, the largest percentage of foreign involvement is occurring in the production of building materials. Western companies, primarily Austrian and German, are becoming involved in the establishment of new production plants as well as in the privatization of state-owned production facilities. Westerners, including Canadians, have also successfully entered the luxury housing market.

In sum, however, it is the mass renovation and new home markets that will engage foreign entrepreneurs in the coming years, and in this regard, Canadians would appear to be well placed to capture a sizeable share of the markets that will develop. Canada's housing sector has the flexibility to respond to CEE climatic and other conditions that are almost identical to those found in Canada and the industry has demonstrated that it has the capacity to deliver large amounts of high quality housing at an affordable price. Canadians would also appear to be well positioned to address the massive amount of renovation and renewal that needs to be undertaken throughout the CEE region as well as municipal and other infrastructure that needs to be provided in conjunction with dwellings.

However, Canadian firms will be competing against Western Europeans who have a locational advantage which can often offer prospective buyers relatively low-level financing based on credits obtained from their respective governments. Most of the European Community governments, recognizing the CEE markets' potential importance to their national economies, are actively supporting the endeavours of their domestic companies in the CEE region and the level of support that these governments offer far exceeds Canadian government initiatives to date.

Taking into account the potential size of the long-term market and the fact that it will remain unsatisfied for many decades, Canada's housing sector should immediately position itself to ensure a substantial share of the long-term market. All segments of Canada's housing sector should pool their resources, coordinate efforts and develop a strategy that will allow them to participate effectively in the restructuring of the CEE housing sectors and the creation of their respective housing markets. The information exchange that was provided at *CMHC's Workshop on Housing Opportunities in Central and Eastern Europe* in Montebello, Quebec on April 19-20, 1993, served as an initial and productive step in this direction.

CEE HOUSING OPPORTUNITIES

INTRODUCTION

Trading countries such as Canada need to be interested in Central and Eastern Europe (CEE) because:

- Over 400 million people inhabit the former Soviet-controlled region.
- All countries in the CEE region have demonstrated an enormous appetite for Western goods. The CEE region currently buys about US \$60-70 billion worth of products annually from suppliers in the OECD countries and this amount should increase significantly by the end of the decade.
- The CEE region is well endowed with natural resources. Materials, such as lumber, minerals, fossil fuels, and aggregates, have the potential to generate hard currency income as well as attract large amounts of investment capital.
- The capital stock and physical infrastructure of the CEE region is obsolete. Decades of declining investment and neglect have left most of the CEE countries with industrial equipment and production methods that are antiquated and inefficient. Significant proportions of the supporting physical infrastructure are non-functioning by Western standards and need to be upgraded or replaced.
- Political and economic transition has created a climate in which CEE countries are eager to attract investment. By the spring of 1992, over 200 Western companies were registered in Moscow and even more in Budapest, Warsaw and Prague. Currently, there is a severe shortage of suitable office and residential accommodation in the CEE region to serve the needs of Western firms.

OPPORTUNITIES IN THE CEE REGION

The transformation of CEE housing sectors will provide numerous potential opportunities for Canada's housing sector, especially in the long-term. The size of the long-term market is immense and will remain unsatisfied for decades to come. It is estimated that over fifty percent of the existing housing stock requires major renovations and that there will be a regional need for over 15 million new housing units by the year 2000.

Due to a limited productive capacity, CEE housing sectors will not be able to address potential demand without foreign participation. There is also a recognition that CEE housing sectors must be restructured to become more compatible with a market-based system and that the required know-how to accomplish this transformation will have to be imported.

The extent of the disarray in CEE countries affects all segments of their housing sectors. Construction technologies and management methods will have to be transferred from foreign organizations. Also, virtually all professional services, and especially services relating to housing finance in a market-based housing system, will have to be introduced. However, because of the many political, economic, and social changes that are taking place, Canadian organizations wanting to participate in CEE markets will need to do so prudently.

In order to participate in the long-term market, Canadian firms would be well advised to start with markets that are viable in the short-term, develop working relationships with persons with intimate knowledge of the local environment and establish contact with local business and political decision-makers. Furthermore, Canadian firms need to recognize that potential CEE clients are wary of Westerners and are unlikely to enter into a business relationship until a foundation of trust has been established. This will include being confident that the foreign firm intends to be in the CEE market over the long haul. Also, a strong commitment to creating as much value added as possible in the local community is needed to ensure strong support from authorities in the host country.

Short-Term Opportunities

In the short-term, CEE markets offer some possibilities for suppliers of products and services that can be utilized directly in the construction process. For example, it is reported that some Canadian building products including windows, asphalt shingles, vinyl siding and steel doors are in strong demand in advanced markets such as Poland. However, Canadian suppliers of state-of-the-art construction technologies will probably have to either wait for the market to become more active, or introduce their services on a limited basis, usually supported by their own financing.

Niche Markets

At the present time, financially viable niche markets are centred around activities that are typically able to generate hard currency or countertrade that is easily converted into hard currency. There are several niche markets that are currently being served by Canadian firms and these include building luxury housing for the representatives of Western commercial interests and well-to-do nationals and providing accommodation for foreign travellers. Canadian firms are also currently involved in providing housing-related products and services for resource extraction and other activities that require establishing residential accommodation in remote areas. Another short-term opportunity has arisen in conjunction with the provision of products and expertise for thermal-retrofitting existing dwellings and commercial buildings.

The proportion of the population that is able to potentially afford housing in the short-term ranges from a few percentage points in countries like Poland to a minute fraction of one percent in countries like Russia. This segment of the population includes diplomats, Western business people, repatriates and the emerging Central and Eastern European commercial elite.

Government and Multilateral Assistance Projects

As much as \$25 billion has been injected into the CEE regional economy by Western governments and business interests to support economic reforms and finance new investments. It is also being increasingly recognized that restructuring the CEE region's economies must continue to be strongly supported from abroad and it is relevant to note in this regard that the Government of Canada recently announced its intent to shift aid and funding priorities from the southern developing countries to the CEE region. Another relevant development is the view by both recipient and donor countries that external support must include technical and financial aid aimed at strengthening CEE housing sectors and supporting housing-oriented reforms.

Canadian organizations have access to federal funding for technical assistance projects and commercial venture financing is available from both provincial and federal agencies. Assistance that will help Canadian firms to participate in tendered contracts is also available from multilateral organizations such as the World Bank and the European Bank for Reconstruction and Development. Further, Canadian federal agencies are actively helping Canadian firms to access funds from multilateral organizations.

To date, federal technical assistance to the CEE region has generally consisted of financing the transfer of Canadian knowledge and expertise (consulting services) that will underpin future market-based housing sectors in the CEE region and these consulting services have related to financial, environmental and urban management. However, as housing becomes a higher CEE priority, and as the Canadian government pursues its intention to re-focus its aid to strengthen export and commercial linkages, it can be expected that assistance may take the form of programs and projects that have significant housing components. Possibilities in this regard could include the construction of housing for returning Russian soldiers, the promotion of Canadian wood-frame housing technology and the export of Canadian technologies relating to the rehabilitation and energy retrofitting of high-rise concrete structures.

Long-Term Opportunities

Opportunities in the longer term will mainly encompass products, services and technologies related to the mass market and these will relate to both the development of new affordable housing as well as the renovation, rehabilitation and retrofitting of the existing housing stock. In addition, specific market niches will continue to exist and many Canadian firms will continue to serve these markets, some on an exclusive basis.

Western firms are currently taking steps to ensure that they will be in a position to effectively participate in the mass market once it emerges, and in some cases, are incurring significant initial costs to establish a presence in the CEE region and participate in the creation of the market. In order to survive in a situation of limited effective demand and at the same time develop a profile in the marketplace, contractors are building offices, hotels and upper-end housing for the Western clients that are doing business in the CEE region. Also, for the same reason, manufacturers are

establishing facilities that are capable of producing building materials for both domestic and export markets.

It is expected that mass housing opportunities will not occur until effective demand improves for the general population. On a regional scale, this will not happen for at least a decade, however, Poland, Hungary and the Czech Republic could develop effective housing demand within a much shorter time. This will require stable and functioning real estate markets (i.e. enforceable legal framework, comprehensive inventory of land, bankers with underwriting abilities, etc.) that will allow lenders to discard their perception that housing is a high-risk investment.

Geographic Incidence of Opportunities

Opportunities are being created in all parts of the CEE region. For example, the extraction of natural resources by Western firms operating in the Caspian Depression, in Siberia and in and Kazakhstan have resulted in some noteworthy possibilities. For example, there is a growing demand for modular housing in projects under development as well as for more permanent types of housing at established sites.

In addition, opportunities for luxury housing have appeared in many of the CEE's capitals, especially the cities that are attracting significant amounts of Western investment. Similar opportunities related to diplomatic housing have been created in the capitals of the newly-independent republics, including Kiev, Riga, Tallinn, Vilnius, and Bratislava.

The termination of subsidies and changes in Communist policies has caused significant demographic shifts and migration patterns:

- With the cessation of farming subsidies and the resulting collapse of the agricultural sector, many people are now migrating to the cities to find work.
- It is estimated that over one million people could return to the central and southern parts of Russia in response to decreased subsidies under Russia's revised northern settlement policy.
- There is a mass migration of people out of areas experiencing ethnic conflict.
- Resettlement plans are being developed for people living in communities that have been seriously contaminated by the Chernobyl nuclear accident.

SPECIFIC OPPORTUNITIES

Specific housing-related opportunities have been identified throughout the CEE region in a number of different housing-related areas. These opportunities have been divided into the

following categories:

- Existing Housing;
- New Housing;
- Physical Infrastructure;
- Building Products and Technologies;
- Special Cases; and
- Housing-Related Services.

Existing Housing

Rehabilitating/Energy-Retrofitting of Pre-Cast Concrete Buildings

There are hundreds of thousands of high-rise pre-cast concrete buildings of the same age and building technology and virtually all have the same problems. They all require upgrading to higher standards of energy efficiency, lay-out and comfort. There are acute shortages of materials and know-how that are required to perform these tasks. With the privatization of the housing stock, a large number of new owners will renovate once financing and suitable materials become available. This type of housing dominates the Russian urban landscape and is present to a greater or lesser extent in urban centres throughout the CEE region.

High-rise rehabilitation is potentially the largest single problem facing government officials in all CEE countries since failure to make needed repairs will result in the failure of many of these structures within the next decade and their replacement would be beyond the financial capacities of CEE countries. Failure to make these buildings more attractive to their occupants will also mean that few of these buildings will ever be privatized and will remain a permanent financial burden on municipal governments.

Conversion/Restoration of Centrally-Located Old Buildings

Virtually all of the beautiful, neo-classical residential buildings located near city centres are urgently in need of restoration and retrofitting for energy efficiency. Such buildings already occupy centrally-located sites within cities and are desirable locations in which to live. Conversion of these buildings to new mixed-uses and condominiums are activities that are being pursued by Western enterprises. In some cases, these firms have entered into joint ventures with the owners of such buildings (often municipalities) wherein the Western partner finances and upgrades the units for a portion of the hard currency rent or an equity position (or long-term lease of prime space) in the restored building. Other reported cases have involved the renovation of housing units within privately or cooperatively-owned buildings by Western firms. In these projects, the ground floors were converted into commercial space and the top floors were redeveloped as office space. The firms were paid for the conversions and other work performed from the proceeds of sale of the commercial and office spaces.

Opportunities of this kind are most prevalent in older cities like Prague, Krakow, Budapest, and Riga, which still contain large numbers of historic buildings that are structurally sound. These buildings have the advantage that their ownership can be established unequivocally. This will permit the building to be offered as prime collateral for any loans that may be required and thus allow the renovations to proceed without fear that ownership of the building will be contested once the work has been completed.

Thermal-Retrofitting of Single Family Dwellings

The outskirts of many of the CEE regional capitals contain a significant amount of private housing that urgently needs repairs. Upgrading in terms of energy efficiency is especially important in these dwellings because the termination of energy subsidies has resulted in prohibitive energy costs.

Further, there are many secondary homes outside of the cities. These homes are being used as summer cottages and could not be winterized under Communist housing policies. Due to the acute need for housing, pressures exist to convert these houses into year-round, permanent residences. For example, around the city of St. Petersburg, there are between 80,000 and 100,000 private housing units that could potentially be winterized to provide permanent housing.

Building Demolition and Recycling of Building Materials

Thousands of the Soviet-style apartment buildings, older neglected structures, and even some of the newer but poorly-built buildings are uninhabitable and will have to be torn down to make way for new development. Canadian firms are specialized in the demolition of buildings in built-up areas as well as the recycling of previously-used building materials. No estimates are available of the potential in this area throughout the CEE region. However, in Hungary alone, it is reported that as many as 50,000 housing units become obsolete annually and many of these need to be demolished for reasons of safety or to make way for new construction.

New Housing

Provision of Luxury Housing

Demand currently exists for all types of luxury housing such as detached single family homes, especially where these dwellings are built in self-contained and secure communities within commuting distance of the downtown business districts of major CEE cities. There also exists a limited market for Western-style luxury mid-rise apartment buildings with secured premises and recreational facilities in or near the central business districts of the capital cities. These types of luxury housing are being demanded by diplomats, Western business people, repatriates and newly-rich Central and Eastern Europeans. Opportunities for the development of high-end

housing units have arisen in many of the regional capitals, especially the cities that are attracting significant amounts of Western investment, as well as in the capital cities of the newly-independent countries such as Kiev, Riga, Tallinn, Vilnius and Bratislava.

Providing North American style housing for repatriated citizens is a small but promising market opportunity. There is a potential market being created from affluent citizens returning to their countries of origin mainly from North America. Repatriates have the necessary capital to purchase new housing. Further, the presence of this familiar market segment, which is accustomed to North American housing technology and building techniques, reduces the need for time-consuming and potentially expensive marketing investments that are directed toward stimulating demand for North American housing products and technology.

Canadian developers have extensive experience in developing housing projects and are technically well placed to respond to CEE needs for new low, medium and high-density housing in and around urban areas. This experience extends to providing the supporting physical and administrative infrastructure that will be required.

Affordable Housing for the Mass Market

One of Canada's overall strengths is its ability to build large amounts of high quality housing quickly and at a low cost. However, the segment of the market that would require this capacity is not expected to materialize in the CEE region in the foreseeable future. Nonetheless, there is a large amount of pent-up demand for affordable housing in a detached, semi-detached or low-rise form with a small private garden. In these cases, building form (masonry, wood, wood-panel or other) and quality are important. The units could be as small as 50-60 sq.m. in size, but of a design suitable for families. The prime factor hindering the development of the mass market is the absence of a mortgage market. Once effective demand is created, providing housing for the mass market should continue at a high level of activity for several decades.

It is expected that Poland, Hungary, and the Czech Republic will be the first CEE countries to develop mass housing markets. In these countries in the short-term, the best opportunities for Canadian investors interested in ultimately providing new housing for the mass market might be to consider building basic elements of wood-frame homes that could be adapted to any required configuration by working with local architects. This kind of flexibility in approaching CEE housing markets could be expected to fare well vis-à-vis locally-built housing which tends to be inflexible, technologically dated and lacking of imagination. At the same time, however, Canadian builders would need to be aware of local preferences for particular architectural styles, materials, etc. and incorporate these elements into the products that they offer.

One style of home that may have potential if marketed correctly is the "three generation home" which can accommodate grandparents, parents and their children. This type of home is thought to be an option that is capable of accommodating an extended family unit in a style of living that is relatively economical.

Physical Infrastructure

Modernization/Expansion of Infrastructure and Municipal Services

Municipal services and infrastructure are generally in poor condition, and in many areas outside of large urban centres, this infrastructure may be non-existent. District heating and cooling plants as well as sewage and waste disposal facilities are unable to cope effectively with current requirements. There is an especially severe shortage of basic infrastructure outside cities.

Telecommunication Systems

There is a dire need for the installation of telephone systems into existing housing units as well as the development of networks to service new housing. The waiting period for the installation of a telephone ranges from 2-10 years for the typical new CEE household. The attractiveness of new housing is closely linked to the extent that new housing can be well served with communications and other basic services. The situation is relevant for firms relying on telephone and fax lines to conduct business. For example, in Budapest, old, damaged and short-circuiting cables buried beneath the city are reputed to cost business people uncounted frustration, time and money every business day. The business sector is currently exploring the potential for digital phone lines and satellites to help remedy deficiencies in Budapest's telecommunications network. The World Bank estimates that over \$30 billion dollars will be spent on telecommunications infrastructure in the CEE region in the next decade.

Housing Products and Building Materials

Heating/Energy Conservation Products and Technologies

Until the last year or two, energy efficiency was not a cost consideration for individual households since energy was supplied at a highly subsidized rate, and in most cases, energy was delivered in bulk to individual buildings and a nominal charge was made to each household in the building. With the termination of energy subsidies, however, an overwhelming majority of dwelling units in the CEE region are excessively costly to heat or cool and require retrofitting with energy saving products such as individual meters, energy-conserving windows, thermostats, doors, wall and ceiling insulation, and appliances. For example, since the end of 1991, energy costs have risen over 1400% in Latvia. In response, the Latvian government declared an energy emergency in the fall of 1992, and allocated \$40 million for emergency energy conservation measures under the Energy Sector Emergency Investment Project.

Building Products Manufacturing

A number of Canadian firms are providing a variety of building products and materials through joint ventures, licensing and other arrangements with CEE companies and the potential exists for practice to be further expanded as Canadian products gain acceptance in CEE markets. Some of these firms are not only providing products for CEE markets but are aiming at Western European markets and are using the relatively low-cost and technically-competent labour pool in certain CEE countries to gain a competitive edge.

Foreign competition in this segment of the market will be fierce. For example, it is reported that a trade show in Poznan, Poland in January 1993 attracted hundreds of German, Austrian, Italian and Swedish firms showing their products in every imaginable branch of the construction industry including construction equipment, tools, hardware, windows, doors, kitchen and bathroom systems, plumbing, electrical materials, structural materials, brick, wood, plywood, roof systems, tiling and siding. A number of these firms have already set up manufacturing facilities in Poland. The Canadian presence at the Poznan trade show was limited to a few lines of imported products such as asphalt roof shingles, vinyl siding and prefabricated wood homes. It has been reported that demand for Canadian-made materials in the short-term is likely to be limited to roof coverings, windows, OSB sheathing, pre-fab metal chimneys, vinyl siding, steel doors and possibly pre-finished interior panelling.

Products of high quality, such as vinyl doors, windows, plumbing and tiles, are already being manufactured in Poland. Also, these products have the potential to be very competitive on the international market. It is reported, for example, that Polish-made flexible polyethylene has the potential to be cost-competitive in Canada.

Retail Building Product Sales

The CEE region is characterized by the absence of distribution networks and poor co-ordination among suppliers of building and finishing materials. Consequently, it is very difficult and expensive for small contractors or private home-owners to purchase tools, building materials and supplies needed to undertake or complete even the simplest projects. CEE flats are usually sold without cupboards, bathroom or kitchen fixtures and are often occupied unpainted and without finished flooring. Opportunities exist for the establishment of retail outlets that would function as central and local distributors of a variety of building products and tools for both the contractor and the do-it-yourself client.

Investing in State-Owned Building Material Production

Western European multinational corporations, and especially German-based firms, have been actively acquiring the assets of firms being privatized, or are investing in firms that CEE countries have decided should be retained, either wholly or partially, in the public domain. These

investment opportunities are thought to be of a short-term nature and the most attractive investments are rapidly disappearing.

Special Cases/Niche Markets

Defence Conversion - Housing for Russian Military Personnel

There is an immediate and urgent need in Russia for low-cost, energy-efficient housing for Russian military personnel currently stationed at bases in the former Warsaw Pact countries. Treaties signed after the break-up of the Warsaw Pact oblige Russian troops to vacate former Soviet bases. The Russians cannot leave, however, until housing is provided in Russia. It is estimated that there are over 200,000 officers that will require new housing for their families. Further, the commitment of the Russian legislature to provide housing for Russian military was illustrated when they rejected President Yeltsin's proposed referendum of April 1992 and re-allocated the referendum's funds to assist in housing Russia's returning military personnel.

The physical need is tremendous, but as always, the issue involves financing which is in short supply in Russia. Also, a successful repatriation program requires support in both the country being vacated and the recipient country. In January 1993, Germany signed an agreement worth more than \$100 million to build housing (average value of \$108,000) for Russian military personnel and it is possible that funding for an initiative of this kind could result from forthcoming G-7 meetings.

Hotel and Resort Development

There is a severe shortage of hotels in all of the regional capitals, tourist areas and along major highways. There is a significant demand for Western quality hotels of a mid-price range that is unlikely to be satisfied for several years. Furthermore, tourism-related activities have a high potential for generating hard currencies. Up until now, the major foreign hotel chains have concentrated their efforts in the largest cities and have targeted their accommodation to the commercial traveller rather than the tourist.

Cottages and Holiday Homes

A class of "nouveau riche" exists which has the financial capacity to purchase secondary housing in tourist areas. Land in these areas is currently relatively inexpensive. There are also opportunities for the building of housing in conjunction with resort/hotel development. This type of housing has a potentially strong appeal for expatriates. It is also reported that there is strong interest by Germans in developing summer cottages in various rural locations in Poland.

Housing in Resource Communities

Opportunities exist for the provision of housing in support of resource extraction and other activities where work camps are needed. In particular, there exists a demand for modular housing to accommodate workers. However, where the settlement has prospects of existing for some time, more permanent types of dwellings may be built if it is cost-effective to do so.

Housing Demonstration

Pilot/demonstration projects have proven to be a particularly effective way of introducing firms, products or technologies to the CEE region, and indeed, may be the only viable way to create or enter a new market. Central and Eastern Europeans are highly traditional in their approach to housing and need to be shown that new products, designs, technologies, etc. are superior to traditional ones before they will respond.

Professional and Service Infrastructure

Property Management

Canada has a significant amount of experience in the property and investment management fields and these are required in the CEE region. Further, Canada's experience in providing and managing public housing could be utilized to establish credibility and position Canadian service companies to gain access to the CEE markets.

Construction Management

There is dire need to improve all facets of the construction management process. There is an acute shortage of the required management skills and quality control is virtually non-existent.

Municipal Information Systems

There is a serious lack of public sector financial resources to perform the work that is urgently needed. Local governments have no means to finance infrastructure due to the absence of a property tax system and updated land records. Consequently, there is a recognized need to establish an information system to assist in the management of all assets and resources.

Mortgage Financing and Construction Loans

The financial and banking services in the CEE region are rudimentary. Currently, there is very little mortgage money available in the CEE countries. Reasonable mortgage funding would make private housing accessible to a much larger segment of the population. Further, access to reasonably priced construction loans would greatly expand the productive capacity of the building industry. At the present time, to secure construction loans in the CEE region, collateral requirements range from 150-200%. Possible options to this problem include UK-type building societies, mortgage-backed securities, CMHC-type mortgage insurance, etc.

Western banks and other lending institutions are in the process of becoming established in the more advanced CEE countries. For example, the Polish-American Mortgage Bank Fund that was established last year currently offers mortgage loans to private borrowers for the purchase of single-family homes. Provided the borrower can contribute 50 percent of the cost, the loan is made available for 15 years based on a 12% annual interest rate. The Polish-American Bank will also provide construction loans for contractors who are building homes to international standards in that country.

Urban and Environmental Consultancy

Canada has a large range of development expertise that could be and is being exported as consulting services (such as approvals process, public participation programs, design, energy efficiency, environmental impacts, indoor air quality, regulation and standards, financing, market forecasting and feasibility, etc.). In the short-term, opportunities are usually limited to participation in Canadian technical aid programs. Nonetheless, opportunities do exist for consultants to perform impact and feasibility studies, economic research, sector studies, tourism and housing potential analysis, etc.

Sales/Marketing Consultancy

Under the command economy of the previous era, marketing, if it was considered at all, was categorized with clerical functions. Further, real estate brokers and Western-style sales forces are rare in the CEE countries.

Opportunities for Government and Industry Associations

Given that demand and opportunities for business exist in the CEE region, it is in Canada's best interest to assist in establishing the underlying framework, infrastructure, and information base within which housing development can be conducted. Canada's experience in establishing and managing public housing can be utilized to position Canadian companies in gaining access to the CEE housing markets. Also, Canadian assistance in establishing national housing institutions in the CEE region would permit Canadian firms to participate effectively in this market.

Public Sector Management and Organization

Both trades people and professionals (engineers, architects, planners) in the CEE countries are comparable or equal to their Canadian counterparts in technical knowledge and skills. However, the management process and financial systems, particularly at the local government level, are often not suited to the needs of a democracy and market-based economy. Advice in strategic planning for economic development, development regulations, financing and taxation, zoning and by-law enforcement, geographic information systems, etc., is urgently required.

Trade Associations and Professional Affiliations

There is a need to organize industry and professional services to make their operations efficient and cost effective. CEE tradespeople are skilled in masonry construction, however, for Canadian wood frame and other technologies to be successfully transplanted to CEE countries, their tradespeople would require re-training.

Organizations such as the Polish-American Home Builders Association in Gdansk provide platforms for the training of Eastern Europeans so that they become familiar with how housing development operates within a free-market. This organization is promoting the interests of U.S. home builders and will allow them to participate on influential advisory boards and allow better access to attractive deals, acquisitions, joint ventures, etc.

Business Management Training

CEE managers are inexperienced with respect to understanding the requirements of market-based business management, especially undertaking decision-making responsibilities. A simple business plan can take on extreme complexity. Canadian experience in business management is required by all CEE firms.

Summary of Opportunities

The following table summarizes the opportunities discussed in Section 3. This table, moreover, indicates the extent to which individual opportunities appear to be available in particular CEE countries, and in addition, an indication is provided as to whether each opportunity is likely to materialize in the short run (0-2 years), the medium term (2-5 years) or the longer term (5-10 years). This table also indicates where a potential opportunity is unlikely to appear.

Time Frame For Housing Sector Opportunities

	Plnd	Hung	Czch	Slvk	Ukrn	Russ	Blgr	Rumn	Slvn	Bltes
Rehabilitating Pre-cast Concrete Buildings*	S	S	S	S	M	M	M	M	--	S
Renovation of Old Central Buildings*	S	S	S	M	M	M	M	M	--	M
Thermal-Retrofitting Single Family Homes	S	S	S	M	M*	M*	M	M	S	S*
Demolishing & Recycling Buildings	S	S	S	S	M	M	M	M	S	M
High-End Housing	S	S	S	S	S	S	S	S	S	S
Affordable Housing*+	S	S	S	S	M	M	S	S	S	S
Infrastructure & Municipal Services*	S	S	S	S	S	M	M	M	--	S
Telecommunications	S	S	S	S	S*	S*	S	S	S	S
Property Management	S	S	S	M	M	L	L	L	S	M
Construction Management	S	S	S	S*	M*	M*	S	M	S	S
Municipal Information Systems	M	S	S	L	L	L	L	L	M	M

Source: EconoMix Research Associates 1993

- S** Short-term Opportunity (0 - 2 years)
- M** Medium-term Opportunity (2 - 5 years)
- L** Long-term Opportunity (5 - 10 years)
- No Foreseeable Opportunity
- *** Short-term Opportunities are only in association with government programs (Canada, World Bank & EBRD)
- +** Based on local government policies and support.

Time Frame for Housing Sector Opportunities (Cont.)

	Plnd	Hung	Czech	Slovak	Ukrn	Russ	Blgr	Rumn	Slovn	Blts
Urban & Environmental Consultants	S	S	S	S	S	M	S	M	--	S
Sales & Marketing Consultants	S	S	S	M	L	L	M	L	S	M
Heating & Energy Technologies*	S	S	S	S	S	S	S	M	--	S
Building Products & Manufacturing Technologies	S	S	S	S	S	S	S	S	S	S
Retail Building Products Sales Centre	S	S	S	S	M	M	M	M	S	M
Investing in Private Companies	S	S	S	S	S	S	S	S	S	S
Investing in State Building Material Enterprises with Export Potential	S	S	S	S	S	S	S	M	--	S
Housing for Russian Military*	--	--	--	--	--	S	--	--	--	--
Hotel & Resort Development	S	S	S	S	S	S	S	M	L	S
Cottages & Holiday Homes	S	S	S	M	L	L	M	L	M	L
Housing for Resource Extraction & Other Work Camp Activities	--	--	--	--	M	M	--	L	--	--
Building Pilot Projects*	S	S	S	M	L	L	L	L	M	M
Public Sector Management Systems*	S	S	S	S	S	S	S	S	--	S
Trade & Professional Associations*	S	S	S	S	M	M	M	M	S	M
Skills & Management Training	S	S	S	S	S	S	S	S	S	S

Source: EconoMix Research Associates 1993

S Short-term Opportunity (0 - 2 years)

M Medium-term Opportunity (2 - 5 years)

L Long-term Opportunity (5 - 10 years)

-- No Foreseeable Opportunity

***** Short-term Opportunities are only in association with government programs (Canada, World Bank & EBRD).

+ Based on local government policies and support.

STRATEGIES FOR APPROACHING OPPORTUNITIES

INTRODUCTION

Canadian organizations wishing to access the emerging CEE markets must have a good understanding of the current state of affairs in the target CEE market, how it evolved, the extent of present disorders, as well as the nature of the emerging marketplace. These organizations will need to develop knowledge-based and creative solutions to overcome the many obstacles that will be encountered, and above all, caution must be exercised. A proactive and effective strategy for accessing CEE markets will require that individuals with in-depth knowledge of the local environment be consulted or employed as team members.

Firms seeking to establish ventures will most likely encounter considerable difficulty in obtaining government approval and local acceptance if there is a relatively low amount of value being added to the local community. Also, the matter of compensation will be a relevant consideration and alternate payment options will need to be considered. Generally speaking, activities that involve investments will be highly supported by host governments as these generally imply greater permanence and involvement by the local community than sales activities.

FEASIBILITY OF PROPOSED VENTURE

It is crucial that a significant effort be invested in undertaking a detailed risk analysis. Since there are no established markets in the CEE region in a Western sense, potential yields will be directly related to inherent risks and financial markets. In order to perform a comprehensive risk assessment, all three determinants of feasibility (market, political and financial) need to be explored by individuals with an in-depth understanding of the local business environment and marketplace.

Market Feasibility

Determining market potential is particularly challenging in the CEE region, since markets are evolving very rapidly and do not behave as typical Western markets. There are very few networks to gather or disseminate basic market information in most parts of the CEE region and any market information that exists is non-verifiable and usually out-dated by the time it is compiled.

Political Feasibility

Many former government bureaucrats and industrial leaders have remained in power and many are still active in a decision-making capacity. Because of the influence of some of these

individuals, CEE market segments may not function as they do in the West. For example, the best quality product at the best price may be at a significant disadvantage due to the influence of individuals in decision-making positions. Nonetheless, a well-conceived project will usually be supported in due course.

Financial Feasibility

Because of volatile and fluctuating exchange rates resulting from high rates of inflation and interest, market forecasts do not remain valid for long. Furthermore, the accounting systems employed by local firms are inconsistent and lack standard procedures. Banking systems and procedures that are in place are rudimentary and this gives rise to long delays. Some CEE countries, such as Poland, require that hard currency investment funds first be converted into the domestic currency which is subject to devaluation. Taxes, especially social and income taxes, can also be extremely high. The accounting system required by the governments can be very cumbersome since the systems were developed decades ago for huge state-owned enterprises. Also, bribes can amount to as much as one-third of start-up costs.

COLLECTION OF INFORMATION/ESTABLISHMENT OF CONTACTS

There are two dominant characteristics with respect to collecting information and establishing contacts in the CEE region.

- (i) Since most of the physical assets of CEE countries are now controlled by local governments and approval for investment and development are required from these governments, establishing strong relations with local officials is critical to ensuring a successful venture in the CEE region.
- (ii) There is a lack of market-related information.

Consequently, it is important that the various Canadian private, public and non-governmental organizations that are operating in the CEE region are contacted. All these organizations can provide support to Canadian organizations interested in doing business in the CEE region, especially with respect to identifying and approaching decision-makers. (See PART VIII).

ORGANIZATIONAL STRUCTURE OF A BUSINESS VENTURE

The organizational form of the business venture will depend upon the local business environment and climate and on the nature of the proposed activity and these factors will determine whether or not it will be beneficial to work with a local partner.

Horizontal Integration

By entering into a joint venture with local partners, Canadian firms may be able to more quickly adapt to the realities of the local marketplace than if they were to rely solely on their own resources. Further, a local partner may be valuable in establishing contacts, providing a knowledge of the local language, formulating business strategies and understanding local customs, tastes and ways of doing business.

Taking on local partners, however, may entail significant disadvantages and these can result in inefficiency, exploitation, dishonesty and high training costs. It is in this area that prior and meticulous research is required since most Western negative experiences in the CEE region occur as a result of poorly-conceived partnerships. Generally speaking, it is recommended that some form of a joint venture relationship be entered into if a strong and reliable partner can be found and an appropriate arrangement can be struck.

Vertical Integration

Vertical integration permits the Canadian firm to ensure that its business practices, services and products conform fully to corporate standards. Generally speaking, vertical integration will be pursued only where quality control is paramount and where other options are simply not feasible. However, implementation of this approach can be costly and the organization could be perceived as being unwilling to become integrated into the local community. Other drawbacks to this approach could include high costs and a failure to appreciate the subtleties of the local marketplace.

RISK FACTORS

Determining the potential of housing-related investments in the CEE region requires being fully aware of the dynamics of that particular marketplace because:

- The scale, speed and complexity of the changes that are occurring in the CEE region are unlikely to have been encountered elsewhere.
- The experience which many Canadian entrepreneurs have gained from traditional markets may not be particularly helpful in analyzing CEE market opportunities.
- The potential exists for continued political, social and economic instability in comparison to Western markets.
- The severity and depth of the environmental problems in the CEE region are only now being revealed and their associated economic implications have yet to be assessed.

It must also be noted that the CEE countries do not comprise a homogenous market - there are more than a hundred languages and ethnic groups in the former Soviet Union. Each country is unique and must be considered accordingly. Examination of the dynamics of each country must be undertaken to gain a full understanding of the potential implications of future investment. Hungary, Poland, and the Czech Republic would appear to provide the best opportunities in the short term. However, this does not mean that specific market niches do not exist in the other CEE countries.

As the region of Eastern Europe further opens to Western markets, different nations pose varying degrees of individual potential and dangers for investors. Table 2.2 is a comprehensive comparative analysis of the CEE countries intended to provide a general risk assessment for entry into the region. The analysis is based on both quantitative economic data from published sources and from qualitative first-hand experience gathered through interviews.

Many factors must be taken into consideration when detailing a "best case" scenario for investment into the CEE region. Any thought toward investment in the CEE region must be considered within a long-term framework for investment. This is because new investors will actually be participating in the creation of a market and a high level of profitability will be generated after the market has become established.

Further, despite the best planning efforts, the diversity and changing nature of the region will often result in the unexpected. It should be understood that the fluidity at which events occur in the region is quite unlike the investment environment of any traditional western market.

Weak government, uncommitted reform efforts, high external debt payments, high inflation, and falling living standards all constitute other ailments compounding the economic difficulties for the CEE region. Nevertheless, there are indications that some nations of the CEE region are solidifying their economic, political, and social elements at a greater speed than others. The potential for these countries lies in their continued movement toward free-market integration, political reform, and the relative success of the efforts to date.

There are two main categories of risk when conducting business in the CEE region:

- Political/legislative.
- Economic/financial.

Political/Legislative

Political risks are mainly a result of the fluidity of the situation in Eastern Europe; political and economic structures are not yet developed and democratic mechanisms have yet to work. The political situation in the CEE region remains very unstable. In various parts of the region there are examples of wars, ethnic tensions, nationalism, strikes, and political hostilities both among

factions within individual countries and between countries. All of these factors have negative economic consequences for the macro-region. This instability slows foreign investment in the forms of capital stock, investment dollars and jobs in the CEE region.

Governance Issues

While elections have taken place in many of the countries of the CEE, this does not represent the development of complete democratic institutions. Much decision-making is done individually and without due regard for the people being represented. Government corruption is also widespread among the countries of the CEE and takes various forms, such as bribery, extortion, stealing, process delay, and lack of procedural approvals for new businesses to proceed.

Further, the breakdown of the central Soviet authority led to a decentralization of decision-making to the local level. The local governments do not have any experience in democratic governance. Elections have been confused with democracy. Consequently, the municipal governments are over-run with large numbers of elected officials who severely constrict the decision-making process.

Civil Unrest

The net result of the communist economic system was an inefficient allocation of resources versus that in the market economy. While goods and rents in the Soviet system were relatively cheap because of state subsidies, they were in extremely short supply relative to the population. Furthermore, the goods were relatively inferior in relation to similar product classes available in Western-based market economy.

The general population of the CEE expected immediate benefits with the introduction of the reforms. However, as production is shifted from the state to private enterprises, only hardship and worsening economic conditions have prevailed in most of the CEE countries. Consequently, due to public unrest, political stability is a growing concern.

Military Implications

In becoming and maintaining its reputation as a "superpower", the Soviet Union directed a huge amount of resources to the military. With the break-up of the U.S.S.R., dissolution of the Warsaw Pact in 1991, and severe economic strife, the support of the military in the economies of the CEE was removed. While this caused some economic dislocation in the CEE macro-region, most of the impact was and continues to be experienced in the countries of the former Soviet Union. The three most compelling problems are:

- A large proportion of past capital investments will be rendered obsolete, since production will be redirected from military manufacturing to consumer goods with export potential.
- The reduced need for a large military will result in a huge increase in the number of unemployed and underemployed especially in Russia. It is expected that some of the soldiers will stay in the countries where they had been stationed. Consequently, they may face discrimination and resentment. This could lead to heightened local tensions.
- The stockpile of weapons and the deadly nuclear arsenal positioned around the former U.S.S.R. has resulted in the creation of smaller superpowers, thus increasing the potential for disaster. While Russia retains most of the weaponry, the Ukraine and Kazakhstan both have nuclear capability. The recent conflict over control of the Black Sea Fleet, between Russia and the Ukraine, is one example. An increase in tensions or the ascent to power of a dictator in one of the countries could create a dangerous situation.

War has made conducting business in most of former Yugoslavia impossible, while in some areas of the former Soviet Union, territorial debates and ethnic unrest have made the risk unpredictable. The following is a list of some political factors that could potentially affect risk considerations:

- Moldova: Dniester Republic in the east and Gagauz in the south seek autonomy from the Russian Federation,
- Crimea is claimed by Russia, Ukraine and Crimean Tatars,
- Karachai-Cherkess and Kabardin-Balkhar (both near Georgia) hope to separate,
- Chechen-Ingush (near Georgia) separated and is at odds with Moscow,
- Abkhazia (near the Black Sea) seeks republic status,
- The Russian majority in South Ossetia (Georgia) hopes to join Russia,
- Armenians in Nagorno-Karabakh seek independence from Azerbaijan,
- Tatarstan (large area in Russia) seeks economic and political autonomy,
- Tajikistan is engaged in civil war, and
- In Latvia, officials declared it improper for Russian war dead to remain in Latvia - the bodies were exhumed and sent back to Russia.

Economic/Financial

Economic risk in the CEE is inherently connected with political risk. The connection comes from the fact that the region's economy was centrally planned by politicians for many decades. Even in the midst of current efforts toward reform, economic stability and development is still based on awkward policies, and conflicting, disruptive, or inconsistent legislation. The lack of basic ownership rights can often make business decisions tentative at best.

The pace and success of perestroika (rebuilding and restructuring) is not always so much a function of market trends and basic economics of life, but rather a function of the reactions of politicians to popular social and political pressure. The end results for the investor can be quite often unpredictable and unexpected.

Economic risks are usually evaluated before business decisions are made anywhere in the world and, to establish the feasibility of a particular venture, it is usually a routine task in a market economy. In the case of the CEE, the issue of risk assessment becomes complex. This complexity is rooted in the region's lack of experience with market economies as well as the existence of contradictory economic trends and political decisions - a characteristic typical of the region as it moves through its transition from command economy to free market.

Since freedom of choice and decision-making opportunities were denied to the general public for decades, an unpredictable set of expenditure preferences, with little relationship to expected needs, is being exhibited. As a result, traditional market forces will not always necessarily work in the CEE region. For example, a Western firm may be able to provide a better product/service at a better price, however, the Eastern Europeans may not buy that product/service. This is a result of several reasons such as corruption and a lack of bureaucratic will to break established links.

Business Related Risks for Exporters

One of the most important considerations when entering the CEE in the housing sector is how to deal with specific circumstances such as the detrimental business environment. To succeed in the CEE's housing sectors, it is not enough to provide the best possible service/goods at the best possible price. It is often essential to make the right contact, to understand the intricacies of business connections in the CEE, and to be familiar with the internal workings of the legislative/regulative environment. The complexity involved with acquiring a simple import permit, the inability to exchange profits for usable hard currency, or the frustration that comes with the simple registration of a business entity in the CEE can frustrate even the most seasoned western business persons.

In addition, there are billions of dollars worth of services and "completed" sales that remain unpaid in the CEE every year. The resultant mentality that "I do not get paid so I don't pay either" is both an undesirable and an incompatible thought for most western businesses. The fact

that most business transactions today in the CEE region, including the purchase of homes, is occurring on a cash-in-hand/money-up-front basis, also implies that much creativity on the part of the foreign player is required to make things happen successfully.

To maximize opportunities in order to expand exports, firms must understand the different types of business risks which could threaten the export venture. A lack of Western accounting and banking systems in Central Eastern Europe means firms interested in exporting to that region must be especially aware of potential credit risks. Commercial risks are a particular problem in the CEE region as local businesses try to make the adjustment to a free market-demand economy.

Problems which will affect those exporting to the CEE region are not unlike those that they might encounter in the West. However, specific risks such as insolvency or bankruptcy carry particular dangers. Not only are insolvency and bankruptcy becoming more common; there is also a deficiency of legislation providing protection against them. In addition, it is likely that, due to a lack of capital, the possibility of default on contract either through refusal to pay or inability to pay is likely to increase. Other similar risks include the repudiation of goods or the unilateral termination of the contract by the buyer.

The fluid nature of the political environment itself poses some specific political risks including currency conversion and transfer difficulties. Government and central bank currency and foreign exchange policies sometimes change and prevent repatriation of earnings. The volatile nature of the money markets in the CEE region can also result in the rapid depreciation of given currencies overnight.

As previously discussed, the potential for war-related risk in or near to a firm's market can jeopardize business ventures. The war in the former Yugoslavia has had a profound impact on the whole region. The feasibility of property deals in Budapest have often come under threat as potential financial backers shy away due to a shared border with Serbia and a perception of relative proximity to the fighting.

Other possible risks include the potential for governments and their policies to continue to change. The repercussions may include permits being revoked or required for commercial activity by Canadian or CEE governments. The conflict in former Yugoslavia has seen similar restrictions on trade imposed by the UN which are being observed by most international governments.

There is the possible risk of expropriation which could result in the loss of control over equipment on a foreign job site, or which could threaten actual Canadian investments. Although guarantee against this risk is fairly uniform across the CEE region, politically unstable areas may still be a hazard for investment.

Comparative Analysis

Hungary, Poland, and Czech Republic were identified as providing the best opportunities in the short term. However, this does not mean that there may not be special market niches in the other CEE countries. Furthermore, Russia and Ukraine should not be ignored given the sheer size of the potential market. The following tables compare and rank major CEE countries in terms of their short-term market potential.

- Table 2.1, entitled "Estimated Course of Development for CEE Countries", provides an estimate of the time that individual countries will spend in three phases of their future development. The first phase is one in which economies shrink as countries begin to implement economic reform policies. The second phase (restructuring) will depend on the time required for economic reforms to take hold and upon the relative success of these reforms (economies will expand up to about 4% per annum). The final phase (growth) will occur when economic growth is sustained at greater than 4% annually.
- Table 2.2, entitled "Indicators for Investment", provides a subjective ranking for the seven selected countries based on criteria related to investment potential. Each criteria is ranked on a scale ranging from +5 (excellent) to -5 (very poor).

Estimated Course of Development For CEE Countries

	DEVELOPMENT PHASES		
	SHRINKING	RESTRUCTURING	GROWTH
HUNGARY	UNTIL THE END OF 1993	1992-1994	FROM 1994
CZECH REPUBLIC	UNTIL 1993	1993-1996	FROM 1997
POLAND	UNTIL 1992	1992-1993	FROM 1993
RUSSIA	UNTIL 1997	1998-2000	UNPREDICTABLE
UKRAINE	UNTIL 1996	1997-2000	UNPREDICTABLE
SLOVENIA	UNTIL 1994	1995-2000	UNPREDICTABLE
RUMANIA	UNTIL 1994	FROM 1995	UNPREDICTABLE
BULGARIA	UNTIL 1994	FROM 1995	UNPREDICTABLE

Source: Economix Research Associates, March 1993

Indicators For Investment

	HUNG	POL	CZCH	RUSS	UKRA	SLOV	RUM	BUL
SOCIAL STABILITY	-1	0	-2	-5	-4	-2	-3	-3
POLITICAL STABILITY	-1	0	-3	-5	-4	-3	-4	-3
CAPABILITY FOR RESTRUCTURING	5	5	4	-3	-2	4	-3	-3
INFLATION	1	-1	1	-5	-5	-4	-2	-2
LIVING STANDARDS	3	1	3	-5	-5	4	-4	-4
ADMINISTR. EFFICIENCY	-1	-3	-3	-5	-5	-3	-4	-3
FINANCIAL SYSTEM	2	1	1	-3	-2	1	-4	-2
POTENTIAL MARKET SIZE	1	3	2	5	4	1	2	1
HUMAN RESOURCES	4	3	4	-2	0	0	-2	-1
MANAGEMENT POTENTIAL	5	3	4	0	1	4	-2	1
TECHNICAL INFRASTR.	-2	-4	-2	-5	-5	-1	-5	-4
MINERAL RESOURCES	-2	1	3	5	4	2	2	-1
FREE MARKET STRUCTURE	1	1	0	-4	-3	0	-4	-4
FOREIGN INVESTMENT	5	4	4	1	1	1	-2	-2
FOREIGN DEBT AS % OF GDP	-4	-4	-1	0	0	-2	0	-2
ABILITY TO PAY DEBT	3	2	3	-4	-4	0	-2	-1
POLITICAL INITIATIVE	4	5	2	4	3	3	-5	-3
EXTENT OF ACTIVITY IN FOREIGN POLITICS	4	4	2	5	4	0	-2	-3
CULTURAL GAP	4	4	3	0	1	3	-4	-5
ENVIRONMENT	0	-2	-2	-3	-4	1	-3	-2
QUALITY OF HOUSING STOCK	0	-1	1	-5	-4	3	-4	-3
LAND REFORM	3	4	3	-5	-5	0	1	-1
TOTAL SUM	34	26	27	-39	-34	12	-54	-50

Source: Economix Research Associates, March 1993

RECOMMENDATIONS

Determining the feasibility of entering the CEE

- *It is essential that individuals with an in-depth knowledge of the CEE and/or experience in the CEE be retained as consultants or as team members. Multilingual capabilities serve as an invaluable asset.*
- *Utilize Canadian government contacts and linkages.* An introduction from a Canadian government official or agency is highly recommended. Canadian entrepreneurs are most welcome if they are perceived to be on a trade mission representing Canadian industry or government. Canadian assistance programs should be utilized as vehicles. Experiences and contacts gained from such projects are invaluable.
- *A long-term commitment to the local market will be required and value must be added to the existing local process.* While large gains have been realized in the recent past, the market has become far more sophisticated as the local players have become more demanding and competitive. Thus, it is essential that sound and secure business relationships be created between Canadian and CEE interests. Under the Communist regime, relationships of any sort were largely discouraged. Consequently, the present atmosphere demands a high degree of trust and mutual confidence. Canadian ventures that are perceived to be aimed at short-term gains will face serious criticism and adversity. Something with value added must be brought to the negotiating table.
- *Perform detailed feasibility analyses.* While there seems to be a significant market for Canadian goods and services in Poland and Hungary, there would also seem to be considerable potential for failure if those markets were entered before additional specific studies were undertaken. Every possible scenario should be examined prior to investing. One must closely consider issues such as supply and distribution networks, lack of adequate infrastructure, weakness in local partners, and the degree of competition. Furthermore, *be cautious when using existing market research.* The CEE markets are evolving very rapidly and information about market development is scarce and/or non-verifiable. In most areas of the CEE region, especially in the former Soviet Union, detailed, reliable market research is non-existent or is out-dated upon completion. As a result, Westerners already established in the CEE region are a valuable source of information since they have established networks and know the local business environment.
- *Trade fairs have become an important place to exchange information, meet distributors and suppliers, and learn about the marketplace.*
- *It is imperative that a positive relationship is established with government officials, especially at the municipal level.* A key feature of Eastern Europe's

political and economic transformation is the devolution of decision-making authority to the municipal level. Local governments have control over virtually all public assets within their jurisdictional boundaries as well as power of approval over most incoming investment. Consequently, it is important that good relations with the local officials are maintained.

- *Ensure that you are negotiating with the correct authorities and be wary of claims of connections and power by government officials.* Use established Canadian contacts and relations (Canadian embassies and institutions operating in CEE region) or else finding the correct authorities may take much time. Further, remember that governments are in a state of flux and thus, government officials can be replaced.
- *Employ a lawyer that is intimate with the local legislative environment.* The legal environment is rapidly changing especially with respect to housing and private enterprise. A lawyer can help reduce the risks associated with a marketplace that has a large number of uncertainties. In many cases, lawyer fees are set according to the jurisdiction where you are from (e.g. a Toronto firm would pay Toronto prices).
- *When considering doing business in Central and Eastern Europe, think in terms of what is affordable and give serious thought to how your customers are going to pay.* While the currencies are, with some exceptions fully convertible, Western goods and technologies are very expensive for the local people. Although there is "hard currency" in circulation, the average person does not have access to large amounts of it. Payment for services rendered or products delivered can become very difficult as there is little guarantee of either in the legal system for retribution. Thus, financial reliability is essential. Bartering is a possibility if you can find goods or services that can later be traded for hard currency.
- *Negotiate for tax and other concessions at the local level.* Many regions are willing to compete with one another by offering more favourable tax concessions and incentives. This may prove frustrating as local governments are only beginning to formulate tax incentive strategies.
- *Identify time deadlines for tax holidays.* As an example, if new joint ventures, subsidiaries or acquisitions are started in Hungary by December 1993, foreign firms will enjoy a 60% corporate profit tax holiday in the first five years of operations and 40% during the second five year period.
- *Do not plan a long-term strategy that relies on the present legal infrastructure. The legal framework will develop toward European Community standards.* It is expected that the CEE governments will soon adopt production and material standards as well as antitrust, pollution control and taxation legislation that are in line with EC standards. Further, changes in the law are rapidly occurring and are

sometimes unpredictable. Ensure that contracts are negotiated to account for future changes.

- *Production costs may not always be substantially lower than those in the West.* Although wages are 4 to 10 times cheaper than those in the West, low productivity, training costs, and an inadequate business infrastructure are a few of the factors that must be taken into consideration when estimating production costs. In addition, employment and social costs may be equal to 100% of wage costs.
- *Beware of potential environmental clean-up liabilities.* A comprehensive environmental audit of any site should be performed prior to purchase. Furthermore, be cautious of issues such as workforce health.
- *Always verify land ownership claims.* Confirm former ownership (i.e. use local land registries). Attempt to receive guarantees from the government to remove liability for future claims. It is imperative that control of the land is acquired and maintained.
- *The lack of telecommunication infrastructure can drastically hamper normal business activities, therefore, take steps to address this problem immediately.*

Participating in the Housing Sector

- *If a strong and competent local private partner can be found, a joint venture is recommended.* A local partner will usually prove to be invaluable in terms of knowledge of the local language and customary ways of transacting business. A reliable partner will help facilitate the establishment of contacts with municipal officials, distributors, suppliers and clients, particularly if the partner is one of many private firms being run by former key government officials and managers of state-owned companies. Further, many of the most enterprising and entrepreneurial individuals have established dynamic companies that are effectively serving the changing markets. These companies are only limited by a lack of capital and modern know-how and would serve as ideal partners.

With respect to local distributors, the breakdown of the previous economic system has created immense problems with regards to distribution and existing supply and distribution networks are unreliable or non-existent. As a result, private distributors are only now beginning to develop.

In Poland, with respect to larger cities such as Warsaw or Krakow, it is less advisable to enter into joint ventures with government considering the number of officials and levels that can potentially slow down the process. Rather, cooperation should be with the private sector. In some countries such as Russia, it is more advisable to use vertical integration as local partners, resources and suppliers can be highly unreliable.

- *Nonetheless, be cautious when entering into any business relationship or partnership with local businessmen.* Westerners are often perceived as very rich and careless with their money. Many Western firms found that their local partners regularly lost interest in joint ventures soon after new office equipment and furnishings had been purchased and technology was transferred. Due diligence and review of local partner is required. Further, the local partner's trust must also be attained. It is recommended that trust be acquired to a level where the local partner is able to represent your business interests and that you are able to represent the partner's, in both the CEE and in Canada.
- *A comprehensive management training system should be implemented.* Although CEE managers do have in-depth knowledge as to the functioning of systems within the CEE region, familiarity with Western management techniques is recommended. CEE managers are inexperienced with respect to understanding the requirements of Western businesses and undertaking decision-making responsibilities. For example, a simple business plan can take on extreme complexity.
- *Local traditions and culture with respect to housing must be taken into consideration.* In the absence of mortgage money being readily available, it would seem that the traditional ways of acquiring a private home in the CEE will continue into the foreseeable future. The traditional way involves both sweat equity and cash. Thus, technology or techniques transferred from Canada will be difficult for local builders to use. Remember also that: Central and Eastern Europeans have not traditionally thought in terms of "move-up" housing; design differences between Canadian and CEE homes can be subtle; and Central and Eastern Europeans are hesitant about purchasing what is not readily tangible. It is necessary to construct and show a visible model home to answer their doubts. The comment, "If they can't touch it, they won't buy it", illustrates the point that consumers must be assured of the product before they invest.
- *Masonry construction presents fewer obstacles.* Pre-fab or modular construction could be very risky. However, a commitment to doing all or part of the manufacturing locally could make the product more attractive to both purchasers and government regulators. Improvements in concrete or masonry-based building techniques seem to have the best chance of acceptance at this time but Polish builders are very interested in learning traditional Canadian wood frame techniques due to an abundance of local wood. Local tradesmen are not generally experienced in wood frame technology and would thus have to be fully retrained. It was observed that the US has set up a vocational school in Warsaw to train local tradesmen in American home building technology.

- *Examine the feasibility of producing building materials in the CEE rather than only exporting products from Canada.* Western firms wanting only to export building products to the CEE will find much resistance from government officials. However, when value is added to the local economy, government officials will be more willing to facilitate business ventures.
- *When considering the establishment of a building products factory in the CEE, closely examine the potential for supplying Western European markets.* Currently, foreign investors and their local partners are taking advantage of new products and production technology, and lower production costs to capture a significant proportion of the depressed local market. Until local and other CEE markets recover, it is expected that 60-80% of the production will be for export to Western Europe. For example, it is estimated that there is effective demand for 2.1 million housing units in Germany and it is forecasted that 500,000 houses will be produced annually in the short-term.

CONCLUSION

Efforts by the West European and American housing industries to gain a significant share of the CEE's long-term markets are greatly exceeding Canada's attempts. Taking into account the potential size of the long-term market, the high level of local interest for Western goods and services and the fact that the market could remain unsatisfied for many decades, Canada's housing sector should immediately position itself to ensure a substantial share of the long-term market.

The opportunities, recommendations and strategies illustrated in this report serve as invaluable guiding tools to effectively entering and/or creating these markets. Specifically, the following factors deserve close attention:

- CEE officials at the local government level now control virtually all housing-related resources and are responsible for the planning and approvals process. However, the officials lack the required knowledge to effectively manage development in accordance with a market-based and democratic system.
- Local governments now own most of the state-owned housing stock as well as most of the land in the cities and surrounding region, and many lucrative deals have reportedly been structured through joint ventures with the local government.
- Many Western firms developing housing in the CEE region have reported that strong links with local officials are critical to expediting the potentially bankrupting approvals process.
- The private sector is emerging as the primary producer of housing and related products. However, these firms lack marketing and business management skills as well as familiarity with modern technologies and processes.

Since virtually all aspects of the CEE's housing sectors are in dire need of assistance, all segments of Canada's housing sector should immediately pool their resources, coordinate efforts and develop a strategy that will allow them to effectively participate in the restructuring of the CEE's housing sectors and the creation of the CEE region's housing markets. A "Team Canada" approach should be taken whereby all past, present and future activities, contacts and experiences are collected and disseminated to all segments of Canada's housing sector.

Initially, there is a need for the continuous collection of information on changing market conditions in the CEE to compensate for the acute shortage of market-related information in the CEE region. Currently, there are numerous Canadian companies working very closely with CEE decision-makers. However, there is no organized sharing of information. Ideally, the experiences of these Canadians could serve as the basis to informing future strategies and activities.

The creation of new, long-term mass markets will require this "Team Canada" approach given the large scope of the task. In strengthening the CEE's housing market, the Canadian strategy should emphasize providing technical assistance to decision-makers at the local level as well as to private entrepreneurs. For example, this assistance could be related to the formulation and enforcement of by-laws and building material standards, and understanding new Canadian building systems. This would serve as an effective means of penetrating the local market in the short-term as well as to ensure a strong position in the long-term.

MACRO EFFECTS OF TRANSFORMATION & RESTRUCTURING ¹

INTRODUCTION

Under the Communist system, complete regulation of the CEE's housing sector reflected the overall level of regulation of the national economies. Economic reality in the CEE region was characterized by an absence of free market conditions, namely:

- Limited access to new ideas and products,
- Barriers to the flow of persons, information, finances and products, and
- Product development was influenced by bureaucratic decisions rather than consumer preference.

The economy was further constricted by a strong, steady stream of "state-manufactured propaganda", with the goal of convincing the population at large that the Communist course of action was both good and necessary. In the end, the legacy of Communism ensured that the current political and economic transitions in the CEE would be very precarious.

The recent massive restructuring of these economies has resulted in a marketplace with great fluidity, which presents unique problems and requires innovative approaches and considerations to every business considering investment in any sector of the CEE, especially the housing sector.

What follows is a short but essential description of the political and economic circumstances that pose major obstacles to a comprehensive risk assessment of market entry.

POLITICAL AND ECONOMIC HISTORY

Very special circumstances have resulted from decades of totalitarian regimes and the restriction of decision-making in both the personal and economic spheres. Consequently, the external investor must identify and implement creative solutions to the challenges that will be encountered. This requires an understanding of how the current state of affairs came to be in different CEE countries, the nature and scope of the present economic and social disorder throughout the CEE region as well as the main characteristics of the emerging CEE marketplace.

¹ It should be noted that this part of the report is generally descriptive of the overall situation and is not necessarily applicable to all countries or areas. Each country's experiences will be unique in their political and geographic characteristics and therefore the problems and opportunities will differ in severity and complexity.

Background

The 20th century has been extremely hard on the countries of Central and Eastern Europe. Revolutions, wars, uprisings, terror, hatred, hunger and regimes based on now-discredited ideologies have resulted in over 100 million dead and varying degrees of economic ruin throughout the CEE region. The lack of freedom to move across borders, express opinions and even make normal life decisions has resulted in circumstances that will take many years to overcome.

Political Suppression

Stalin's politics and Soviet economic policies were forced on CEE countries after the Second World War, without any discernible improvements occurring until the 1960s. In all countries, the Communist Party assumed sole power and either suppressed or abolished other political parties, movements or doctrines. Neither divergent political nor religious ideas were tolerated.

The domestic and foreign policies of all the CEE countries were dictated by the Soviet Union. The powerful police, military and covert forces were kept strictly under Communist party control. Laws to govern and protect the peoples of the CEE existed, but they were selectively used to further exert and enhance the control of the Communist party. The secret police had extreme power over every aspect of domestic activities. All acts of resurgence against the Communists regimes were harshly suppressed by the military and the participants were severely punished. Nonetheless, acts of defiance against the Communist regimes sporadically occurred until the 1980s.

Establishment of the Soviet-Type Economy

Consistent with the political control forced on countries of the CEE region, the Communists radically altered the respective national economies. After the Second World War, the economies of the CEE became determined by the current political, economic, and social course of the Soviet Union.

Central planning was established as the new economic system. All factories, businesses and most services were nationalized in the entire CEE region. With the exception of Poland, the majority of arable land in the CEE region was either in state or cooperative ownership by the beginning of the 1960s.

Private enterprise was not only discouraged but those practising it were punished. The role of money in the economy was greatly reduced, and market-established wages were substituted by direct allowances from the State. Prices became heavily subsidised and severely distorted, to the point where nobody was capable of establishing the real cost of producing a given product.

The actual size or capacity of the economy did not matter; the State ensured full employment and being employed became a citizen's duty. Consequently, job sharing became a common practice whereby everybody had a full-time job, with only the equivalent part-time volume of work. The low level of labour productivity, as well as the salary levels and the attitude toward work, duly reflected this fact. The net result was that managers and workers had no financial interest in doing their work efficiently or effectively, since workers could not correlate being more efficient with increased compensation. In most cases, the managers and workers were not even aware whether a given production unit was running profitably or not. In order to maintain full employment, no companies were closed down and the administrative staff in every field of the economy was several times larger than actually needed.

Central Planning

After the Second World War, market relations in the CEE economies were replaced by central planning. Central planning was established as the new basis for allocating resources and factories, businesses and most services were nationalized in the entire CEE region. The Central Planning Office became responsible for establishing production targets, allocating resources to address these targets and for assessing the performance of all economic sectors. The Central Planning Office in each CEE country was directed by the Soviet Union's Communist party through its national Communist party.

Production targets were only set by distant bureaucratic commands. Consequently, all economic leaders and managers were appointed according to their loyalty to the party rather than on their demonstrated ability.

The command economies of the CEE region shared the following attributes:

- The State controlled the production and distribution of all goods with little regard to their real production costs. Consumer demand influenced neither production levels nor prices.
- Production was supply-driven according to the State's perceived need for particular goods. The supply of goods and services was standardized and centrally determined by distant bureaucracies.
- Meeting centrally-determined quotas provided the motivation and the measure of success for the command economy. Efficiency was measured in quantitative terms.
- Economic leaders and managers were appointed according to their loyalty to the Communist party rather than on the basis of any demonstrated ability. Failure to meet the targets had severe consequences for the appointed managers. Non-performance was considered sabotage, especially in the 1950s.

- Private enterprise was not only discouraged but those practising it were punished. In many countries, realizing a profit was considered to be a crime.
- The role of money in the economy was greatly reduced and market-determined wages were replaced by direct allowances from the State.
- Prices became heavily subsidised and severely distorted, to the point where it was impossible to determine the real cost of producing any given product.
- Unemployment was virtually non-existent since every capable person was required to work.

Development of Heavy Industry

Following Soviet economic policy in the late 1940s and the 1950s, a strong emphasis emerged on building a substantial military potential and total economic independence from Western capitalist countries. Further, the surplus derived from any level of production was centralised and redistributed, usually in favour of heavy industry.

The newly-developed heavy industries in the smaller Central European countries were complementary to those in the Soviet Union and, to a much lesser extent, to each other. The industrial structure consisted primarily of large vertically-integrated, state-owned enterprises that employed thousands of people and had a regional monopoly over production and distribution. Certain industrial "tasks", or specializations, were assigned to certain countries, independent of their natural resources, existing capacities, requirements or skills. As a consequence, a huge, inefficient heavy industry developed in each CEE country, at the expense of beneficial regional market specialization.

Degradation of the Physical Environment

The severity of environmental destruction experienced in the CEE requires attention given the enormous associated costs that were inflicted on the people of the region. A half-century of runaway industrialization has left widespread environmental degradation. Behind the tight propaganda controls of the media and away from the scrutiny of international organizations, the Communist regimes poisoned their environment in the name of progress and their industrial policies caused much more damage than was experienced in the Western economies during the same period. While not intending to be alarmist about the profound impact of communist industrial policies on the physical environment, examples include:

- Between 1970 and 1990, life expectancy in Moscow dropped by ten years.
- In Kiev, the capital of Ukraine, the water supply is 1,000 times above the

maximum allowable limit for radioactivity. 60% of Ukraine's population drinks water of sub-standard quality.

- Ukraine has huge coal reserves for energy and no air-pollution controls. Sulphur dioxide emissions exceed five million tonnes annually.
- One-third of Poland's 38 million people live in "ecological hazard" areas. Further, Polish industry generates an estimated 200,000 tonnes of hazardous waste annually with no modern disposal available.
- Acid-rain has damaged more than 600,000 acres of woodland in Poland and one million acres in the former Czechoslovakia. 75% of all trees in Poland show some damage from air pollution.
- Half of Czechoslovakia's drinking water fails to meet national standards.
- Bronchitis and eczema reportedly affect 50% of the children in the former East Germany's industrialized areas.
- In Hungary, about 41% of the population is exposed to high levels of sulphur and nitrogen oxides and 25% of Hungary's 3000 settlements lack safe drinking water. Adequate sewage facilities exist for only about 46% of the population.
- Industrial waste pollutes nearly 70% of Bulgaria's farmland and 65% of its rivers.
- Rumania's largest city, Bucharest, has no sewage-treatment plant. Elsewhere, most of the country's sewage plants do not work properly. Only about 15% of the country's river waters are potable. Approximately 30% of all arable land is threatened by erosion.

Estimates for cleaning up eastern Germany alone run as high as \$300 billion. It is also believed that Poland and the former Czechoslovakia will need more than \$20 billion each during the next decade for environmental restoration.

REFORMATION STRATEGIES

The transition being attempted by the countries of the CEE region is radical in both depth and scope. In order to gain a full understanding of the scope of the problems associated with the current reformation, and why entering this market may present difficulties, it is necessary to discuss the fundamental difference between a Communist economy and a market economy.

The main difference between a market economy and a communist centrally-planned economy is in the basic recognition of consumer demand. Economic decisions in a market economy are based on consumer value judgements, while economic decision-making in the Communist economy was based on meeting production targets set by bureaucrats. A summary of the main differences is as follows:

In a market economy:

- The consumer is sovereign and has choices - the exercise of the consumers' choices in the market will produce a predictable expenditure pattern.
- Goods and services are considered to be of equal importance in supplying consumer demand.
- Firms are free to attempt to best meet the choices of various consumers as they are discernable through their expenditure patterns.
- It is expected that the actions of both consumers and firms will produce the most efficient allocation of resources.
- In theory, the government function is generally to provide public goods, i.e. education, defence, etc., and to ensure that a general level of fairness exists in the market.

In a communist command economy:

- The consumer does not have a choice. Production is purely supply-driven and production targets are set according to state-derived levels of need for various goods.
- Demand is standardized and centrally determined.
- All goods are considered property of the state and are distributed by the state often in no relation to their economic value.
- The government controls the entire system, including all resources.

Political Reform

The process of economic reform was the main driver for political change. The economic failure of the Soviet centrally-planned system was revealed when low oil prices greatly constricted Moscow's revenue and fiscal choices. The appointment of Mikhail Gorbachev in 1985 provided

the Soviet Block with leadership which, when faced with the serious decline of the Soviet economy, turned the economy away from the Stalinist approach and opted for glasnost and perestroika - a policy of openness and major economic restructuring.

From this course of action came a flow of substantial events, all with significant repercussions for the economies and political environments of the entire CEE region. The two most critical events which precipitated the fall of the Communist regimes were:

- The Soviet Union and other nations started focusing on internal problems (i.e. debt, negative economic growth, environmental degradation, etc.) and the extent of these problems became public knowledge resulting in widespread dissatisfaction among the population.
- Vocal populations and popular politicians across the Soviet Union and Central and Eastern Europe demanded more reforms.

As the Communists relinquished their power, a key feature of the political and economic transformation was the devolution of decision-making authority to the municipal level. The future costs of maintaining government infrastructure and assets were also handed over. As a result, while having full political autonomy over their own destiny, the economic and environmental legacy of Soviet rule left the people of the CEE with few choices on which to decide. Furthermore, with the disintegration of the Soviet Union, all accountability for past decisions has vanished.

Municipal officials are now responsible for the management of virtually all government-owned assets within their physical boundaries. It is now the responsibility of local officials to properly utilize these resources to foster economic growth and urban development. However, these governments do not have any experience in managing urban environments within the framework of a democracy and market-based economy.

Economic Reform

The 1960s brought about some relaxation of the centrally-planned system in most CEE countries. During the 1970s, economic reforms were announced, then quietly forgotten, re-announced and then dropped again in almost all CEE countries. Of the several CEE countries where economic reform programs were attempted, some success occurred only in Hungary and Poland where unregulated secondary economies were permitted to develop on a modest scale.

Small private enterprises were allowed to develop marginally in certain sectors of the economy, including housing. This resulted in some savings and the investment of additional resources in private housing production. These market reforms also created an entrepreneurial instinct among many Poles and Hungarians, and accordingly, these countries, along with Czech Republic, are restructuring their economies relatively more quickly and easily than are other CEE countries in which private markets were not allowed to develop.

Since the fall of the Communist regimes in 1989, all CEE countries have taken steps toward democracy and market economies. In order to correct patterns of production and consumption, which were severely distorted by the command system, and in order to allow free interplay between supply and demand, the following measures have been introduced in differing degrees in many of the CEE countries:

- Strict fiscal policy has been adopted, together with improved control of budget incomes and expenditures.
- Subsidies and tax reductions are being seriously cut back.
- Efforts are being made to implement realistic interest rates and reduce subsidized loans.
- Internal convertibility of currencies and stabilization of the exchange rate are being pursued.
- Administrative controls on the distribution of goods are being abolished.
- Free market prices are being allowed to develop and international trade is being liberalized.
- Previously monopolized spheres of trade and production are being de-regulated.
- Former state-owned enterprises are being privatized.

At the micro-level, financially troubled state-owned firms that are being restructured are initiating measures that include:

- Liquidating non-essential assets.
- Restructuring activities in favour of reducing costs and shifting to more profitable activities such as the sale of materials, leasing of premises and machinery, etc.
- Organizational restructuring which includes dividing companies into smaller, specialized or more efficient business units.
- Financial restructuring which includes the cessation or limiting of unprofitable operations as well as making adjustments for the elimination or drastic reduction of government subsidies.
- Capital and ownership restructuring which permits the legal status of firms to be changed to either limited liability or joint stock companies. Further, joint ventures have been allowed.

MACRO CHARACTERISTICS OF THE EMERGING MARKETS

Introduction

Due to the radical nature of the economic transition, the economic reforms that are being undertaken in the CEE region require arduous stabilization requirements. The transition has been further exacerbated by the following factors:

- The reforms have been initiated during a period of severe economic instability in the CEE region.
- There has been no possibility of financing the overall economic transition through additional debt because the CEE countries are already heavily indebted and the West is in a severe global recession.

As a result, the economic reforms have been brought to the border line of political feasibility in all CEE countries. Accordingly, CEE countries have implemented economic reforms to varying degrees. The countries that used "shock therapy", namely Poland and to a certain extent, Hungary and the Czech Republic, by ending all subsidies and creating a legal environment that fostered the development of private enterprise, have been able to reverse the downward trend in output and employment. On the other hand, countries such as Russia, Slovakia and Albania, which have yet to enforce and expedite the required economic reforms, are still in severe economic turmoil with dismal future prospects.

Gross National Product and Industrial Output

With the ongoing collapse of state planning and military-industrial complex of the former Soviet Union, the CEE region has seen a deterioration of its collective economies. The output of the CEE region will likely deteriorate further in the near future as the effects of shifting production from a state-planned system to a market-based economy continues. However, decreasing industrial output for many of the CEE countries can sometimes be considered beneficial, since the country is actually saving money by stopping subsidies to highly inefficient and unprofitable industries, thus forcing them to become financially accountable or face insolvency. Therefore, many economists see falling industrial output as a positive sign of quick restructuring. Overall, the economies of the CEE in 1992 had collective GNP estimated at \$683 billion. The Central European share, i.e. Hungary, Poland, Rumania, the former Czechoslovakia, and Bulgaria, of that figure is 27% or \$184 billion versus the 73% or \$499 billion share of the former Soviet Union. Be aware that the reported value of the GNP for most of the former Soviet republics filters through a non-market system and artificial exchange rates. Consequently, the reported value is over-estimated. This is especially true for Russia.

Trends in GDP and Industrial Production

Changes in GDP in %

Indust. Prod. Change in %

	1989	1990	1991	1992	1989	1990	1991	1992
Albania	11.7	-13.1	-30.0	9.0*	5.0	-7.6	-42.5	n.a.
Bulgaria	-0.3	-17.5	-25.7	-22.0	2.2	-12.6	-23.3	-22.0
Czechoslovakia	1.4	-1.4	-15.9	-7.5*	0.8	-3.5	-24.7	-11.0
Czech Rep.	2.4	.8	-19.0	-7.1	1.7	-3.3	-24.4	-10.6
Slovakia	1.1	-3.8	-19.3	-6.0	-1.3	-4.0	-25.4	-12.5
Croatia	-1.5	-8.5	n.a.	-24.3	-1.0	-11.0	-28.5	-14.6
Present Yugo.	-1.9	-8.4	-11.1	-27.0	1.0	-11.7	-17.4	-22.9
Poland	0.2	-11.6	-7.6	1.0*	-0.5	-24.2	-11.9	4.2
Hungary	0.4	-3.3	-11.9	-5.0*	-2.5	-4.5	-19.1	-9.8
Rumania	-5.8	-7.4	-13.7	-15.4	-2.1	-17.8	-19.6	-22.1
Slovenia	-0.5	-3.4	-9.3	-6.5	1.1	-10.5	-12.4	-13.2
Soviet Union	2.5	-4.0	---	---	1.7	-1.2	---	---
CIS	---	---	-10.1	-18.5	---	---	-7.8	-18.2
Azerbaijan	-8.9	-11.3	-0.4	-28.2	0.7	-6.3	4.8	-24.0
Belarus	8.2	-2.4	-3.0	-11.0	4.6	2.1	-1.5	-9.6
Kazakhstan	-0.1	-0.9	-10.3	-14.2	2.5	-0.8	-0.9	-14.8
Kyrgyzstan	4.5	4.8	-5.2	-26.0	5.2	-0.6	-0.3	-26.8
Moldova	8.8	-1.5	-18.0	-21.3	5.7	3.2	-11.1	-21.7
Russia	1.6	-4.0	-11.0	-20.0	1.4	-0.1	-8.0	-18.8
Armenia	8.4	-8.2	-11.4	-42.6	-8.3	-7.5	-7.7	-52.5
Tajikistan	-6.5	0.2	-8.4	-31.0	1.8	1.2	-3.6	-24.3
Turkmen.	-7.0	1.8	-0.6	n.a.	3.3	3.2	4.8	-16.7
Ukraine	5.0	-3.6	-11.2	-15.0	2.8	-0.1	-4.8	-9.0
Uzbekistan	3.1	4.3	-0.9	-12.9	3.6	1.8	1.5	-6.2
Georgia	-3.4	-4.3	n.a.	n.a.	0.7	-5.7	n.a.	n.a.
Estonia	6.6	-3.6	-12.6	-28.0	0.7	-5.6	-9.0	-38.9
Latvia	7.4	-1.4	-7.9	-43.9	3.1	-0.2	-0.1	-35.1
Lithuania	1.6	-6.0	-6.7	-35.0	4.2	-2.8	-4.9	-51.2
Former GDR	2.1	-14.7	-33.9	6.0	2.3	-28.1	-28.1	-6.0

* National income substituted for GDP

Source: Weekly World Economy (HVG), U.N. Economic Commission, May 1993

Average Gross Income (\$ U.S.)

Bulgaria	119.8
Croatia	106.5
Czech Republic	191.6
Estonia	62.7
Hungary	366.7
Former GDR	1568.8
Latvia	53.6
Lithuania	19.2
Poland	208.5
Russia	31.0
Rumania	75.8
Slovak Republic	187.4
Slovenia	438.7

Source: Weekly World Economy (HVG), U.N. Economic Commission, May 1993

Exports and Imports

Apart from raw materials and a limited number of manufactured products, most of the CEE countries, such as Russia, produce products with very little export potential. Much of the trade that the countries of the CEE engage in, primarily foodstuffs and fuel, is with former parts of the Soviet Block. Nonetheless, exports are increasing to countries elsewhere in the world. Some countries, like Hungary, and to a lesser extent Poland and Czech Republic, were able to quickly switch export markets from the East to the West. After the initial crash period, exports actually rose from previous levels. This is a very positive sign since the countries' outputs can now be better measured by Western standards.

Trade liberalization has been experienced at different degrees in the CEE region. In countries like Poland and Hungary virtually all commercial businesses now have the right to import goods. However, in countries like Russia, trade liberalization efforts are still retarded due to a complex bureaucracy and a lack of products with export potential.

Employment

Employment in the CEE has recently declined with the compounded effects of restructuring and global recession. With the countries in the CEE at various stages of restructuring, the prospects for the growth of employment will depend on the ability of respective countries to attract investment, shift existing production from state-controlled enterprises to private firms, and produce products that have export potential. Unemployment estimates are available for the overall macro-region, but likely understate the true economic reality, even if black market activities are taken into account. In Central Europe, reported rates vary from 12% in the former Czechoslovakia to a high of 18% in Poland.

Unemployment was virtually non-existent under the Communist system. Consequently, there have been massive increases in the level of unemployment during the transition period as production is being shifted from the public to private sector. The high rate of unemployment is a very natural sign of the restructuring of the economy. Further, unemployment levels may never be able to reach previous lows for some time since the size of the employed labour force will be a function of the capacity of the economy rather than an administrative decision. The next step will be the restructuring and retraining of the labour force so that it will be able to function in the new industries and take advantage of trends and market needs.

Unemployment Levels in 1993

In 000's % Ratio*

Bulgaria*	577	15.9
Czech Rep.	158	3.0
Croatia	262	18.5
Present Yugo.*	749	24.8
Poland	2,584	14.0
Hungary	700	13.3
Rumania	949	8.5
Slovak. Rep.	286	11.2
Slovenia*	118	13.3
CIS*	800	0.7
Russia	628	0.8
Former GDR	1,190	15.0

*Data from December 1992 * Compared to employed labour
Source: Weekly World Economy (HVG), U.N. Economic Commission.
May 1993

Inflation

Inflation has been a severe and persistent problem for all of the CEE countries. Some countries, like Hungary, Poland and Czech Republic, have been able to control inflation to more manageable levels as compared to the former Soviet republics. In these countries, all subsidies were virtually eliminated. However, in most of the other CEE countries, especially in Russia, subsidies, in the form of credit at annual interest rates well below the rate of inflation, continue to persist. This has led to hyper-inflation ranging from 500% to +2000% per annum. In Central European countries, inflation has shown some signs of decline to more manageable levels. However, in the former Soviet Union, the very high rates experienced by most of the countries will continue to distort prices, produce upward pressure on wages and contribute to political instability.

Rate of Inflation Compared to Previous Year (%)

	1991	1992
Albania	104.1	249.1
Bulgaria	338.5	79.3
Czechoslovakia	57.9	10.8
Czech Rep.	52.0	11.1
Slovakia	58.3	10.0
Croatia	124.2	634.0
Present Yugo.	121.8	9337.0
Poland	70.3	43.0
Hungary	35.0	23.0
Rumania	165.5	210.4
Slovenia	117.7	201.3
CIS	89.1	852.0
Russia	91.8	1110.0
Estonia	155.8	1076.0
Latvia	172.2	951.2
Lithuania	216.4	1020.8
Former GDR	17.3	11.0

Source: Weekly World Economy (HVG). U.N. Economic Commission.
May 1993

External Debt

All CEE countries have a very high debt, except for Rumania which also has arguably the worst supporting physical infrastructure in place. Hungary has the highest debt per capita (estimated at over \$2,000 per capita), however, it has one of the comparably best supporting physical infrastructure in place. The high government debts will significantly limit the social benefits that can be provided. This will undoubtedly add to political unrest, since many of the benefits have been in place for four decades.

Outstanding External Debt (Convertible Currency/Current \$ Million)

	1989	1990	1991	1992	1993
Bulgaria	10224	11030	12490	13500	14950
Czechoslovakia	7915	8085	9367	9400	9900
Hungary	20515	21270	22657	21700	21500
Poland	41387	48475	48412	47200	46900
Rumania	532	528	1627	2900	3970
USSR/CIS	56500	59600	61520	75000	81000

Source: Credit Lyonnais (Economic and Financial Research Department August 1992)

Outstanding External Debt Per Capita (Convertible Currency/Current \$)

	1989	1990	1991	1992	1993
Bulgaria	1136	1223	1382	1493	1654
Czechoslovakia	506	516	601	603	635
Hungary	1937	2014	2150	2059	2040
Poland	1088	1270	1264	1232	1224
Rumania	23	22	70	124	170
USSR/CIS	198	207	214	260	281

Source: Credit Lyonnais (Economic and Financial Research Department August 1992).

SUMMARY AND CONCLUSION

Based on the analysis of the overall area, the current situation of the CEE Macro-region can be summarized under the following main points:

- *Collectively, the population of the CEE has endured tremendous societal stress due to the radical changes experienced since the end of the war. The CEE is again at a crisis stage. With the freedoms of democracy and the movement to a market economy, the citizenry has become responsible for what it can achieve. The people of the CEE will need to exhibit further motivation to benefit fully from the opportunities which will become available to them.*
- *Civil discipline has severely broken down in many countries in the CEE, since the fear and respect for the military and the police has waned given their past actions. Increased crime coupled with the strained morale of the population will deter restructuring efforts.*
- *Continued political change in the direction of democracy and market economics will benefit the stability of the area in the long run, however, the strong possibility exists that various ethnic, nationalist, religious and ideological conflicts will occur.*
- *The environmental legacy of the former command economy will perpetuate a drastically reduced overall standard of living for the foreseeable future due to the high costs associated with remediation.*
- *Overall, the social and economic structure of the CEE is in a severely crippled state. Economic production in all countries was prioritized on supplying the centralized system which emphasised heavy industry and military armaments versus the development of balanced growth in each of the countries. This resulted in the widespread misallocation of available resources.*

The transformation of the CEE economies from traditional inefficient heavy industries to more market-based economies will be laden for the long-term with further economic strife. Past economic emphasis on resources and heavy industry will give way to the development of consumer goods and service industries along with a resurgence of localized agricultural production.

- *A factor which could ease economic restructuring in some countries in the CEE Macro-Region is the wealth of domestic natural and human resources. The increased sustainable export of these commodities to world markets could provide some needed funds, although with the direct result of potentially softening international prices.*

- *Prospects for economic recovery differ between the various countries and are primarily a function of political stability and the comparative advantage of each individual country.*
- *The elimination of state subsidies in various degrees in the CEE region has had an immediate dual adverse impact. This has led to:*
 - Massive price increases for many everyday goods and services.
 - Increased unemployment as traditional centrally-planned enterprises have been closed or down-sized.
- *Failure to offer the CEE assistance in the form of capital, technology, democratic reform, government administration, and entrepreneurial expertise could result in renewed global tensions between the West and parts of the CEE region. Supporting physical infrastructure needs considerable improvements to allow higher order modern economic development to proceed. Concomitantly, with the cessation of central planning, other systems of democratic decision-making will have to evolve to provide the orderly management of future economic growth in a market system manner. CEE officials lack experience in this respect. Immediate and substantial assistance is required.*
- *The CEE region is at an important and dangerous point in its history. The world has an enormous stake in the success of these reforms.*

STRUCTURE AND CONDITION OF CEE HOUSING

INTRODUCTION

Throughout the post-war period, the residential housing sectors of the CEE countries have been in a state of permanent crisis, characterized by continuous excess demand and rapid deterioration of the existing housing stock. Currently, housing production levels are at their lowest levels in over 35 years with an aggregate need of over 15 million housing units. This occurrence is primarily a result of two prevailing factors;

- Legacy of non-functioning communist economic and social policies related to housing. All aspects of the Communist housing sector strategies were ineffective and inefficient - production, distribution, physical management and financial administration.
- Uncertainty and upheaval of a radical economic, social and political transformation.

This part of the report first outlines the Communist strategies related to housing, then presents a regional profile of the current characteristics of the housing sectors in the CEE region, and in conclusion outlines the reformation strategies currently being employed.

COMMUNIST STRATEGIES RELATED TO HOUSING

Communist housing policies were driven by:

- The social need to provide standardized shelter for ever-growing domestic needs, and
- A system of subsidies whereby all revenues, expenses and financing were handled through the national banking system and national housing costs were ultimately absorbed into the national budget.

Until the late 1960s, the governments of the CEE region were heavily involved in their respective housing sectors, which were some of the most tightly controlled sectors of the economy. Initially, such policy was beneficial to the post-war rebuilding efforts, as in the case of Poland, since large parts of the housing stock and the supporting infrastructure had been destroyed. However, the outcome was an inferior, inefficient and inadequate housing stock throughout the CEE region.

The CEE region's housing sectors were in a state of permanent crisis throughout the post-war period because of a chronic need for housing and the continuing deterioration of the existing housing stock, including newly-constructed units. Communist housing strategies were both ineffective and inefficient and there were no mechanisms to stimulate innovation in building technology or need-responsive programs.

Background

Following World War II, immense distribution inequalities and housing scarcity occurred throughout the CEE region. The newly-empowered Communist Parties addressed these problems by nationalizing and redistributing the existing housing stock (in urban centres mainly) and establishing state-owned enterprises to construct and manage the new state-owned rental stock.

Laws were enacted which gave the state housing authority discretionary powers over the allocation of vacant units, second homes, and living space exceeding the needs of inhabitants. This included the nationalization of large proportions of the housing stock in the CEE region, especially in urban areas. A family was only allowed to have one home.

Tenant Property Rights and Tenure

Tenancy rights were, and still are in many CEE countries, stronger than private ownership rights. A tenant in a state-owned housing unit enjoys the following tenure rights:

- Right to permanent occupancy and can transfer that right to relatives,
- Cannot be evicted without compensation in the form of another unit, and
- Right to privately sublet and exchange flats.

This policy has created a situation where many households are over-housed at the end of the family life-cycle, while young families have difficulty in accessing housing. Strong tenant rights have also produced extremely low housing mobility which impedes labour mobility because people are not willing to, or cannot, relocate for employment reasons.

Rents and Utilities

The full cost of living was not built into the salaries of the CEE's population. Under communism, the provision of basic living necessities was considered a responsibility of the state. As a consequence, rents and utilities were heavily subsidized in the CEE region. Prior to 1989, rents amounted to about 2% of household income and covered neither the costs of operation nor of maintenance of the stock.

The drastically low levels of rental and utility costs under the Communist system are the major reasons for the housing affordability problem today, since these costs have sky-rocketed under price liberalization policies. Further, the low rents exacerbated the housing shortage because households wanted to consume more of this cheap but intrinsically valuable commodity. For example, it was estimated that rents in the publicly-owned stock were less than one-tenth of market rents in Hungary in 1991. Once rents are increased, this shortage will be significantly reduced because households will make better use of the existing stock. Households will change their consumption patterns and place a higher importance on housing.

Management and Maintenance of the Housing Stock

State-owned housing comprises about two-thirds of the entire housing stock in most CEE countries. Communal management companies were formed to manage and allocate state-owned housing. Each of these companies managed tens of thousands of units and were known for their inefficient provision of services and their inequitable allocation practices. Due to the companies' monopolistic position, there was no incentive to increase the quality of housing services. Further, the Communist party elite received the best units and this continues to complicate the task of privatizing the state-owned housing stock.

Production of Housing

Rather than spending resources to maintain and upgrade the existing housing stock and municipal infrastructure, Communist governments concentrated on producing new generic housing to meet ever-growing requirements. Consequently, the existing housing stock was, and remains, seriously neglected.

During the Communist era, there were basically two types of housing producers:

- State-owned enterprises and their cooperative clients, and
- Private firms and individuals.

State-owned Enterprises

Housing was produced mainly by state-owned enterprises and their cooperative clients. State enterprises produced well over half of all housing in the CEE region and virtually all of the housing produced in the CEE's urban areas during the Communist era. The housing sector was severely distorted by the state-owned enterprises because they did not forecast any type of demand or cost analysis.

State-owned enterprises were usually large vertically-integrated companies that encompassed construction firms, building material manufacturers and distributors. Each state enterprise was typically the exclusive operator in a specific area and usually employed over 500 workers. The high degree of interdependence within each enterprise compounded inefficiencies and produced rigid organizational, technological and production structures.

State-owned enterprises did not respond to public demand, and therefore, the large amounts of housing that were produced bore little relationship to household requirements or tastes. These enterprises had monopolistic control over the design, investment, and construction of state housing. They standardized demand by optimizing the production companies' preference rather than that of the consumers. They built apartments to national standards and produced only a few basic types of housing. Since performance of the building sector was measured in terms of output only, the units produced were usually of inferior quality.

Production costs were never a factor in building decisions because state-owned enterprises had access to low-interest credit, preferential access to building materials and faced no local competition. State-owned enterprises had soft budget constraints and were not financially accountable to an authority. This resulted in an extremely costly and inefficient monetary allocation system because state-owned enterprises lacked banking expertise and incentives to conduct efficient and responsible transactions. Further, analysis of production costs was never performed. Moreover, all losses and loans were absorbed by the national banking system and ultimately, the national budget.

State building monopolies employed large-panel concrete construction systems that were inflexible and wasteful of energy, capital and other resources. High-rise apartment blocks were mass-produced around "housing factories" on large tracts of vacant land, usually far from the inner city.

In the late 1960s and early 1970s, the governments gradually diminished their role in the residential housing sector and cooperatives became a source of new housing accommodations. The cooperatives' activities have been heavily subsidized by the state. Members of the cooperatives, the prospective tenants, were required to provide only a small part of the apartment's cost while the rest was paid by a state grant or a long-term loan at rates of 1-5%. In addition, they were given large tracts of land for free. The cooperatives would contract the building of the apartment complexes to the state-owned enterprises. In recent years, some cooperatives have now begun to adopt the role of developer due to their large holdings of serviced land.

Private Producers

Very few private construction firms emerged during the Communist era because of restrictions on their activities such as limiting their number of employees and restricting access to state-controlled materials and equipment. Further, state-owned enterprises had preferential treatment

with regards to loans, tax exemptions, and access to construction supplies. This greatly hindered the viability of private firms that were allowed to emerge in the late 1960s in some CEE countries. These firms, often described as workshops, used traditional and outdated technologies and their organizational structures were very basic.

Owner-built single family dwellings, which were unregulated and often built on unserviced land in rural areas, comprised up to a third of housing development in many CEE countries. The overwhelmingly dominant form of construction technology used was labour-intensive masonry. Single-family housing was characterized by high durability and a long life span, usually exceeding a hundred years. Completion times were usually in excess of two years and the prolonged completion time was primarily due to the fact that work was usually performed by family members and only as resources became available.

HOUSING SECTOR TRANSFORMATION STRATEGIES

All CEE governments are restructuring their housing sectors in one way or another and all have initiated measures to:

- Reassign ownership and operational decisions for housing to local governments.
- Privatize state-owned construction enterprises and building materials producers.
- Restructure housing production to increase the number of small and medium-sized companies, promote a competitive environment and facilitate the introduction of alternative technology.
- Establish land markets and land use planning systems that are compatible with a market economy and shift land use planning and development responsibilities to local governments.
- Implement policies that replace public subsidies with private responsibility and reliance on private resources.
- Rationalize the utilization (tenant rights) and management of state-owned housing.
- Transfer responsibility for maintenance and utility costs to tenants.
- Introduce competitive bidding and tendering for housing contracts.

However, important decisions that could expedite investment into the CEE's housing sectors have yet to be made. Foreign investors are still waiting for legislation to be approved related to restitution of property, foreclosure, property rights associated with renting, and the status of the stock of state-owned housing. There is also an absence of guidelines for joint ventures and

licensing agreements. Foreign investors themselves have been negotiating the particulars of joint ventures due to the lack of set government criteria and guidelines. This is allowing for the formation of potential monopolies.

CURRENT SITUATION OF THE CEE HOUSING SECTORS

The existing housing stock is under serviced and in very poor condition. The average age of the housing stock is 40-70 years in the CEE region as compared to 28 years in North America. The post-war era was characterized by the building of apartments by state-owned enterprises. All these apartment units are well below western standards and in poor condition. Rather than allocating money to the maintenance and upgrading of the existing state-owned housing stock, funds were used to build new apartment units.

Since the majority of the population, in most of the CEE countries, resides in housing units owned by the state administration and not in privately owned units (where the care and maintenance is of comparatively superior quality), the deterioration of the housing stock has been very severe. For example, it is estimated that 85% of the state-owned housing stock in Hungary requires major upgrading.

Further, the household size is decreasing, and therefore is causing an increase in the number of households, thus creating more pressure for the housing sector. The CEE region leads the world in suicide, alcoholism, abortion and divorce rates. A contributing factor to these social ills is the housing shortages which are forcing three or four generations of families to live together in cramped and under-serviced housing units. However, due to the lack of credit and financing available to the construction companies, the mainstay of housing currently being built is in the form of self-built detached single family homes on unserviced land.

Market Conditions

Since the transition to democracy commenced in 1989, several changes have occurred in CEE housing sectors to make them more market-oriented. However, the transition to market economies has taken place amidst housing shortages and economic stagnation and this has led to a dramatic increase in the share of household incomes that must be devoted to housing. The whole consumption structure has changed in ways that have immediate impacts on housing production costs and housing affordability.

All CEE housing sectors are facing severe problems. Housing production in the CEE region is at its lowest level in over forty years and continues to decrease. At the same time, there is a growing stock of recently-completed housing that cannot be sold because these units were produced without regard for either the requirements or the financial circumstances of their potential occupants.

Generally speaking, most Central and Eastern Europeans do not have an appreciation of real property transactions. Also, higher risks and lower returns, compared to other potential investments, have deterred investors and entrepreneurs from entering CEE housing sectors.

Most state-owned or recently privatized construction companies are facing serious difficulties as a result of the adverse economic climate, the lack of management skills in a market-based system and an immature real estate market. The viability of the emerging private housing construction and building materials industries, which have been playing an increasing role in the overall production of housing, are also being threatened by the same adverse circumstances that are affecting state-owned or recently privatized enterprises.

The immaturity of the real estate industry in the CEE region is extenuating and prolonging the housing sectors' crisis. Since proper distribution networks, sub-contractors, and reasonable financing terms are not yet in place, potential demand is being seriously constricted in the short-term. Thus, firms wanting to enter the CEE region must be prepared to participate in the development of the market and this could entail additional initial costs and a longer than usual time before profitability occurs.

In the CEE region, a number of obstacles are retarding the restructuring of the housing sectors and emergence of housing markets. These include:

- Affordability problems and low effective demand for housing.
- Lack of in-depth knowledge and experience with housing market mechanisms and their operation.
- Severe recession in the economy and a shortage of capital for business development.
- Absence of institutional infrastructure including consumer credit, banking facilities, building and tendering regulations, capital and stock markets and the like.
- Resistance to new management methods, particularly in former state enterprises.
- Shortages of useful market information, including property listings and information on completed transactions.
- Insufficient experience in conducting market and feasibility analyses, assembling land, raising equity and debt financing and real estate sales.
- Scarcity of serviced urban land with clear title.
- Shortages of capital for house building and industry development.

Consumer Need and Demand

It is estimated that there will be a need for over 4 million new housing units in Poland, Hungary, and the Czech Republic and that there will be over 15 million units needed in the entire CEE region by the year 2000. In addition, over half of the existing housing stock in the CEE region needs major renovations and upgrading.

Notwithstanding these needs, households throughout the CEE region overwhelmingly do not have the income and savings to purchase a home. Lack of affordability is primarily caused by factors such as high interest rates, housing costs which are increasing faster than real wages, and an absence of mortgage lending that can spread the burden of repayment over time. It is expected that only a relatively small proportion of CEE households will be able to enter the housing market in the foreseeable future.

Housing Demand Characteristics

Notwithstanding the limited activity in the marketplace, a housing demand profile has begun to emerge in all CEE countries to a greater or lesser degree:

- The upper end of the housing market aspires to Western finishings and quality and will pay cash as well as premium prices for the right product. These clients include employees of Western corporations, embassies, repatriated citizens and newly-rich nationals. This market is small but significant. In fact, it is the only sector in which there is an active market in many places. The demand in this limited market is for suburban executive single-family homes on estate-sized lots as well as for large and centrally-located luxury apartments.
- Home ownership typically does not follow the same pattern in CEE countries as it does in North America. A CEE family's first home purchase may well be their only one. It may also be their dream home that may be shared by, and passed down to, their children and their families. This means that the CEE house is fundamentally different from a comparable Canadian dwelling. It has to be large enough for at least 2 families to live in and it must be perceived to be durable.
- Central and East Europeans dream of the 220 sq.m. single family detached dwelling with a garden, but are prepared to settle for a 40-110 sq.m. flat in a 3- or 4-storey building. There is market potential for a 50-70 sq.m. detached or semi-detached house if the price is competitive with the low-rise multiple unit. The first-time home buyer is not being provided with low-rise or ground-oriented housing units. All of the housing that was built for this market has been in high-rise apartments located on the fringe of major urban centres.

- The average current selling price for a house has been reported to be about C\$750/sq.m. in both Poland and Hungary. It was repeatedly expressed that a 50-70 sq.m. home in duplex or detached form that could be purchased for about C\$25,000 would sell very quickly under any circumstances, but particularly if reasonable financing was available.
- New housing has to satisfy local cultural needs, traditions and tastes, and attempts to introduce radical new technologies, designs or materials have generally not been successful in the short run. Pre-fabricated or modular housing have been difficult to introduce in some areas and there is an inherent mistrust of 'light' building technologies in many parts of the CEE region. Accordingly, the North American type of cheaper, lighter structures, built from materials with limited durability and designed to last 40 to 60 years has not as of yet evolved nor been accepted by the population.

Organization of Housing Industry

There appears to be no consistent structure to the home building industry in the CEE region. There are no comprehensive training courses or apprenticeship programs and no national licensing requirements. Skills are learned on the job.

Organized networking and lobbying have not yet evolved in the CEE region and the absence of this organizational structure has resulted in:

- Ineffective representation of housing-related industries and interests in public decision-making.
- Lack of public confidence in the durability and integrity of the house building industry.
- Poor sharing of information concerning new techniques, materials and related developments.
- Uneven workmanship and labour practices.

Financing and Mortgages

The banking system and the provision of financial services are rudimentary in the CEE region with the result that simple transactions can take weeks to complete. Furthermore, construction loans are only available where stringent conditions can be met. These may include:

- Short repayment periods.

- Collateral well in excess (150-250%) of the value of loans.
- Guarantees in the form of bank deposits or co-guarantors, and
- Interest rates of 30% to 50%.

Due to very high and volatile interest costs (e.g. +50% in Poland and +35% in Hungary) most private builders use the purchasers' money to finance construction. Thus, where credit is not available, the construction industry cannot expand, acquire adequate supplies or purchase modern equipment.

The emergence of a construction loan and mortgage market for housing has been hindered by a number of factors:

- Few commercial banks have the mandate to provide construction loans and mortgages.
- The current adverse economic climate and high inflation have restricted the ability of the banking system to mobilize funds.
- There is a severe shortage of capital for investments of any kind.
- Collateral for housing loans is difficult to secure.
- High risk perception of the construction industry is difficult to overcome.
- Lack of enforceable foreclosure laws and uncertainty over land ownership have been major factors affecting the house building and development industries.
- The technical capacity of the existing financial systems to evaluate and carry out lending on a commercial basis is inadequate.
- There is a shortage of market assessment and other skills that banks need to support loan underwriting functions.
- Developers and contractors do not have experience in securing construction financing and pre-qualifying home buyers for mortgage loans.
- There is a lack of investors in the housing sector, often because the rate of return has been higher in other sectors.

Further, the initial introduction of the competitive bidding process has detrimentally affected the credit worthiness of the construction industry. Under-capitalized and inexperienced bidders have been submitting very low bids and then defaulting on contracts. As a consequence, the high risk perception of the housing production industry held by lenders has been strongly reinforced.

Nonetheless, the financial markets are improving and foreign banks are establishing branches and introducing consumer financial products, including real property financing.

Local Government: Planning and Approvals Process

Since 1989, regulation of the development and construction industry has been the responsibility of the local governments. However, most local governments have neither the experience nor the capacities to regulate the housing industry, and as a result, housing production in the CEE region has been largely unregulated.

This situation is gradually changing, however, with the result that building codes in Poland and Hungary do not seem to differ substantially from Canadian codes. Energy efficiency requirements also seem comparable to Canadian standards (e.g. double glazing in new units, R-45 walls). Developers and home builders have had mixed experiences in securing approvals for housing development and it has largely depended on the nature of their relationship with the local officials.

North Americans building in CEE countries have generally found that:

- The approval process has tended to be complex and lengthy.
- There is a lack of consistency in the application of regulations.
- Information can be very difficult to obtain from local authorities.
- Supporting legal infrastructure is not in place. There are no standard contracts, bid and performance bonding provisions, liability insurance or warranties.
- There is no clear development policy and the current regulations are outdated and not performance-based.
- Building code enforcement is applied unevenly.

The bureaucracy has been described as "deal breaking". Red tape is prevalent and business dealings are far slower than in Canada. The reason for this is not necessarily because of a large, un-cooperative, self-serving bureaucracy. Rather, it is their lack of knowledge concerning the process, coupled with the fact that laws are changing regularly. Another major contributor to this problem is the general attitude towards work that is inherited from the Communist past and the absence of any tradition that rewarded initiative.

Infrastructure

Municipal infrastructure has not been adequately maintained or upgraded for decades and the responsibility for all aspects of infrastructure (roads, sewage, water supply, district heating, etc.) now resides with local governments which have little experience in managing these facilities. Moreover, there is a serious lack of financial resources at the municipal level with which to undertake the required work. Local governments have few means to finance infrastructure due to the absence of a property tax system and current land records. Consequently, severe restrictions have been placed on the development of large tracts of unserviced land that exist in the vicinity of many urban areas and few developers can afford to finance trunk infrastructure in the current economic climate.

Land

Under the Communist system, most urban land was nationalized and, as a result, the overriding issue with respect to land is its ownership. Clear title is usually only available in cases where land was not nationalized or has been returned to the original owners. As a result, the cost of centrally-located, serviced land with a clear title is very high.

Acquiring serviced land can be a problem. Municipal governments now own virtually all former state-owned assets including land within their respective boundaries. Large tracts of serviced land also remain under the control of some state-owned enterprises and housing cooperatives. Most of these landholders seem to be withholding land from the market in hopes of a higher return in the future. As a consequence, the supply of vacant serviced land within cities is severely limited.

Further, current property law tends to relate to large state-owned firms and the property law that is required to regulate the activities of small business is still being developed. Consequently, competent legal advice is essential before concluding any property transaction in the CEE region.

Labour Issues

The labour force of the CEE region is on average highly educated with a majority having at least finished the equivalent of high school. A high proportion of the population also has university level training, often in mathematics, science and engineering. The population of the CEE region is hard-working and highly trainable if given the right incentive.

With respect to housing, some noteworthy characteristics of the labour force include:

- In Poland, construction workers were being paid C\$4.25/hour while black market labour was C\$1.25/hour. The average monthly wage for a skilled tradesman is between C\$250-300 in Poland and Hungary. It is estimated that the wage of professionals in Hungary is one-fifth that of comparable Canadian wages.

- Technical skills are limited to traditional building methods utilizing concrete and masonry.
- Labour productivity is low as a result of poor technology and management, rather than poor labour quality. The quality of the work is generally acceptable.
- General management abilities in the CEE region are weak and this results in poor decision-making and limited knowledge of finance, marketing and business planning.

Wage Levels

Since the pay scales for residential construction workers have been lower than for commercial construction workers, and the materials and technologies used are more sophisticated than those used for housing, there is a tendency for the higher skilled workers to gravitate to the commercial construction sub-sector.

Technical Skills

With respect to housing-related activities, labour productivity is low as a result of poor technology and management, rather than poor quality labour. The people of the CEE region are commonly regarded as hard working and quite trainable. Their technical skills are, however, currently limited to traditional materials and methods utilizing concrete and masonry. Nonetheless, despite low productivity using these traditional techniques, the quality of the work is generally accepted as adequate.

Improvements in concrete or masonry-based building techniques seem to have the best chance of acceptance at this time but Polish builders are very interested in learning traditional Canadian wood frame ("stick built") techniques due to an abundance of local wood. Local tradesmen are not generally experienced in wood frame technology and would thus have to be fully retrained. Americans have established a vocational school in Warsaw to train local tradesmen in American home building technology.

Further, there is an acute lack of general and specialty contractors who are organized to respond to specific markets, can efficiently compete for work, and who can form their own alliances or relationships as the market dictates or respond to the market independently.

Management Skills

The management abilities of the CEE region are lacking, characterized by poor decision-making capabilities, and a limited knowledge of finance, marketing and business planning. The lack of

management skills is rooted in the former command system where decisions were made from above and, thus, responsibility and accountability was severely limited.

Black Market Labour

A characteristic of the CEE housing sector is the strong presence of a black market labour force. Black market labour in the construction industry is used to minimize construction costs. The use of informal labour represents a significant savings as no social security tax or income tax is paid to the government. Social security tax normally paid by the employer is about 45% of gross income and income tax ranges from 45-50% of gross income.

Building Materials and Manufacturers

As with state-owned construction enterprises, the restructuring of material producers has not been effective and most companies are still not directly servicing the market. In addition, production facilities are generally outdated and inefficient and the materials that are produced are of inferior quality to comparable Western products.

The building materials industry has generally not adapted to changing circumstances due to a reluctance to implement new production technologies and management systems, lack of credit and investment capital, and lack of joint venture guidelines and production agreements. As a result, foreign investors are focusing their efforts on producing new materials rather than supporting the production of existing product lines. Small manufacturers with flexible production runs of custom materials are successfully entering CEE markets.

The building materials industry in the CEE region is typically characterized by:

- An over-supply of traditional, domestically-produced building materials.
- Poor and costly distribution networks due to the continued domination of the building products industry by regionally-based state-owned enterprises and high transportation costs. The current distribution networks do not foster competition.
- High-priced and poor-quality building materials which have little competition in local markets.
- The absence of regulation and performance standards for building products which has hindered the introduction of new materials and technologies.
- The use of large concrete panel technology as the principal housing construction method is ending. However, in the absence of alternative technologies in the short-term, demand tends to favour traditional construction materials.

- New privately-owned companies have been organized to be more flexible and accommodate smaller production runs of custom products. Many of these producers are experiencing strong rates of growth.

Development of Housing

Housing producers in the CEE region belong to one of the following three categories:

- State-owned or privatized companies, most of which have unsold units on the market and which will not survive unless radical changes are made to their operations and management.
- Private construction companies, which are the fastest growing type of producer.
- Private individuals, who are constructing self-built, detached houses, usually on unserviced land.

The once powerful state-owned construction firms are finding it difficult to adapt to a market economy and are now faced with insolvency. In contrast, many small firms capable of building 2-30 homes per year, managed by former employees of the state-owned firms, are emerging strongly in the marketplace.

Notwithstanding progress, housing production capacity in the CEE region remains limited because:

- Subsidies are being rapidly eliminated for the production of housing.
- The lack of serviced land has resulted in extremely high land prices in major cities.
- There is lack of a legal system to ensure the security of debt.
- Modern management techniques and technical skills are in short supply.
- There is an absence of financing (both financial intermediaries and mortgage markets) due to high inflation and the lack of market-driven prices.
- Financing skills are lacking and the banks do not have experience in lending to private developers.
- Cash payments have become the basis for financing home construction in the absence of alternative financing and the unattractiveness of mortgages financed at market rates.

- CEE housing sectors are not attracting investment due to a relatively unattractive risk/reward ratio compared to other investment options.
- Private builders are servicing mainly the upper end of the market and little capability is being developed to serve the general market.
- Builders, general contractors, banks, municipal governments, private entrepreneurs, state-owned enterprises, cooperatives, and design professionals are not effectively coordinating their activities.
- The private development industry for moderately-priced housing is unlikely to evolve on any appreciable scale until legal, tax and financial incentives are introduced.

State-owned and Privatized Enterprises

With the adoption of market-oriented reforms, the protected position of the state-owned enterprises has been reduced. As with other state enterprises, the national governments are requiring construction firms to operate on a more commercial basis. Local governments and cooperatives are now free to choose private contractors for their housing projects.

All state-owned building enterprises are in various stages of restructuring and privatization. However, the restructuring and privatization plans seem to be little more than a realignment of vertically-integrated companies into smaller independent entities that are dependant on a residual "mother" company. The enterprises are only providing services to each other and not to the market. With the cessation of government orders and subsidies, many of these enterprises are unlikely to survive.

Privatized companies have the legal structure of private organizations, however, they are still not fully market-oriented. As noted above, most of the current and former state-owned construction enterprises are in grave financial conditions for the following reasons:

- CEE privatization programs were not specifically geared to the construction industry. Generic strategies for all industrial sectors have been applied with mixed results.
- The status quo has been maintained in virtually all aspects of the operations of former state-owned enterprises. Only recently has there been some interest shown in adopting innovative building technologies and management systems.
- Privatized firms have been either unable or unwilling to shift activities into non-traditional areas of endeavour.

- Marketing studies and business planning have not been undertaken in a serious way.
- Labour productivity in housing production has typically been low due to the widespread use of concrete block techniques and poor management skills.
- Labour productivity in state enterprises has generally been lower than in private construction firms.

There is also reason to believe that newly-restructured organizations may not survive under the current economic conditions due to their lack of flexibility and continued high degree of interdependence.

Private Construction Companies

Private firms have shown a strong emergence and are playing an increasingly significant role in housing production. However, due to their lack of knowledge about how a housing sector functions in a market economy as well as severe financial constraints, their growth and survival is being impeded.

The growth of private sector firms has been hindered by:

- Decreasing demand as new orders are no longer being placed by state and local governments and there has been a dramatic decrease in affordability.
- Shortage of private entrepreneurs and investors in the housing sector. Further, there is a shortage of speciality contractors and of high quality building materials.
- Absence of financial support for private construction firms. Poor economic conditions have left low levels of resources available for new housing investments. There is no government support and since these companies are perceived to be risky and do not have a credit history, construction loans have prohibitive requirements.
- Lack of the knowledge/skills that are needed to function in a market-based economy. Decisions are being made without prior and adequate market analysis or financial feasibility studies. Private construction companies are often not employing market strategies or addressing well-researched market niches.
- Lack of knowledge about modern building technologies and materials is limiting potential productivity and efficiency gains. Private firms are utilizing building technologies and materials that concentrate on heavy construction rather than lighter, less expensive methods.

- Shortages of workers with skills oriented toward new cost-saving technologies and quality control.
- Lack of adequate and reliable supplies of materials due to insufficient production and distribution facilities.
- Private firms not being in a position to effectively address the potentially large housing renovation market because they lack the specific technology and techniques needed for rehabilitation.

Development and Building Costs

Construction costs are difficult to forecast and estimates do not remain valid for long because of inflation and uncertainty about the availability of building materials. Reported costs range upwards of C\$60-80/sq.ft. for single family homes and for low-rise walk-up units although costs C\$25-35/sq.ft. have also been estimated using new or developing technologies. Building costs are apportioned differently than in Canada among land, labour and materials, and this makes rules of thumb difficult to apply with any degree of precision.

Land costs vary widely but generally seem to be much lower than for comparable land in Canada. For example, serviced lots outside Olsztyn, a Polish city with 180,000 residents, can be acquired for as little as C\$12-15/sq.m. whereas a similar lot in Canada would sell for C\$200/sq.m. Unserviced land in the same location in Poland sold for C\$7-8 sq.m. Lot costs in built-up areas within the cities can, however, be ten times greater in Canada than in Poland at the present time.

Other costs, such as fees paid for the subdivision of land, can also be quite different from the Canadian experience. Fees or levies are a percentage of the increase in value as a result of subdivision and these fees are often subject to negotiation with municipalities. In these discussions, the developer attempts to inflate the costs incurred in creating lots, while at the same time, minimizing the estimated return that these lots will command on the market. The municipality, on the other hand, will down-play development costs and seek to inflate the expected selling price of lots.

When acquiring existing buildings, it should be noted that tenants' rights are still protected in all of the former Eastern Bloc countries and that substantial cash payments may be required to tenants in order to gain vacant possession of a flat regardless of who owns it. For example, the current cost to acquire possession of an occupied flat in Riga, Latvia is about C\$5,000.

POLAND'S HOUSING SECTOR

OVERVIEW OF POLAND'S HOUSING SECTOR

Since 1989, Poland, the most populous Eastern European country, has been attempting to transform and improve the standards and activities of its housing sector. A closer examination of the current status, pending changes and unresolved issues affecting the performance of this sector, provides an illustration of the challenges facing the entire CEE region.

Demographic Profile

Poland's population of over 38 million is comprised of 11 million households with about 65% living in cities/towns and 35% in rural areas. The average Polish family has three to four members. The family income is predominantly determined by the earning of the male head of the household. With respect to age groups, the distribution of Poland's population has remained relatively stable during the last decade. In 1990, the share of the prime household formation age group of 20-24 declined marginally to 6.5% from the 1980 share of 9.1%, while the retirement age group (65+) share remained at 10% of the total.

Nationally, the average monthly wage ranges from \$165 to \$234 per month (depending on the source). In December 1992, the minimum wage was fixed at \$89 per month and the minimum income required for an average family was \$186 per month. Burdened with skyrocketing prices and high unemployment, Polish families have been hit hard by the realities of the new market economy - about 46% of Polish households live below the poverty line with another 25% barely exceeding the 2.7 million zloty minimum. This factor of impoverishment affecting the Polish society is one of the main factors impacting on the needs and future growth prospects of the residential housing sector.

Short-Term Macroeconomic Outlook¹

A marked improvement toward a functioning market economy has been made since 1989. The Polish currency (zloty) is fully convertible, the stores are full of western quality goods, and many Polish citizens are becoming affluent. However, this transition has also occurred at a large cost - both socially and politically. The loss of Soviet markets led to a severe recession. Despite tough monetary measures, shortages of goods triggered significant inflation and the consequential impoverishment of the lower and middle economic classes. Further, the politically fragmented parliament is unable to create uniform objectives.

¹ The data in this section is obtained from Strategic Decision Associates 1992 and The Economist 1993.

In 1992, Poland was the only CEE country to halt the post-Communist collapse in GNP. The macro-economic reforms that Poland undertook were standard IMF stabilization programmes, held in place by a fixed exchange rate (the newly convertible zloty was backed by a \$1 billion western-donated fund) and by wage indexation. The effect was a two-tier economy: a rapidly expanding private sector and an ailing state industry.

Industrial production rose by 1.2% during the first 9 months of 1992 (an increase of 10% from the previous 12 months) and is expected to increase by 2% for the year as a whole. Annual inflation, which reached almost 600% in 1990, was about 45% last year and is projected to fall around 30% in 1993. Currently, the inflation rate is about 38%. The net share of exports of commodities and services in national income increased from 21.5% in 1989 to 30.7% in 1990. Poland's hard currency exports rose from some \$8.5 billion in 1989 to more than \$13 billion in 1991. In the first half of 1992, Poland's trade surplus surged to \$1 billion.

For 1993, GNP is forecast to expand by 2% which will be accompanied by a 4% decline in unemployment with additions to the work force amounting to 3.3 million workers. It is expected that private sector employment will soon surpass 50% of total employed. During the first three quarters of 1992, unemployment amounted to 13.8% of the workforce, as compared to 10% during the same period of the previous year. Salaries have declined by 4.3% and pensions by 6%. An even greater decrease has been noted in family incomes owing to rising rents and growing unemployment. For those employed, real earnings have declined by 24% in the last two years.

The private sector, accounting for 50% of GNP, was the source of 55-60% of new jobs created, and accounted for 35% of the companies that export and 55% of those that import. Currently, the private sector is responsible for 27% of Polish industrial production, 77% of construction and 80% of commercial activities. There are 1.6 million non-agricultural private businesses, of which about 55,000 are incorporated (up from 15,000 two years ago); state owned companies number about 8,000. A quarter of all manufacturing is in private hands.

Although there have been substantial strides towards transforming the economy and the forecast reinforces the reversal of the negative economic trend, the positive changes have yet to significantly benefit the well being of the majority of Poles. This situation is not expected to change in the short to medium term. The absence of substantial economic growth and increases in real earnings prevent strong stimulation of the activities of the housing sector.

Household Expenditures

The largest proportion of household expenditures is spent on food. In 1989, it accounted for 37% of the total, while in 1991, its share increased to 45%. In the near-term, food expenditures are forecast to decline as most of the inflationary price increases have already been absorbed. The reverse of this trend is forecast in expenditures on housing and heating. Historically, the share of housing costs was low by Western standards, as the state provided substantial subsidies for

apartment cost and maintenance. Some of the rent and energy increases have been implemented in 1990-91, but additional increases are expected in the near future.

Due to declines in family incomes, the shifting structure of housing ownership, rent and maintenance cost increases and a modest short-term economic outlook, the immediate future of the housing sector is not promising. About 70% of Poland's households are low-income families in need of better quality, cheap rental housing, rather than being candidates for home ownership.

Characteristics of the Residential Housing Sector²

Out of about 11 million housing units, 65% are at least 55 years old and 14% are at least 70 years old. Although the number of residents per housing unit has marginally decreased, from 3.7 in 1978 to 3.5 in 1989, the increase in living space per unit during the same time period has been negligible (from 3.2 to 3.4 rooms per unit). Poland's ratio of 3.5 inhabitants per unit is above the former Czechoslovakia's and Hungary's of 2.7, and below Commonwealth of Independent States (CIS) ratio of 4.0. It is also above most of the EC countries and Canada.

About 80% of the population lives in multi-family units and the remaining 20% in single family dwellings. In 1989, 65% of the total population resided in towns and cities, a marginal increase from 61% in 1978. This trend represents a decline in migration from rural to urban areas characteristic of the 1950s and 1960s. In addition, there is little inter-urban mobility due to lack of viable housing and employment opportunities.

With respect to the quality of housing accommodations, Poland made strides in providing some basic housing amenities, primarily in newer urban areas. Over 95% of urban apartments have running water, 85% are equipped with flush toilets and about 74% have central heating. However, the quality of these amenities and the general quality of the housing units are below Western standards. As a result, construction and renovation companies are purchasing rundown, shell apartments or whole buildings. After renovation, such units are most often resold or rented. In addition, the availability of facilities and amenities in rural areas is relatively lower. It is estimated that as much as 42% of dwellings need refurbishment.

The ownership structure, or more appropriately the investment structure, of the housing sector reflects the centrally planned approach to residential housing construction and distribution. As a result, in 1988, over 34% of the population lived in what the Poles themselves consider substandard housing; specifically, 12.5% of the urban population and 26.7% of the rural population. Over 60% of total housing was equipped with insufficient or poor quality amenities and about 25% of urban housing was overcrowded. The majority of housing stock in Poland (70%) was in multi-unit apartment blocks. Overcrowding did not appear to be an issue with rural housing, which accounted for only 6.6% of the total.

² The data in this section is primarily obtained from Strategic Decision Associates 1992.

In 1989, the state administered over 27% of the urban housing stock (the so-called communal apartments), a decline from 32.8% in 1978. This form of housing, at very low subsidized rents, has experienced the highest demand as most of Poland's families have monthly levels of income of \$200 or less.

Characteristics of the Housing Stock

	# of Units	Percentage
Distribution of Housing Units:		
Urban/Towns	7.3 M	65.2%
Rural	3.9 M	34.8%
TOTAL	11.2 M	
Ownership:		
Privately Owned One-Family Homes	4.6 M	41.1%
Cooperatives	2.8 M	25.0%
Municipality/Local Government	2.1 M	18.8%
Enterprises & Institutions	1.1 M	9.8%
Privately Owned Multi-Family Homes	0.6 M	5.3%
Age:		
Erected before 1945	3.9 M	35.0%
Erected before 1920	1.3 M	11.6%
Conditions:		
Technical state and quality:	Unsatisfactory	
Requires immediate upgrading	1.0 M	9%
Should be Demolished	0.3 M	3%
Urban:		
No bath-rooms	1.5 M	21%
No central heating	2.2 M	30%
No running water in lavatory	1.2 M	17%
Rural:		
No water supply system	1.7 M	43%
No running water in lavatory	3.7 M	94%
Housing Needs:		
# of Households	12.5 M (13.8 M - Forecast for Year 2000)	
# of Housing Units	11.2 M	
Housing Deficit	(1.3 M)	
# of people with deposit waiting to join cooperatives	1.8 M	
Average Housing Unit Size:		
Multi-family units	57.8 m ²	
One-family houses	106.4 m ²	

Source: Ministry of Physical Planning and Construction 1991.

Characteristics of Housing Production

Production of Housing Per Annum:

1978	1979-82	1983-88	1989	1990	1991	1992
284,000	186,000	185-195,000	150,000	134,000	50,000	50,000 (est.)

Construction Firms (1989):

	# Firms	# Employees	Prod'n Value
State and Co-operative sectors	4,100	860,000	55%
"Do it by your own means" system	5,100	580,000	33%
Private sector	128,000	320,000	12%

Construction Firms (1990):

State (public) sector	1,300	596,100
Cooperative sector	465	31,200
Private sector	143,000	239,100

Percentage Share of Private Sector Involved:

	1989	1990	1991
Construction	33%	32%	55%

Basic Production of Construction Companies (1990):

Apartment and public utility buildings	36%
Industrial and commercial structures	19%
Mining industry and civil engineering structures	33%
Power lines and networks	6%

Building Technology:

	1990	1991
Multi-family housing:		
Large-panel construction	70%	66%
Large-block construction	13%	11%
Traditional techniques	8.5%	15%
Other technologies	8.5%	8%

Detached Single-family housing: The basic technology is traditional.

Average completion times:

Multi-family house -	19.1 months
Single-family house -	24 months (7% were completed by)
	36 months (65% were completed by)

Poland has a number of well-educated building engineers and architects.

Numerous Polish enterprises carry out construction works outside Poland. In 1990, these enterprises employed about 50,000 employees abroad.

Source: Min. of Physical Planning and Construction 1991 and The Economist 1993.

Housing Production³

Polish government officials have acknowledged a current shortage of about 1.9 million housing units. By the year 2000, 3.0 million additional housing units will be required.⁴ To achieve this optimum construction volume, Poland would have to increase the ratio of housing unit construction from the current of 3-4 per 1,000 people to 10 per 1,000 people, over a three-fold increase within the next 8 years. There are many barriers to achieving this requirement since the most important factor in stimulating the Polish housing sector is the growth in real family income and not the availability of a mortgage type of financing.

Residential housing construction in Poland peaked during the boom years of the mid-1970s when 280,000 units per year were constructed. By 1980, the total number of units built declined to about 220,000. In 1985, only 190,000 units were constructed and in 1990, the number of new units declined to a 50-year low of just over 134,000.

Between 1980-1990, the largest decline in housing sector investment, 67%, was a result of a general curtailment of the state's function in providing housing. The activities of co-operatives have also declined reducing the number of housing completions by over 43%. However, in terms of its size, 51% of the total, the co-operatives are still the largest sector of Poland's residential housing industry, followed by the rapidly growing private sector, at over 35% of the total.

According to the Housing Research Institute, state-owned enterprises produced some 130,000 units in 1990, of which approximately 65% were produced for co-operatives. This command system (state-owned enterprises and cooperatives) will produce only 40,000 units in 1992 and is in the process of being dismantled. Given the magnitude of housing production that is required, Poland can not rely on sole proprietorships and small builders to produce the volumes required, especially when financing becomes available and economic conditions improve. Private investors and a real estate development industry will be required with a significant amount of foreign involvement.

Policies and Legislation Related to Housing

With respect to housing-related policies and legislation, Poland is characterized by a lack of national policies, which is incompatible with a market economy, and legislation that is out-dated and inconsistently enforced. The following changes are affecting the functioning of the housing sector:

Law of Local Government - As a result of the May 1990 reforms, Local Government

³ Data from this section was primarily obtained from PADCO 1992 and Hadjuk 1992.

⁴ Shortfall in 1990 was estimated at 1.3 million by the World Bank and 1.9 million by the bureau of Statistics. Projections for 2000 include replacement of 200,000 - 700,000 units.

Authorities were given wide autonomy in financial and administrative matters and have since become interested in participating with foreign capital in investment projects. Further, a process called "communalization" is being conducted where large tracts of the Treasury's real estate properties are being transferred to Local Government Authorities, in accordance with specific rules that allow for the income from these properties to flow directly to these Authorities.

Reprivatization Law - A considerable number of individuals are attempting to reclaim property that was taken from them by previous authorities. The Association of Pre-World War II Warsaw Property Owners, which has fourteen hundred members, is pushing hard to force legislation through that would enable them to re-claim vast amounts of Warsaw property. Some reprivatization of property is likely to be brought in, and previous owners will have an opportunity to present their claims for return or compensation in lieu. The deadline for filing restitution claims was on December 31, 1992. A draft law was submitted to parliament in March 1992 that would allow for the return of small real property holdings unless the holdings were currently being used as social care institutions. The draft proposes that owners of larger real property holdings be offered substitute premises whenever possible or receive vouchers exchangeable for stock in privatized Polish industry. Further, owners of lands which underwent re-development can only claim compensation for the lost properties (Goodman & Jostmeier 1993).

Public Housing - Since most of Poland's population could be classified as low-income families the need for affordable rental housing is recognized by the Polish government as a pressing priority. The Ministry of Spatial Construction recently proposed creation of a National Housing Fund that would finance housing for the poor. The Fund would collect funds from various sources, including the state budget and communal resources. Land would be donated by local authorities, in the form of a non-monetary contribution, and the housing would be non-profit. The aforementioned undertaking is still in the proposal stage and the parliament must amend several laws in order to begin the crediting process. In March 1992, legislation was passed that permitted mortgages to be recorded against co-operatives housing units, perhaps signalling the government's readiness to allow free sales of these units (Goodman & Jostmeier 1993).

Landlord-Tenant Legislation - Most residential property belongs directly or indirectly to the Polish state. Although the remaining housing facilities are technically privately owned, many of the units are not freely marketable. The state forcibly placed tenants in these units during 1947-69 and 1980-83 periods. The landlord may not charge rents above the statutory public housing maximum and may not terminate the existing lease unless the tenant agrees to the termination - which means that the tenant must be provided with a comparable housing unit at the landlord's expense (Goodman & Jostmeier 1993). However, recent changes in legislation now permit eviction of tenants for prolonged non-payment of rent (Goodman & Jostmeier 1993).

Home Ownership - The former Communist governments outlawed the right to own more

than one housing unit. This law has since been rescinded. Real estate is now considered to be a popular investment.

Foreign Land Ownership - Foreign nationals and joint venture companies with a foreign stake exceeding 49% have the right to buy real estate and land in Poland from private persons or lease real estate from the state. Foreign entities wishing to buy real estate in Poland have to apply to the Ministry of Internal Affairs. Applications are usually approved or rejected within two months. Foreign buyers must pay a stamp duty amounting to 1% of the value of the real estate. In 1990, the Interior Ministry issued 565 permits for purchase of property by foreigners and refused 24 applications. About 76 licenses went to foreign companies establishing joint ventures in Poland. The Ministry of Agriculture also rejected 24 applications related to development on farmland.⁵

If a potential foreign buyer fails to receive an Interior Ministry permit, the other way of obtaining ownership of real estate is to establish a company with a Polish partner who already owns such rights. The Polish partner should, however, possess a majority stake in the joint venture company. However, no title insurance exists in Poland. Investors must be very cautious whenever a real estate interest other than a fully documented ownership right is involved. Further, beware that many discrepancies appear in the recording systems (Goodman & Jostmeier 1993). Another important restriction is that Polish and foreign investors are not allowed to use farmland for non-farming purposes. Changing the status of land from farming to non-farming requires permission from local authorities. A change in status involves charges paid to the state. These charges now range from about \$1,000 per hectare for the poorest quality land to \$50,000 per hectare for the best.

Mortgage Financing

The World Bank, The US Agency for International Development, the European Bank for Reconstruction and Development, various European Community funding vehicles, and other smaller international funding organizations are currently preparing programs totalling \$2.6 billion aimed at creating primary and secondary mortgage markets in Poland (Goodman & Jostmeier 1993).

Poland is the only country in Eastern Europe where a housing finance program is about to become operational. The World Bank Housing Finance Project (WBHFP) and the Housing Guarantee Program (HGP) are expected to receive final approval and the agreements are expected to be signed by early 1993. The Polish National Bank (PKO) remains the only participating bank under the WBHFP and the HGP for the time being. The PKO has trained some of its staff and has begun making mortgage loans using the new dual-index-mortgage instrument (PADCO 1992).

⁵ "Real Estate Market in Poland" which was received from Canadian Polish Consulate in November 1992.

Since June 1992, through the First Polish-American Mortgage Bank, long-term mortgages are available in Poland. Families who can afford a 25% down payment and devote 25% of their monthly net income to service the principal and interest payments can obtain a mortgage. Using these parameters and the current average cost of \$40,000, or 580 million zloty (USD = 14,500 zloty), for a 100 sq.m. apartment, the potential owner would have to finance \$30,000.

Given current financing conditions, financing \$30,000 over 15 years with an interest rate of 48% per year would result in monthly payments of 16.7 million zloty, or \$1,156.

Based on the above analysis, it is evident that, in a country where nearly 70% of households have an average monthly gross income of slightly over \$200, or 3 million zloty, availability of 48% mortgages will not have a great impact on the growth in home ownership. The length of mortgage financing is also of low importance to the majority of Polish households.

Nonetheless, over 900 mortgage loans were made as of October 1, 1992. The majority of these loans, granted by the PKO, were for primarily self-built single family housing. The average loan amount was for 120,000,000 zloty, approximately 25% of the construction value of the house. No loan "window" appears to have been opened for developers to apply for construction loans for projects as a whole and no system for preparing market appraisals has been developed.

Only substantial growth in real family income and/or reduction of house prices would result in wider home ownership. However, these two factors are not expected to improve in the near-term. Hence, the availability of conventional mortgage financing only applies to the richest strata of Polish society. During the next four years, about 20,000 such families are expected to take advantage of its availability.

Local Government

In November 1991, the allocation of land and buildings was transferred to local authorities. Local authorities now have the right to decide whether arable land should be converted for non-arable uses, such as for housing, and if the time-consuming procedures for updating regional development plans should be omitted. This, in effect, means that these authorities own or allocate about 80% of Poland's real estate.

All construction, alteration or demolition of residential and commercial buildings requires approval from the relevant local administrative authority's department of architecture. However, since the local governments do not have any experience with development controls, the planning and approvals process is unpredictable and can be lengthy.

Developers and Builders of Housing

With the exception of self-built housing, there are currently three general types of Polish

organizations that are building/developing housing; namely state-owned enterprises, cooperatives and private firms.

State-owned Enterprises

This battered sector is no longer capable of continuing to fulfil its' role of providing residential housing. In the future, its' role will be even further diminished or eliminated, as state enterprises undergo privatization and restructuring in order to concentrate on business objectives.

The majority of the larger state-owned enterprises are now entering a phase of restructuring, entailing ownership transformations, changes to organizational structure (partition of large enterprise into several smaller ones) and improvements to construction technologies.

From the beginning of these reforms, most of the state-owned companies found it difficult to adapt to the changing conditions. Faced with an immediate cessation of subsidies in 1990, they raised prices and cut production, instead of cutting costs. As a result, inflation was raised to higher levels than had been expected. Later, when a lack of demand drove sales down, many enterprises stopped paying their bills and debts drastically accumulated.

The need to privatize the industry is reinforced by poor national economic conditions and the loss of government-subsidized financing for housing. This has forced many large vertically-integrated firms and smaller state-owned enterprises to restructure themselves into smaller, more competitive units or face bankruptcy and liquidation. However, the privatization process has been complicated by the fact that, of the 1400 state-owned enterprises involved in the construction industry, only about 250 are controlled by the National Government with the vast majority of the remainder controlled by the Provincial Governments.

Cooperatives

During the last 40 years, virtually the only means of purchasing a home in Poland was through a co-operative, and families could wait up to twenty years to have an apartment allocated to them. Nonetheless, very few Polish cooperatives are owned by their residents. Rather, they are owned or heavily subsidized by the State.

The role of housing cooperatives is currently undergoing a process of structural change. The government's former role is being largely replaced by local and foreign developers who have been building to higher standards and at competitive prices. Since 1991, however, government has been cutting subsidies to cooperatives (although in 1991, about 6% of the total budget, or 13.3 billion zloty was allocated for cooperative construction and maintenance).

Although the cooperative movement has steadily grown since 1980, both in numbers and in membership, its' future could be gloomy without an effective transformation to an "ownership-based" model and without continuous support from state subsidies.

Emergence Private Developers and Builders

During the last two years, the activities of private developers have been steadily increasing. Private firms offer more luxurious and cheaper housing, as compared to co-operatives. Currently, most of these homes have to be fully paid upon completion. However, as discussed previously, plans are being developed to provide prospective buyers with medium-term financing. In this respect, foreign developers will have an advantage as they often offer Western levels of mortgage interest rates to buyers, as in the case of a group of German developers utilizing credit given to Poland by the German government.

Results of studies conducted by PADCO (1992) indicate that:

- The private construction industry in Poland is currently estimated to consist of over 14,000 'trading companies' (includes contractors, design firms, building materials producers and distributors) and over 140,000 'sole proprietorships'.
- These numbers have doubled in the last two years as Poland has embarked on a 'crash' program to create a market-based economy.
- The majority (76%) of these 'trading companies' employ fewer than 50 persons.
- While only 36% of construction value in 1990 was in housing, 55% of the volume was undertaken by sole proprietorships or self-builders.

The growth of the private sector housing construction industry is currently constrained by the overall economic environment, legal and financial impediments and the lack of effective demand.

Building Material Suppliers and Manufacturers

Domestic building materials are supplied by some 350 state firms and a considerable number of private companies. Some 150 plants supplying concrete prefabricated products (i.e. panels) are in operation. Concrete panel technology is, however, going out of use in residential house building and is being replaced by mixed technologies. PADCO (1992) reports that:

- The precipitous drop in housing production from 217,000 units in 1980 to 130,000 units in 1990 has led to an oversupply of basic building materials.

- Distribution remains poor and regionally based due to the continued domination of the building materials industry by regionally based state-owned enterprises.
- Transportation costs are high and timely delivery has been a traditional problem. Quality is generally poor and prices remain high.
- Equivalent imported materials are similar in price despite import taxes.
- The introduction of new materials and building products remains slow, at least in terms of local production.
- The use of large concrete panel technology as the principal housing construction technique is ending with apparently no new technologies in sight to replace it.

Real Estate Market

The Communist government's neglect of construction and real estate development created significant shortages of housing and commercial facilities. Therefore, it is estimated that a decade of intensive housing construction is needed to alleviate the shortages. Polish markets are therefore searching for investment capital as well as more efficient technologies and techniques.

Despite the apparent unavailability of affordable funding, the general real estate price index in Poland increased threefold in 1990 and 1991. In large cities such as Warsaw, Krakow, Wroclaw, Gdansk, or Szczecin, real estate prices increased six to sevenfold (Goodman & Jostmeier 1993). However, the price of property is balancing out in the Polish market as a result of: recent legislation liberalising real estate transactions; the introduction of private notaries; and allowing privately owned apartments in co-operatives to be sold. As a result, the number of real estate agents as well as the number of properties being listed has been increasing and property costs are levelling off as supply begins to meet demand.

Although the Polish real estate market has been developing very quickly in the last two to three years, it is still premature to speak of a well-functioning real estate market. The market is limited to Warsaw and some selected large cities. It is not extensive, lacks active agents and is primarily limited to apartments.

Residential Property

Fewer new homes were built in 1992 than in 1991. However, the standard and size of accommodations increased considerably; to a present 60 sq.m., as compared with 50 sq.m. in 1970. By the end of 1991, there were some 2,000,000 families waiting to purchase a residential unit. 700,000 families had already paid for their homes in full to the various housing cooperatives (Chydzik 1992). Polish Government statistics state that there are a substantial

number of families with the ability to pay for their homes outright, and over 1,000,000 families have around \$50,000 in cash at their disposal towards a family home. The biggest market in residential sales is likely to be in the mid-range for units of around 180 sq.m. By all accounts, demand for such homes is tremendous and is unlikely to be fulfilled for a decade or so.

According to recent estimates, there is a need to construct between 2.7-3.6 million housing units by the year 2000, as well as to carry out repairs to and modernize (including thermal-renovations) the existing housing stock. An official estimate of the total investment needed in the Polish housing sector between now and the year 2000 is \$59 billion. The first step toward meeting these enormous needs is \$1 billion in housing loan guarantees which will be allocated to Poland in 1993 by the US government.

Most residential property purchases are concluded on a cash basis. The fact that some Poles have large amounts of cash is not inconsistent with Polish realities. A secondary economy which permitted many residents to become wealthy existed throughout the Communist era. Secondly, since the introduction of the economic reforms, a group of young entrepreneurs has been able to generate a significant amount of cash. Thirdly, non-Polish Europeans have been leading buyers of Polish real estate using funds from their home countries (Goodman & Jostmeier 1993).

Apartments. For 1992, the average price for one sq.m. of apartment floor space increased in price by about 1 million zloty or 15% from 1991. In real terms, compared to an inflation index of about 50%, apartment prices have fallen by 30-35% (Warszawa 1993). Currently, greatest demand is for small apartments. At the beginning of 1993, prices for one-room apartments of 24-31 sq.m. stood at 6.5-7 million zloty per sq.m.. Apartments of 50-68 sq.m. rose in price by about 500-800,000 zloty per sq.m.. The largest increase in price has been for large apartments of over 100 sq.m.. There is currently a large number of luxury accommodations being constructed (Warszawa 1993). T.W. Development, a U.S. based-company out of Ochoa, Florida, is currently finishing a North American-style residential complex, complete with retail space, which is expected to be ready for occupancy in March 1993. The 8 hectare site includes landscape gardens, a swimming pool, tennis courts, 24 hour security, and a building complex containing 370 apartment units. About half of the units have been sold at \$1000 per sq.m., with unit sizes varying from 99-135 sq.m..

Detached Single Family Houses and Townhouses. A market for luxury dwellings is quickly growing in Warsaw, especially to satisfy the needs of foreign businessmen and politicians. The available accommodation is sub-standard and in short supply. Rents range from an average of \$2,000 monthly for a 1,200 sq.ft. apartment to \$6,000 monthly for a centrally located villa in Warsaw (Goodman & Jostmeier 1993).

Curtis Developments, another U.S.-based company, is involved in the construction of an enclosed and landscaped estate of family houses of similar design and size in a village called Piaseczno (about 25 km out of the centre of Warsaw). The project includes 96 units of three bedroom duplexes and four-plexes on a ten acre fenced property. Thirty units have already been sold, mainly to wealthy Poles. The price for a unit of 160 sq.m. is \$100,000. This joint venture project was targeted at senior executives of Western companies operating in Poland.

Commercial Real Estate

There is at present an acute lack of suitable commercial and hotel premises in most of Poland's major cities. Scarcity and growing demand result in very high renting prices. Offices rent for an average of \$45 per sq.m. per month and new commercial space is advertised as high as \$60-80 sq.m. per month. In Warsaw, commercial space costing an equivalent of \$60 per sq.m. in August 1992 cost \$69 per sq.m. per month by December 1992. The demand is so great that most offices under construction are pre-let before completion or even before the first brick is laid. This is the case with the Epstein Engineering Export Ltd. building, a 50,000 sq.m. 36-story block next to the Marriott Hotel. Epstein claims that the building costs of their investment will be recouped within a few months (Estate News 1992).

In the next four years, a considerable number of 2 and 3 star hotels in and around Warsaw and other major Polish cities will be greatly required. It is estimated that Warsaw has a shortage of 11,000 hotel beds. Most hotel construction to date has been financed and developed by the Austrians and French; office developments by Austrians and Germans. Estimates indicate that, by mid-1992, there were over 7,000 commercial developments due to be completed. Another gap in the Polish real estate market is the tremendous lack of shopping and warehouse space.

Co-operatives own a significant amount of vacant and serviced land. The co-operatives lack funds to develop these unutilized areas, which are suitable for the building of multi-level car parking garages, retail shops and community service facilities, as well as additional residential buildings. Due to the severe lack of capital, foreign firms have been able to enter into amenable joint-venture relationships.

Foreign Involvement in Poland's Building Industry

Of the 21 million foreigners coming into Poland in the first six months of 1992, nearly 7 million were on business. Some 15% stayed for one year or more. Therefore, nearly 1,000,000 foreigners are living and working in Poland, with about 25% of these concentrated in and around the capital, Warsaw. In 1992, there were 7,000 foreign companies operating in Poland with a combined turnover of \$16,000 million annually, generating a net profit of some \$800 million (Chydzik 1992).

Many developers are concentrating their efforts on this large foreign population. The top range is attracting several foreign developers. Top range homes are targeted primarily at senior diplomats and chief executives. Our market research has verified that nearly 200 such homes are immediately required in Warsaw, and about another 600 will be needed within two years. In 1992, over 200 hectares of land have been bought by developers from Hong Kong, Korea, USA, Britain, Canada, Austria and Germany (Chydzik 1992).

Summary of Key Elements in Poland's Housing Sector

Land	
Availability	Limited. controlled by local governments and coops.
Title	Clear title difficult to obtain in some cities. especially Warsaw.
Cost	High costs due to limited availability and difficulty in obtaining parcels with clear titles.
Infrastructure	
Availability	Limited capacity within urban areas. Limited or non-existent facilities on urban periphery.
Financing	Local governments have no means to finance.
Cost Recovery	No tax assessments or collection systems in place.
Building Materials/ Manufactures	
Quality	Domestic products are generally inferior to imports. Limited range of products and need better standards.
Cost	High costs due to lack of competition. Domestic material prices are similar to the cost of imports.
Technology	Introduction of new building technologies and products have been slow.
Construction/ Contractors	
Management Skills	Limited knowledge of business. finance and marketing.
Technical Skills	Limited to traditional methods and materials.
Privatization	Process is very slow and has a detrimental impact on competition.
Cost	High costs due to traditional methods and slow execution.
Development/Developers	
Cooperatives	Future role in housing development.
Financing	Lack of understanding of requirements and skills.
Management/Technical Skills	Limited knowledge of business. finance. marketing and the development process.
Investment	Current risks/rewards unattractive to most investors
Regulations/Regulators	
Development Controls	Process is lengthy and unpredictable.
Bonding/Warranties & Guarantees	Not available or enforceable
Codes and Standards	Lack of performance based standards that are consistent with Western European codes.

Summary (Continued).

Finance/Bankers Construction Loans	Untested procedures for developers to apply.
Mortgage Loans	Unattainable pre-qualification standards for buyers.
Credits	Business loans and supplier credits are not available or have high collateral requirements.
Appraisals	Markets appraisals are not currently required by banks.
Market/Consumers Real Estate Agents	No formal network to gather and disseminate market information
Market Studies	Limited understanding of requirements and limited information.

Source: PADCO, November 1992.

NOTES FROM FACT FINDING MISSION TO POLAND⁶

OLSZTYN, POLAND

Meeting With Budimex Engineering & Construction

A meeting was arranged with a group of people in the residential building industry. The host for this meeting was Andrzej Stryjewski, Director, Budimex Engineering & Construction (a state owned company).

The approach by the Canadian mission for this meeting was to propose 15 questions for discussion with the Polish builders. Once the issue had been thoroughly discussed, the discussion turned to the Canadian view. The majority of information was translated as the discussion progressed.

The following are notes made during the wide ranging discussions that lasted for over 4 hours.

Overview of Housing in Poland

- Predominately medium to high rise multiples in the urban areas and single family in the rural areas. No understanding of what we refer to as townhouses.

⁶ This section consists of observations and notes on meetings attended by Gordon Thompson, President of Candev Building Corporation, and Colin Hefferon, Vice-President of Masthead Properties.

- Housing in Poland is built to a medium standard, not to western standards. A very large amount of renovation work is required for both the commercial and residential sectors.
- Housing in most of Eastern Europe averages 30-40 sq.m. while in Poland the average is closer to 16 sq.m.. In Olsztyn however 80% of the housing is above this average.
- Post War housing is much larger than the average, but often overcrowded with more than one family or extended families.
- The industry has experienced a 10 year decline in housing starts which has been exacerbated in the last three years. Building starts for Olsztyn this year were poor. Two high rise apartment buildings and 150 single family dwellings were built.
- Currently, Poland averages around 50,000 starts per year.

Government Policy in Housing

- The government exhibits a lot of goodwill but not much happens. Builders feel they don't get much support from government.
- Housing finance vehicles are not in place yet.
- They are not being encouraged by any level of government to produce materials locally. There are currently 5 proposals before government for the privatization of material manufacturing products, so things are changing. The individuals involved in the manufacturing sector felt it was very difficult to develop healthy markets until their industry is privatized.

Changes in Urban and Rural Population "Demographics"

- There is a very clear and significant shift of people moving from rural areas to the city. In the main, people are making the move to get a place to live and a job. Expectations of jobs and a place to live have been met by the reality of no jobs and no place to live.
- People who live in the urban areas do not view this shift in demographics positively. In fact they are angry at what they see.

Consumers Wants, Desires and Expectations

- Land is expensive so builders are focusing on multiples.
- Lot of interest in privately owned single family houses but very few buyers. One builder told of a new project he opened recently. He had between 200 and 300 visitors to his sales office. From these visits 35 sales were concluded, but only 5 wound up financially able to go ahead. The majority felt that given the current economic environment the single family home for most is only a dream. The general view was that as the economy improves and the market economy matures a great demand will materialize for the single family home.
- Consumers want quality but will accept less. Too many years of only being offered low quality goods.
- High rise construction has become almost impossible to do because of the large amount of financing required and the shortage of any form of credit.

Standards and Codes

- Up to the present, all housing was built for the government, so the standard was the norm, no rules and no inspections. Inspections are now the rule and they feel the system will be more formalized in the future. Nonetheless, the builders advised that officials who carry out construction site inspections will visit only if the project is not too far away from where they live.
- Standards are set by the Polish Ministry of Building. In the past, standards for materials were often set for purely political reasons. Construction standards are set to a medium level of quality. Builders agreed they stay close to the minimum accepted standard. The builders felt that in many instances the standards for building materials are set too high (e.g. fire resistance and chemical content).
- Since 1984 builders have had more freedom to experiment and go beyond the standard. Builders can now build or design what they want as long as it meets the minimum standard. Same situation as occurs in Canada.
- 7-11 sq.m. per person of living space is a regulation. There exists a maximum standard (200 sq.m.) for the size of a house. Standards for the insulation of roofs and walls is very similar to Canadian. For example, walls are set at R40.
- Many western products meet the standard or exceed it, but it takes a very long period of time to get approvals. All new materials must go through rigorous testing.

- The Olsztyn builders expressed concern that their peers in Warsaw were consulted by government on changes, but their views were not sought. They felt an industry association like the Canadian Home Builders would be very beneficial.

Regulations/Bureaucracy

- It can take up to six months to get a building permit, similar to the time required in Canada. Government does have time constraints under which it must respond. In most instances this is 30 days.
- The land development approvals process is basically convincing local government that the land is suitable for development, that the land is suitable for housing, and that the form/type of housing you plan to build is suitable.

Land Supply

- There are no levies, but a complicated system of profit sharing with the municipality does exist. The basic understanding of the system is the developer buys the land, then negotiates the approximate end selling price with the municipality. A tax is then paid equal to half the profit before servicing.
- As in most of Canada, there is no shortage of developable land. The market price for land in the centre of Olsztyn is \$50-60 sq.m. for single family home construction, including servicing. Out side of town land sells for \$6 sq.m., without services. With services, this same land sells for \$10-12 sq.m.. (Toronto would be \$200 sq.m.).
- You are often required to put in municipal utilities such as electricity, in order to speed up your project, with a promise from government to pay you back later. Most development projects are on a pay as you go basis.

Financing: Developer/Builder/Consumer

- The financial market for this industry can only be described as a disaster. Financing for all three of the players mentioned above is almost non-existent or outrageously expensive. Inflation is running at 50%.
- Interest rates to a private builder is 50% plus. One builder recently reported arranging financing for a cooperative project at a rate of 56%.
- These rates have put the consumer of housing on a cash only basis.

Legal Structure of Land Ownership

- Private citizens can and do own land. They are free to sell or buy.
- Land can be leased from the government for periods of 40 to 99 years.
- Foreign Ownership of land is allowed under certain conditions; none of the builders present were aware of what the rules were.

Building and Construction Costs

- For purpose of this discussion it should be remembered that many products brought to the market are manufactured by state owned companies, therefore as the builders pointed out, they are to some degree subsidized.

Labour Supply

- They rated their workforce as 40% to 45% skilled and 30% to 40% satisfactory. The point was made that Polish workers were recognized the world over as hard working people. The Budimex Director made the point that his Company often does work for the Germans who have an extremely high level of productivity.
- The labour force is unionized but there are no strikes. The labour force does not resist change and in fact are eager to learn new methods. There is an abundance of very qualified Engineers.

Material Supply

- All building materials are in good supply. Majority of materials are all produced in Poland. Polish manufactured products meet European standards.
- Imported materials take a long time to get into the country and are then subject to a 20% import duty and the 15% V.A.T. Some imported materials can be landed tax free (e.g. any products to do with the environment).

Structure of the Industry

- In the past, it was the practice of the builders to employ all the necessary trades to construct a home. In the past few years they have started to move to a sub-contracting system similar to ours.

- Much of the materials they use are kept as inventory and warehoused by the builder.
- The majority of builders stay in their local market, but the point was made that if they were to grow, they must not be afraid to go elsewhere. There is no requirement to be licensed in Poland.
- Industry education can be obtained by attending high schools geared towards various technologies, trade schools or university level training such as Engineering. Some of the larger firms provide their own training.
- Some of the technologies and trades have formed associations but there is not one for builders.

Meeting with Andrzej Starkiewicz, Private Builder.

- This gentleman is the owner of his own land development and building company and was present at the Budimex meeting the previous day.
- He currently has three houses under construction in what would be termed a very rural area, about 15 minutes outside Olsztyn.
- The construction methods appeared very crude and slow. The masonry work was extremely sloppy but once it is covered over with the exterior finish one would never know. He is using cheap Russian labour therefore he is not concerned with building quickly to save cost.
- The project site has about 90 lots and has its own well. Sewage will be handled by holding tanks until enough homes are sold, then a sewage treatment plant will be built.
- He advised it will take approximately two years to build each house.

Tour: Building site of a state-owned enterprise - Director of this company was also at the Budimex meeting.

- A visit was made to an apartment style building of 45 units, with retail space on the ground floor. There is an acute shortage of retail space in Poland so the retail leases went quickly and all the apartment units had been sold.
- Construction techniques are western style and appeared to be very efficient. Building materials include double glazed sealed windows, metal roofs, etc.

Following this site visit a meeting was held with the two builders.

- Both builders are very familiar with Prefab or Pre-engineered housing. They were firm on the point of view that this type of housing was not the solution for them.
- They want the Canadians to teach them wood frame construction. Not only does it create local jobs for the lumber mills, but it also puts people to work building the houses. While this would represent a non-traditional type of home, the consumers would buy it if the price was right.

OLSZTYNEK, POLAND

Meeting with Mayor Jerzy Tytz and six members of the local strategic planning sub-committee.

- Population of the town is 7000 and 13,000 including the surrounding region. They see their community as having potential as a tourism area. The area is surrounded by lakes and forest as well as a number of points of historical significance. A major highway passes very near and acts as a draw for holiday makers from all parts of Europe.
- The town has an urgent need to house 250 families. Land is available in the town for \$6 sq.m. with lots at \$400-500 sq.m.. There are no levies and services would be put in by the town at minimal cost. The lots can be bought or leased by putting down 25% with the balance over 99 years.
- Current building costs are about \$300 sq.m.. These costs do not include kitchen or bathroom cabinets as they are provided by the owner. The owner also paints his own house. A 50 sq.m. home would cost \$39,000 (land at \$6 x 400 sq.m., and construction costs at \$300 x 50 sq.m.).
- There is no shortage of land and the town currently owns a 90 unit site that is serviced and ready to go. There did not appear to be any private development taking place in the area but it certainly would be welcomed by the mayor.
- Mayor Tytz took us for lunch at Meirki which was a retreat for the Communist party elite. It was previously owned by the Central Committee of the Polish United Workers Party. The mayor would like to see this facility turned into a world class resort. It is in the Canadian mission's estimate the site has great potential.

KRAKOW, POLAND

Meeting with David Lucas, a U.S. builder - His company has the rights to a building technology owned by TRONCO.

- His company is in the final approval stages and is getting ready to build a model home.
- They are building a \$120 sq.m. house using 8 inch galvanized pipe. The costs are about \$20 sq.ft. and the homes final cost at about \$50,000. The steel will be purchased locally and the pipe is fabricated on site by a rolling machine that costs \$100,000 to purchase. This machine can be moved easily from site to site. The pipe has a R40 value. Assembly of this house requires no skilled labour.
- The interior is finished with Gyproc or just painted. The exterior is finished with any of the traditional materials eg. siding, brick, stucco, etc. The structure can go to three stories and span 16 feet.
- They have chosen this method of construction as it has been their experience that wood frame housing will not sell in this market. From experience, he felt the lumber was of very poor quality and was rough and wet. In addition, there is tremendous wastage as the carpenters are not skilled. He was aware of a Canadian Company in Warsaw that was building wood frame housing and were losing a great deal of money.
- TRONCO is currently building 200 of these houses in Israel.

WARSAW, POLAND

Meeting with Frank Parzych, Commercial Officer, Canadian Embassy. He is a native of Poland.

- The majority of new housing in Warsaw is in the form of multiple dwellings. The target selling price is around \$500-600 sq.m., anything above this price threshold is out of the market.
- Many Canadian Prefab builders have examined the market and backed off (ie. Valhalla Homes). One Canadian Company PRI TEC opened a project with a prefab house at \$90,000 and never sold a house.
- The devaluation of the Polish currency and import taxes have worked against the economics of this type of housing.

- As is the case elsewhere in Poland, mortgage financing is the single most significant impediment to housing affordability and access. An American bank has formed a joint venture with the Polish Bank PKO, called the Polish American Mortgage Bank. This institution will provide loans for 50% of the selling price amortized over 15 years, at a rate of 12%. The builder can arrange financing of 40% for 1 year at 14%. The goal of this new program is to do 15 projects in 1993. Not a great deal by our standards but possibly the beginning of a solution. The current system requires that the loan not exceed the family income earned in a 47 month period, 25% Gross Debt Servicing, at a rate of 41.8%.
- The Canadian mission was informed of a large private ownership project being completed by a Toronto firm, Dynasty Promotions, operating in Poland under the name Jeff Pol. Construction will be completed by Ellis Don of Canada. The plan is to take Polish workers to Canada and then train them there for the work on the Warsaw project. There is no financing in place yet, but the project is 50% sold out. Purchases have mostly been to foreign buyers. As a result of previous bad experiences, the purchaser's deposits are in escrow in an Austrian Bank.

Meeting: Budimex Engineering & Construction H.O. Warsaw

- Budimex was founded in 1968 and is the largest construction company in Poland. It is in the process of being privatized but is still state-owned. Price Waterhouse is handling the privatization and 43% is now publicly held. The employees own 11%.
- Their operations are global. Until recent times 50% of their business was in communist countries where the work was guaranteed, and the other 50% was tendered projects around the world. Currently, 90% of their work is in foreign countries.
- They recently built a Holiday Inn in Warsaw.
- They are doing very little housing at the moment. They have one subdivision underway 25 km from Warsaw. The houses are 120-170 sq.m.. The houses are of traditional construction except they have garages. Construction costs are \$380-420 sq.m. and the selling price is \$55-70,000.
- Their advice to us was that Canadians could do very well if they came to Poland and built pre-fab housing with Polish labour and materials using Canadian technology. Budimex is currently working with the university to produce experimental pre-fab housing. The concept is to build half of the house in a factory and the remainder on site.

- They are experimenting with 30 to 50 homes. The houses will be built in about 3.5 months and the costs are estimated at \$300 sq.m.. This is substantially below the average cost for a house.

Meeting with M.T. Team Corporation Ltd. Warsaw

- A visit was held at the offices of Mr. Tadeusz Mackowiak, the President and owner of M.T. Team Corporation Ltd. Currently, Mr. Mackowiak is looking for a Canadian partner who is willing to invest a small amount of capital but take over the day to day management of his projects. Mr. Mackowiak provided a tour of the company's development site as well as his modern window manufacturing plant.
- His site is large enough to build 300 houses in which the first phase will be 40 high end townhouses. Plans call for the project to have an extensive amenity package including a pool, tennis and golf course. An American company will be doing the golf course.
- It is his view that land prices are poised to take off and that now may be the last chance to acquire land.
- Good profits are available in the manufacture of building materials. His window company is doing very well.
- It was the opinion of the Canadian mission members that Mr. Mackowiak was a very well connected entrepreneur who would be a valuable partner.

INTERVIEW WITH MR. M. BIELIC OF GROUPE CAPITAL

Mr. Bielic is building residential housing units in Poland. Nearly half of the materials that he uses are imported from Canada, including doors, windows and shingles, the other half purchased locally. The following is an account of Mr. Bielic's observations of Poland:

Eastern European Opportunities

Mr. Bielic has more work than he can handle; enough for ten years; and he is being paid cash up front for many of his dealings. Poland is the land of opportunity in East Europe, considering its large population base and its rate of economic transition and growth. Approximately 3 million housing units will have to be supplied to meet present demand until the year 2000, without consideration of birth or immigration rates.

Ukraine, with a population of nearly fifty million, also presents an excellent opportunity for housing construction. Both Poland and the Ukraine further have the advantage of being situated at the former Soviet Union's doorstep, which is in the process of becoming another enormous potential market. Although countries such as Hungary and Czechoslovakia are similarly progressing at a rapid pace, market volume is limited.

Housing in Poland

Since the fall of Communism in Poland, the State surrendered its housing responsibilities to the municipalities. Much of this responsibility is to low-income families and many municipalities have the financial ability to afford units and are in the process of looking for builders and developers.

As a former Polish citizen from the south, Mr. Bielic's contacts in the country, particularly those within Ministries, have proven invaluable in securing business opportunities. Furthermore, his personal knowledge of how business operates in Poland, including legal and notarial requirements, ownership rights, municipal rules and regulations concerning housing, infrastructure requirements and technical understanding of building practices, particularly of wood-frame construction, has served as a vehicle for establishing joint ventures with a number of municipalities. Mr. Bielic recommends creating joint ventures with municipalities, who have authority over land and infrastructure, rather than with private landowners in smaller cities and towns. This strategy substantially reduces time and red tape and guarantees prompt access to building permits.

Nonetheless, red tape is still prevalent and business dealings are far slower than in Canada. The reason for this is not necessarily because of a large, un-cooperative, self-serving bureaucracy, as we in Canada may complain about. Rather, it is their lack of knowledge concerning the process, coupled with the fact that laws are changing regularly, that decelerates progress. Municipal bureaucracies tend to be far slower in business than are Ministries, which are very co-operative. Furthermore, there are forty-nine "vojvodships" in the country; regional, intermediary levels of government each supervising ten to twenty separate smaller municipalities. Although these are generally very open-minded, it is difficult to find a vojvodship that will fully co-operate in a business venture.

Mr. Bielic believes that the root of the problem is the general attitude inherited from the Communist past: people are not yet used to real work. They are also used to making excuses and hiding behind a mass of rules and regulations to prevent having to work. With patience, it can be shown to them that their outdated rules negatively affect their jurisdictions and that change will be mutually beneficial. Another consideration is that the Mayor can be called off at any time by Council. As officials are generally ambitious, it would be advisable to form amiable relations with as many members of municipal Council as possible to avoid internal disputes and possible failure of the venture. Involving the whole community in a bottom-up process is ideal. Further, small private landowners are considered insignificant in the

development process as municipalities have the power to expropriate lands at will. Municipalities are adverse to expropriating agricultural land. Evaluation and appraisal of land must be conducted by Polish professional evaluators.

With respect to larger cities, such as Warsaw or Krakow, it is less advisable to enter into joint ventures with government considering the number of officials and levels that can potentially slow down the process. Rather, cooperation should be with the private sector. Note that, in the larger cities, a degree of land speculation exists given the expectation of escalating land value.

International Competition

Although Canada is highly respected in Poland, international competition is substantial. Groupe Capital itself is using Austrian and American banks as opposed to Canadian banks for its projects, although using Canadian banks would be preferable. Unfortunately, Canadian banks have not discovered the lucrative Polish market.

The US is particularly advanced and organized in attempting to corner this market, strategically establishing itself throughout the country. The establishment of American branch plants opened the way for creating a mortgage system for potential home buyers. American distribution centres for building materials coupled with American schools to train local labour in American building practices fortifies the American presence and access to housing markets. In the Polish Press, the term "2 by 4" has become common. It was introduced by American interests.

Mr. Bielic argues that Canadians initially arrived in Poland ahead of the U.S. and could have seized opportunities. However, in Canadian fashion, we allowed the Americans, our "Big Brother" to the south, to pave the way for us. Thus, Canadians now find themselves nearly two years behind the States. Nonetheless, although the U.S. is well-organized, it is not as of yet clearly visible, having spent its efforts on the foundations to its network.

Groupe Capital is using American banks and the American training school sponsored by the U.S. Congress to train its own tradesmen. Canadians can use the American foundation to their own ends as Canadian technology is similar to American. Thus, many opportunities still exist for Canadians in Poland. The Polish system is rapidly becoming user-friendly to set up business ventures and most building materials are locally available.

Austria also has established close ties to Poland. Historically, strong ties have always existed between the two countries. Austria was sympathetic towards Poland following World War II and assisted a number of Poles in escaping through Austrian borders. Links have been preserved ever since as Austrians are now well-positioned in financial and other business ventures in Poland.

It is probable as well that, over time, Poles themselves will gain more and more control over their building activities using domestic resources.

Canadian Banking Opportunities

It would still be advisable that Canadian banks become involved in the process. Detours exist around Polish banking regulations. A bank in partnership with a Polish organization, such as a building company, could channel funds through its partner to fund building activities and provide mortgages to potential buyers of units in the project.

These partnerships could offer competitive mortgage rates to its clients (i.e. 10%). Aid funds for mortgages available from international organizations such as PKO and US AID are very expensive. World Bank loans fail to make housing affordable for the majority of potential buyers; families must put up 50-60% of the cost of the home up front. Furthermore, Poles prefer to secure their savings in hard dollars as opposed to the local currency.

Opportunities for Canadian Housing Sector

Canadian building products are in great demand, including windows, shingles and doors. Steel doors are particularly needed to afford greater home security. Canadian building products, once visible in Poland, will easily make their way to Western Europe. Germany has already requested Mr. Bielic that modular homes be imported from Canada.

Concerning housing units, Poles would generally prefer residing in conditions superior to that offered by traditional Communist housing or low-level co-operative housing. Cottages and condominiums represent possible primary or secondary residences. A class of "nouveau riche" exists which has the ability to purchase secondary housing in tourist areas such as are found in the region of Olsztyn in the north-east.

There are great opportunities for supplying Poles who fled the country, such as southern Poles who settled in Chicago, who now wish to take up primary or secondary residence in their native areas.

The comment, "If they can't touch it, they won't buy it", illustrates the point that Poles must be assured of the product, particularly single-family homes, before they invest. Thus, it is necessary to construct and show a visible model home to answer their doubts. Promotion of products in the CEE region is also somewhat easier than in the West. In Poland there are only two TV stations, thus, advertising or attention for a product can become widespread throughout the country almost immediately.

Caution must be used in the introduction of new materials. For example, Poles will not invest in products with which they are not familiar. While brick and stone are accepted building materials, the use of wood and vinyl is new and suspect. A recent housing project outside of Warsaw using vinyl siding encountered a number of problems as it was evident that the switch to vinyl was too sudden for the market. Another handicap of the project was that very cheap Russian labour (25-50 cents/hour) was used for building. Although Polish law admits immigrant

Russian workers, quality is very poor. Nonetheless, given the poor quality, cheap labour, non-traditional materials used, and distance from Warsaw, the majority of the housing units were eventually sold at nearly \$100,000 each. This clearly illustrates the dire need for housing.

Housing floor space of \$350 USD per sq.m., or C\$40 per sq.ft., is seen as acceptable. C\$500 per sq.m. is liveable. Over C\$500, only the truly wealthy can afford this and families do exist which can afford this price. In Warsaw, houses may be sold at C\$1000 per sq.m. Prices per square foot for similar housing construction in Canada range between C\$60-\$70.

Labour costs for construction tradesmen are about C\$32 hour in Canada. In Poland, wages range from a generous C\$2.40 per hour to an extremely generous C\$4 per hour. A fair wage for a skilled tradesman on a 40-hour work-week is about C\$250 month, C\$300 month being very generous. Government restrictions limit wages, high wages being more heavily taxed. For large projects requiring heavy machinery, more expensive labour may be needed. For example, the large Polish construction company, Budimix, pays nearly \$4 USD per hour.

In conclusion, a minimum initial investment of at least C\$100,000 is recommended, although there is no minimum capital requirement. Greater returns will result from larger investments. Capital may be withdrawn at any time from the country. Undoubtedly, investors must be cautious in business ventures with their Polish counterparts. In consideration of the American initiative in Poland, Canadian involvement should be in the form of a united front as opposed to a piecemeal assortment of individual competitors given that the scale of the market is far too grand to be taken on alone.

INFORMATION ON THE GOVERNMENT OF POLAND AND WORLD BANK HOUSING FINANCE PROJECT

The Government of Poland and the World Bank are preparing a national housing credit program. The following information answers the most frequently asked questions about the program, known as the Housing Finance Project⁷.

What is the Housing Finance Project?

The Housing Finance Project (HFP) is designed to encourage, support and introduce changes in the country's housing sector which are consistent with a market-based economy. The HFP will offer construction and mortgage credits, and provide technical assistance and training to banks, gmina officials and developers of large construction projects.

⁷ This information was received from Irena Stocka, Project Manager of the Housing Finance Project in November '92.

How will the HFP's system operate?

The HFP is not a separate system for housing finance; instead, it is integrated into the existing banking system. The HFP will establish a national credit fund, known as the Mortgage Fund (the "Fund"). Commercial/retail banks will borrow from the Fund to make construction and mortgage loans. *All credit applications will be submitted to a retail bank.*

A Housing Finance Project Office (HFPO) has been established. The HFPO will provide guidelines to banks and housing investors for preparing and analyzing housing projects. The HFPO will assist banks in reviewing applications for construction credits, and it will offer training to banks in analyzing and processing requests for mortgage credits.

What kind of credits will be available under the HFP?

The HFP will offer two types of credits:

- A. *Construction credits.* Investors, including private companies, cooperatives and gminas, are eligible to apply for credits for new construction and substantial renovation. Each project will be analyzed for its financial feasibility, compliance with the HFP's design standards, and compliance with legal and competitive bidding requirements. Individuals and families are also able to borrow mortgage credits to construct or complete single family homes.
- B. *Mortgage credits.* Individuals and families are eligible to borrow long-term mortgage credits for the purpose of buying a new flat or house which will be their primary residence. The amount an individual or family is eligible to borrow is based on total household income.

All construction and mortgage credits must be secured by the property, including land and buildings. The bank may require additional guarantees.

Which banks can participate in the HFP?

In principle, all banks licensed to conduct business in Poland are eligible to borrow from the Mortgage Fund. However, a bank which wants credit from the Fund must submit audited statements and other documentation which may be required to enable the Fund to review the bank's operations. Banks will be pre-qualified to participate in the Fund's construction or mortgage programs, or both. In addition, banks must:

- Participate in construction and/or mortgage loans using their own resources, at a minimum level of 20% of the total amount of credit.

- Establish a separate account for each construction and mortgage loan.
- Demonstrate sound fiscal performance and management.

CONSTRUCTION CREDITS

What kind of housing projects are eligible for construction financing?

- New construction of multi-family projects, including flats, apartment buildings, rowhouses, duplexes, semi-detached units, and rooftop additions.
- New construction or completion of a single family house which will be the borrower's principal residence, provided that the sum of the construction credit and the borrower's own investment is sufficient to enable the house to be occupied.
- Completion of housing projects on which construction has stopped, provided the project is consistent with the HFP's standards for financial feasibility and design, and complies with other requirements.
- Substantial renovation and repair of residential buildings, provided a plan is approved for providing alternative housing for tenants who will be displaced by the renovation and the renovation will result in greater energy efficiency.
- Substantial improvement of single family homes or flats, provided the unit already serves as the borrower's principal residence, and the cost of the improvements exceeds 25% of the current appraised market value of the unit.
- New construction or renovation of commercial spaces, provided the commercial space is part of a larger housing project and the costs attributable to commercial space do not exceed 15% of total project costs.

Who can borrow construction credits?

- Individuals, families, and/or groups of individuals.
- Private or public firms, enterprises and partnerships which are licensed to conduct business in Poland.
- Joint venture companies between Polish and foreign investors.
- Gminas and other governmental bodies or institutions.

- Cooperatives.
- Foundations and other non-profit organizations.

What are the terms and conditions of construction financing?

- *Terms of credit and repayment period:* Construction credits can be borrowed for the period of time it takes to complete construction and sell the units, up to a maximum of 24 months. For instance, if a project is completed and the units are sold in 14 months, then the construction loan would be for a period of 14 months. Construction credits must be repaid as units are sold. For families who build their own house, construction credits will be converted to a long-term mortgage loan when the construction is completed.
- *Credit in stages:* Credits will be advanced in stages based on the progress of construction. No advance may be outstanding for more than 24 months.
- *Interest rate and repayment of interest:* The interest rate on construction credits is ***the current market rate for construction credits, as established by the local bank***. The interest rate is adjusted periodically to reflect changes in the bank's prevailing market rate. No interest payments are required during the construction period, and unpaid interest will be recapitalized. Borrowers may choose, however, to repay some or all of the interest during construction.

What is the maximum amount for construction credits?

Multi-family: The maximum loan amount for each project is subject to the following limitations:

- The project size cannot exceed 100 residential units.
- Credits for projects whose total costs exceed the equivalent of US\$ 1 million must first be approved by the World Bank.

Each project will be analyzed for its financial feasibility, including an analysis of the market for the finished units. Naturally, an investor who proposes a very large project will need to demonstrate his capability to implement the project. In addition, there will be an "equity" requirement for each project, meaning that the construction credits will not cover 100% of total project costs. The minimum equity requirement in projects is 25%, meaning that total credits from all sources will finance a maximum of 75% of total project costs. Equity may come from:

- Cash investment by investor.

- Current appraised market value of land when the land is already owned by an investor in the project, and the purchase of land does not need to be financed.
- Pre-payment of fees to lease the land if required to secure the perpetual use of the land.
- Cash pre-payments made by the future buyers of the units, if these pre-payments are invested in the project before the construction credits.
- Project preparation expenses (e.g., architect fees) incurred prior to the commencement of construction.

Construction of single family homes: The amount an individual or family can borrow to build their own home, or make substantial home improvements, is the amount that they would be eligible to borrow under the mortgage credit program. The maximum amount is up to 30 times the borrower's current monthly household income. Borrowers must contribute a minimum of 25% equity to the project.

How much can the retail bank borrow from the Mortgage Fund for construction?

Retail banks can borrow from the Mortgage Fund up to a maximum of 80% of the total construction credit, which is equivalent to 60% of total project costs. Retail banks are required to use their own resources to finance the balance of the construction credit, which is equal to a minimum of 20% of the credit or 15% of total project costs.

Let's look at an example. A project is expected to cost 8 billion zloty (Z). The investor's equity requirement is Z 2 billion, leaving a credit balance of Z 6 billion. The bank can borrow Z 4.8 billion from the Mortgage Fund (which is equal to 80% of Z 6 billion); at the same time, the bank adds to the construction credit Z 1.2 billion from its own resources. If the same investor increases his equity and needs only a loan in the amount of Z 4 billion, the Mortgage Fund's share would be Z 3.2 billion and the retail bank's share would be Z 800 million.

What is included in "total project costs"?

"Total project costs" is the basis on which the eligible amount of a construction credit is calculated. Eligible project costs include:

- Direct construction costs, including labour, materials, and use of equipment and vehicles; indirect construction costs, including overhead, administration, and project supervision; and a reasonable profit on construction as defined by the HFPO.

- On-site infrastructure and connections.
- Purchase price of land, perpetual ground lease fees, or market value of land if it is already owned by the investor.
- Project preparation expenses, including architectural and design fees, legal fees, land registration fees, and related miscellaneous expenses.

Ineligible project costs include:

- Off-site infrastructure, such as the construction of a sewage treatment plant or expansion of the district heating system. A proportional share of such expenses may be financed, but only if the proportional costs will be repaid from the sale of the housing units.

What are the competitive bidding requirements?

All projects proposed by gminas or other governmental bodies, public/private partnerships, cooperatives, and public enterprises are required to comply with the HFP's competitive bidding requirements in the following instances:

- The sale or lease of land for the purpose of housing development.
- The award of a construction contract, including contracts for the construction of infrastructure

Projects which will be built on privately-owned land, and in which the investors are private sector firms, enterprises or organization, are exempt from the HFP's competitive bidding requirements unless total project costs exceed the equivalent of US\$ 1 million.

On what basis will the financial feasibility of a project be determined?

The basic standards for financial feasibility are:

- Construction and other project costs are realistic.
- All potential direct and indirect costs have been taken into consideration.
- Adequate sources of financing have been identified to cover all project costs.
- The project proposes to recover all costs through the sale of the housing units.

In multi-family and land improvement projects, 60% of the units or serviced plots must be pre-sold.

What are the HFP's design and technical standards?

The HFP does not require the use of any particular type of technology, building materials or construction methods. However, the HFP encourages the use of lower cost materials, and preference is given to projects resulting in energy savings during a building's life cycle. All projects must have valid building permits and comply with local regulations. In addition, all projects must have adequate sanitation facilities, water supply and access to public services, and they must meet minimum energy conservation standards. More detailed design and technical guidelines can be obtained at the local bank which accepts credit applications.

What should I do if I want to prepare a project for the HFP?

The first steps, of course, are to locate a site for housing construction and begin to make preliminary designs and cost estimates. When you have a project ready for an initial review, you should complete the form, "Application for Construction Credit (Multi-family)", and send this form to the Housing Project Office. At the same time, you should begin to discuss the project with your commercial bank. Ultimately, the commercial bank will need to approve the project, and it is important for the bank to begin to participate in the project's development early in the planning stages. After completing the application form, you have to submit it to the commercial/retail bank.

What if my estimated costs are only preliminary and not final?

You should submit the credit application when you feel you have enough information for a preliminary review of your project. We expect the cost estimates for every project to be revised, probably several times. Obviously, you should try to estimate your actual costs as accurately as possible, but in many cases, you will need to ask for competitive bids before estimating actual costs. Also, over time, it is likely that inflation will force costs to be adjusted.

MORTGAGE CREDITS

What is the HFP's mortgage credit program?

The mortgage credit program provides long-term financing to enable individuals and households to purchase a house or flat. Commercial banks will borrow funds from the Mortgage Fund on a long-term basis, and on-lend these funds to mortgage borrowers. Individuals and households borrow mortgage credits directly from the bank, thus eliminating the need for obtaining a house or flat through intermediary organizations such as cooperatives.

What are the terms and conditions for mortgage credits?

The HFP is introducing a new form of long-term mortgage credit, known as the Dual Indexed Mortgage or DIM. The DIM is designed to be affordable to the average Polish household. The specific terms and conditions for mortgage credits are:

- *Maximum loan amount* - The amount of mortgage credit an individual or family is eligible to borrow is up to 36 times the current monthly household income or 75% of the appraised market value of the unit to be purchased, whichever is less. A borrower must pay in cash the difference between 75% of the unit's appraised value and its selling price.
- *Monthly payment* - The initial monthly payment is 25% of current household income. The monthly payment is increased periodically at the same rate of increase in the national wage index. Under this system, over time borrowers pay more in nominal terms, but the level of their payments should remain close to 25% of household income.
- *Interest rate* - The interest rate is the current market rate established by the commercial bank. The interest rate on the loan is adjustable and fluctuates according to market rates. In months when the interest rate is high, and the family's monthly payment is insufficient to pay the interest which is due, then the unpaid interest is recapitalized. When the monthly payment exceeds the amount of interest which is due that month, then the excess is used to repay the loan's capital balance. Through this process, over time all interest and capital is repaid by the family.
- *Repayment period* - There is no fixed or specific repayment period. Instead, the period of repayment will depend on how fast incomes rise relative to how fast interest rates decline. If incomes rise quickly and interest rates fall sharply, then the repayment period will be shorter. If incomes increase more slowly and interest rates remain high, then the repayment period will be longer. Generally, it is anticipated that there will be recapitalization of interest for the first few years, but that all interest and capital will be repaid in approximately 25 years.

How much can the retail bank borrow from the Mortgage Fund to make long-term loans for the purchase of a house or flat?

The total mortgage credit may not exceed 75% of the unit's sale price. Of this amount, the retail bank may borrow a maximum of 80% (or 60% of the appraised value) from the Mortgage Fund. The balance of the credit must come from the bank's own resources.

What can be purchased with the mortgage credits?

Eligible properties which can be purchased with the HFP's mortgage credits include:

- Flats or houses built with the HFP's construction credits, with a maximum net usable space of 100 sq.m. and 150 sq.m., respectively.
- Other new houses or flats with a maximum net usable space of 100 sq.m. and 150 sq.m. respectively, which meet the HFP's design standards and applicable competitive bidding requirements.

Ineligible properties for mortgage credits include:

- Commercial properties.
- Flats or houses which will not serve as a family's primary residence, such as vacation homes.

If I borrow construction credits to build my own house, or to make substantial home improvements, am I eligible for long-term mortgage financing?

Yes. If you build your own home or make substantial home improvements with credits from the HFP, your construction loan will be converted to a long-term mortgage credit when the construction is completed. In these cases, your maximum construction credit can not exceed 36 times your current household income. Also, the sum of your construction credit and your own investment must be enough for you to finish construction and occupy the unit.

If I am a member of a cooperative, can I still apply for mortgage credit?

Yes. Members of cooperatives are eligible to borrow mortgage credits for the purpose of purchasing a newly built cooperative housing unit.

How is total household income defined?

Household income is defined as verifiable and regular income from all sources of all family members or persons who are currently living together or plan to live together in the unit to be purchased and who contribute or will contribute on a regular basis to meeting the household's expenses. Contributions to household income from persons not living together, such as regular payments received from parents or relatives living overseas, can be considered as part of household income at the discretion of the bank if such sources of income can be verified. In all cases, it is the borrower's responsibility to provide evidence to the bank of household income.

Eligible sources of household income include:

- Salaries from full-time employment and verifiable income from part-time or occasional employment.
- Verifiable receipt of regular cash contributions from relatives or close friends.
- Payments from retirement or pension plans.
- Other sources which provide verifiable and regular income to the household.

Can you give an example of how the mortgage credit program will work?

Let's look at one example, but from two perspectives:

- An investor plans to build a 60 sq.m. flat at Z 5 million per sq.m., including all costs. The final sales price is Z 300 million. A family is required to make a 25% down payment in cash, or Z 75 million, resulting in a loan amount of Z 225 million. To be eligible for that loan, the family's total household income would need to be Z 6,250,000 (calculated as Z 225 million divided by 36). The family's first monthly payment would be Z 1,562,500 (25% of household income), which would be increased periodically based on changes in the national wage index.
- Another family, with an income of only Z 4.5 million, wants to buy the same flat, but it is eligible to borrow only Z 162 million (or 36 times Z 4.5 million). To buy the flat, the family would need to make a down payment in cash of Z 138 million (calculated as Z 300 million minus Z 162 million), or 46% of the total sales price. In this case, the family's first monthly payment would be Z 1,125,000 (25% of household income), which would be increased periodically based on changes in the national wage index.

These examples demonstrate that, in a market-based housing system, there is an interaction between incomes, savings and construction costs. A family with a lower income but more savings will be able to purchase the same flat as a family with a higher income but less savings. Similar to these examples, housing investors should estimate the income and down payment requirements for their finished units, and analyze whether or not enough families will be able to afford them. Using the above examples, if there are not enough families earning sufficient income, or if there are not enough families able to make the required down payment, then the investor will need to find ways to lower his project costs, or build smaller units.

HUNGARY'S HOUSING SECTOR ¹

ANALYSIS OF THE HOUSING MARKETS IN THE HUNGARIAN HOUSING SECTOR

Demographic Profile

Throughout the 1980s, Hungary experienced a trend during which time the population was both decreasing and aging. This population decrease has been occurring at roughly the same rate as in many Western nations now experiencing zero growth rates and an increasing elderly segment. As such, the demographic profile in Hungary is similar to many Western markets.

A census taken in January 1990 estimated the Hungarian population to be 10,374,823. Population has decreased annually since 1990 at the rate of approximately 20,000 people per year. As of January 1990, the total number of households was 3,814,850. 100,200 households consisted of two families, and 2,900 households consisted of three or more families. Hungary has the world's highest suicide rate which is largely attributed to the poor quality and cramped housing conditions.

Macroeconomic Conditions

Regional Considerations

The CEE region is in crisis. However, the level of crisis varies from nation to nation:

- The crisis will continue for the foreseeable future in Bulgaria, Albania, the Soviet Union's successor states, the former republics of Yugoslavia, and to a lesser extent, Slovakia.
- The crisis in the Czech Republic, Poland, and Hungary could possibly end in two to three years in conjunction with a more stable economic situation.

The situation in the former German Democratic Republic (East Germany) is very different in comparison to the remainder of the CEE. Initial economic opportunities were naturally capitalized on by West German consultants and private firms.

¹ This case study is based on a report prepared by A&B Building Trade Information and Marketing Office (1992).

The present status of former East Germany includes two important considerations:

- The extent of the economic crisis in the former East Germany is far less acute than that compared to other countries of the region.
- The market is far more difficult for potential investors to penetrate than other nations of the CEE region.

In general, where market potential is concerned, the most attractive targets for investment are Hungary, the Czech Republic and Poland.

Hungary's Economic Situation

Estimating market potential in Hungary has been a difficult task. For a long period of time, there were significant discrepancies between official government predictions and those made by international agencies and consultants. This gap has been gradually closing and there is now little real fundamental difference between government and professional forecasts. There is now realistic estimates for unemployment, inflation, foreign investment, industrial production, GDP and GNP figures.

In Hungary, improvements in the economy are encouraging a rapid increase in foreign investment. In 1987, there were less than 9,600 organizations with legal rights as private enterprises. By the end of the first half of 1992, there were more than 60,000. While development of the small business sector improved and grew in 1992, growth and development of middle-sized enterprises was much slower.

Some successful small businesses, including those in the building sector, have passed the initial stages of development and are now beginning to reach a critical plateau. At this stage, the successfully developing small business may become a sluggish middle-sized enterprise. The problem is not that the enterprises have lost their flexibility or entrepreneurial capacity, but rather that they lack the expertise and knowledge necessary to accommodate business expansion.

Hungary has enjoyed years of limited private enterprise and entrepreneurial freedom in comparison to other countries in the CEE region. This has helped to ensure that the efforts toward reform will eventually lead to some degree of economic prosperity once the transition to a market economy had been initiated.

The private small business sector has always had a relatively close relationship with Hungary's state enterprises, the public sector having traditionally been a "soft market" for private business. However, similar to many former centrally-planned nations, Hungary's state enterprises, which are in the throws of privatisation, are having the greatest trouble adjusting to the new market forces.

There have been few progressive strategies created to help ensure long-term industrial reform and viability for large state industries. Since the second half of the 1980s, a short-term approach to operating the state industries has dominated. The problems of political instability and fluctuating industrial and economic policy have only contributed to the growing inefficiencies and redundant nature of former state industries. As a result, the state of the private sector's relationship with state enterprises is questionable, thus threatening a portion of the private sector's economic base.

Another characteristic of the Hungarian economy is that there are few business federations or associations for employees or for employers. As a result, government, industry, and labour lack basic representative organizations needed to articulate cohesive and coordinated industrial policy.

Forecasts Related to the Hungarian Economy in 1992 & 1993 (1991 = 100)²

Designation	1992		1993	
	Worst Scenario	Best Scenario	Worst Scenario	Best Scenario
Gross National Product	91	95	94	103
Industrial Production	85	90	94	103
Agricultural Production	82	90	80	99
Population Consumption	90	98	94	103
Investment	95	100	97	106
Export	102	108	100	107
Import	92	97	95	108
Consumers Price Index	123	120	125	116
Current Balance of Payments (Millions USD)	300	800	-500	100
Unemployment (Thousand People)	800	700	1200	900
Budget Deficit (Ft Millions)	210	198	250	185

Political Situation

The last round of national elections which accompanied the movement to reform was held in March 1990. Local government elections followed in August 1990. The next set of elections will be held in 1994.

Currently, there is a coalition government at the national level. The political situation is stable

² These forecasts have been prepared by A&B Building Trade Information and Marketing Office and Economic Research Institute based on data from the Kopint-Datorg and Budapest Bank.

but there are strongly opposing views within the coalition and the ruling party. The majority party is the Hungarian Democratic Forum has a central and right wing. The central wing contains the Prime Minister, Jozef Antall, and his supporters. The right wing consists of a Vice-President, Istvan Csurka, and his nationalistic supporters. To further complicate the situation, the President of Hungary, Arpad Goncz, who is elected by the parliament, is a member of the formal opposition.

Against strong opposition, the ruling party has placed party members at the head of the national media. This act is being justified on the grounds that it will prevent Communist ideologies from being expressed in the media.

The general population's mood is very pessimistic and feels that the reforms are moving too slow and the governments economic strategy is ineffective and that the government has too many nationalistic tendencies. Consequently, at the present time, the ruling party is very unpopular and is not likely to be re-elected in 1994.

Financial Situation

Presently, the Hungarian forint can be quite easily converted. Hungarian importers can buy foreign currency freely and foreign investors can exchange their forint income for other convertible currencies of their choice.

For 1992, capital coming into the country was estimated at about \$1.5 billion, the foreign currency reserve at about \$5 billion. The reserve is estimated to be sufficient to finance import deficits for about 7 months.

In an interview with Bod Peter Akos, the president of the Hungarian National Bank in December 1992, the following statistics were indicated:

Decline in the Ratio of Credit Payments to Exports

Year	Decline in the Ratio of Credit Payments to Exports
1990	43.2%
1991	32.0%
1992	29.0% (expected)
1993	23.2% (expected)

On January 1, 1993, the Hungarian National Bank's base interest rate decreased from 21% to 20% per annum. The Bank also dropped long-term re-financing credit interest rates from 21% to 20%. The Hungarian money market is still considered to be poorly functioning, and the mortgage market is yet to be fully developed.

Currently, the main source of domestic revenue for the Hungarian government to finance reform is through taxation.

Summary of Housing Stock Data

The following quantitative data sets represent new housing starts and completions in Hungary based on 1990 and 1991 census housing statistics.

Increases Occurring in Hungarian House Stock (1960-1990)

Year	Total Housing Stock (000's)	Increase in Housing Stock	
		Housing Stock (000's)	% Change
1960	2.758		
1970	3.122	364	13.2%
1980	3.542	420	13.5%
1990	3.817	275	7.8%

From 1970 to 1980, 194,701 new homes were constructed in Hungary. From 1976 to 1980, an average of 20,000 homes were constructed yearly. From 1980 to 1990, total construction was 132,886 homes. From 1986 to 1990, construction is estimated at about 11,387 yearly. The majority of construction occurred in rapidly growing urban areas where rising populations escalated demand for housing. Overall, the City of Budapest had a slight increase in housing stock of 7.9%, housing stock in provincial towns increased by 13.5%, and the housing stock in villages increased by only 2.0%.

Between 1980 and 1990 the total amount of housing stock increased by only 7.8% as construction and completion of homes was drastically reduced. In 1991, an estimated 5,471 homes were completed, representing the lowest number of housing completions since 1951.

In 1980, more than 30,000 homes were built using government subsidies. In 1992, the total number of new homes built was estimated at only 20,000 of which the number of homes built from using government subsidies numbered only a few hundred.

Besides the changing supply of homes being built, the quality of the housing stock has also changed as the percentage of homes with three or more rooms has increased substantially. The following table helps to illustrate the changing nature of homes in the Hungarian housing market:

Distribution of the Housing Stock According to Number of Rooms

Year	One Room		Two Rooms		Three or More Rooms		Total	
	Units 000's	%	Units 000's	%	Units 000's	%	Units 000's	%
1970	1,440	46.1	1,348	43.2	334	10.7	3,122	100
1980	973	27.5	1,720	48.5	849	24.0	3,542	100
1990	622	16.3	1,708	44.7	1,487	39.0	3,817	100

Distribution of Housing Stock According to Ownership

Year	Private Ownership	Public & Other	Total
1980	74.3%	25.7%	100%
1990	77.7%	22.3%	100%
Homes Built Between 1980-1990	86.8%	13.2%	100%

In January 1992, Hungarian official statistics show 3,917,317 homes registered to owners. Of this, 20.5% or 803,807 of the homes were registered in Budapest. There are approximately 2.6 people per home. Average area per home is 69 sq.m. Although the average Hungarian home is larger than those in other former socialist countries, it is still substantially smaller than those in Western countries.

Characteristics of Housing Stock in Hungary and Developed Countries (1990)

Countries	Average Area (sq.m.)	Homes per 1000 Residents
Hungary	69.0	371.4
Finland	73.8	434.0
Belgium	82.1	382.2
Austria	83.9	377.0
France	85.4	464.0
Denmark	107.0	458.2

Throughout the 1990s, the average area of homes increased in every former socialist country mainly because the state enterprises became insignificant, thus reducing the construction of typical small, high-rise flats, and the demand for more space increased thus increasing the proportion of single family homes.

This trend was particularly pervasive in Hungary. Total average area of all new houses built between 1986-1990 period increased by 8.3% translating into an increase from 83.0 sq.m. to 89.9 sq.m.. Further, newly built homes between 1990 and 1991 had an average area of 90.0 sq.m., comparable to those in more developed countries.

The same trend also applies to both technical standards and the quality of comfort in new Hungarian homes. It can be seen that the Hungarian housing stock, while still well below Western standards, has begun to quickly improve in quality. The number of homes built has declined substantially although most new homes now meet higher national standards. Further, between 1985 and 1990, the amount of floor space and the level of comfort has improved substantially and the value of the average home is now higher than in previous years.

For example, in the 1960s, 18.5% of new homes built were constructed of mud, sun-dried and non-fired brick. In the 1980s, this number was estimated at only 0.9%.

A particularly large number of homes using concrete panel technology were built in the 1970s. Precast concrete panel homes had been popular with state housing enterprises because they suited socialist industrialization requirements: they were simple to build; they could be mass-produced; and they were considered suitable for any type of tenant or family.

These homes are no longer considered suitable given their poor design layout and small living space. Technical aspects such as sound insulation, moulding, and finishing, are also sub-standard and poorly finished.

Although construction of concrete homes has declined substantially, floor space has improved marginally. In 1986, 17,084 homes were built from concrete panels with an average area of 55.7 sq.m.. While, in 1990, 6,087 homes were built using concrete panels and the average area increased to 62.7 sq.m..

In general, finishing and building materials remain below standard in both aesthetic and technical quality. However, new panel-built dwellings are improving the most in quality. Improvements include higher roofs built from concrete roof tiles instead of flat panel roofs. Further, physical design of interior rooms has been modernized. On average, every panel home currently being built now has two medium-size rooms, a kitchen, washroom, toilette, and a hallway.

There exists a high density of older multi-dwelling buildings throughout Hungary which are in very poor condition. The estimated cost of renovating the older stock in Budapest alone is estimated at about \$2.5 billion.

Some additional characteristics of the Hungarian housing sector include the following:

Areas supplied with public utilities - The country's infrastructural capacity is very weak. This situation is evident in cities and more so in outlying villages.

Drinking water supply - In general, all towns are supplied with drinking water, as compared to only 70% of villages. The remaining 30% of villages are supplied from wells. Well water is often not potable, however, and local residents drink the water at their own risk.

Sewage disposal - Systems for sewage treatment and disposal are generally outdated and require either upgrading or replacement.

Electrical power supply - Electrical power supply is well developed across the country.

Gas supply - Hungary's sources of natural gas are inadequate for meeting domestic demand. Southern areas of the country are better serviced.

Telecommunications - Generally, the phone system is poorly developed throughout the whole country, although modernization of the phone system began in the mid-1980s. It is not unusual for a home in Budapest and in the surrounding counties to wait 5-8 years to get a telephone line installed.

Distribution of Hungarian Housing Stock by Year of Construction

Time Period	Budapest		Country Total	
	# of Homes	Distribution	# of Homes	Distribution
Before 1900	109,450	14.7	337,700	9.4
Between 1900-1919	90,400	12.1	289,600	8.1
Between 1920-1944	134,700	18.0	507,800	14.2
Between 1945-1959	48,000	6.4	420,700	11.8
Between 1960-1969	84,650	11.3	543,700	15.2
Between 1970-1979	160,300	21.5	851,250	23.9
Between 1980-1989	119,350	16.0	619,750	17.4
Total	746,850	100.0	3,567,500	100.0

Distribution of Housing Stock by County

Counties	# of Homes	Density Persons/Home
Budapest	803,807	2.49
Baranya	152,497	2.74
Bács	220,164	2.46
Békés	163,732	2.49
Borsod	274,099	2.75
Csongrád	177,030	2.47
Fejér	153,102	2.76
Gyor	152,953	2.77
Hajdu	203,371	2.70
Heves	128,902	2.58
Jász	166,361	2.54
Komárom	116,556	2.69
Nógrád	86,991	2.57
Pest	347,526	2.78
Somogy	127,448	2.68
Szabolcs	197,075	2.87
Tolna	94,856	2.66
Vas	99,018	2.78
Veszprém	139,636	2.73
Zala	112,193	2.71
Total	3,917,317	2.64

New Home Construction in Counties (January to End of September)

Counties	1991	1992
Budapest	2.111	1.169
Baranya	751	545
Bacs	1.107	651
Bekes	541	325
Borsod	1.301	1.053
Csongrad	643	757
Fejer	703	629
Gyor	804	716
Hajdu	1.423	773
Heves	682	373
Jasz	680	487
Komarom	484	344
Nograd	306	206
Pest	2.071	1.248
Somogy	575	517
Szabolcs	1.476	918
Tolna	383	303
Vas	481	296
Veszprem	823	730
Zala	874	554
Total	18.219	12.594
Total Year	33.164	22.940

Professional Real Estate Services

After 1945, all aspects of the real estate trade were controlled by the government. In 1982, statutes were passed allowing lawyers to become involved with real estate and, from 1990, restrictions were lifted allowing anyone to practise real estate professions upon completion of a special examination. Legislation, however, continues to regulate many aspects of the industry, such as restricting fees for real estate services to 3-4% percent of the purchase price.

A number of real estate agencies have a database of available listed properties. Listing a property may require a registration charge up to 10,000 Hungarian forint. Such a charge includes all administrative work, legal advice, the bill of sale, and government procedures.

Real Estate Organizations:

- Hungarian Real Estate Chamber
Member of the Hungarian Economic Chamber.
Established in 1991 with 21 founding members.
Present membership: 66.
- National Real Estate Federation
Established in 1990 with 31 founder members.
Present membership: 147.
Goals: lobbying, education, information base.
Member of the Hungarian Real Estate Chamber.
- Real Estate Money Market
Began in September 1992 with 13 brokers.

Real Estate Media:

- "EXPRESS" advertising paper (daily)
- "Real Estate" (weekly)
- Daily newspapers

Foreign real estate firms and real estate developers in the Hungarian market:

- Jones Lang Wootton
- Jendrush & Partner (Hamburg)
- Dollar Land Limited Company (London)
- DTZ /Debenham Jean Thouard Zadelhoff

Real Estate Industry Deficiencies

While there are a number of small property databases existing among different firms, there is no comprehensive national database. There have been some negotiations with Dutch and US-AID firms to this effect, but no decisions or firm commitments have been made thus far. Because there is no central database, one property will often be registered in 6-8 different databases at the same time. Other detriments to the industry include:

- A lack of capital retarding the development of an efficient real estate market.
- A lack of market studies and appraisal services related to properties for sale.
- A lack of detailed organizational plans for properties owned by local governments, which adds to delays at the commencement of development projects.

Overview of Real Estate Market

The Hungarian real estate market has been stagnant for many years. Although supply is much greater than demand, there has not been any associated drop in prices. Most market activity is concentrated in Budapest. This is reflected in the fact that property prices in Budapest are double that of the rest of the country. Outside of the capital region, the real estate market is virtually stagnant, although there is some market activity in western areas near the Austrian border. The World EXPO, to be held in Budapest in 1996, has apparently had little to no effect on the market.

Cost of Building Lots - In Budapest, the most expensive building lots are in the I, II, V and XII districts. On average in Buda, the cost for building lots is approximately 25,000 Forint per sq.m.. In Pest, the cost is approximately 4,170 Forint per sq.m..

Residences - Domestically, demand exists mainly for inexpensive and small homes. Foreign market demand tends toward expensive, luxury, green belt homes. Cost for luxury homes is about 120,000 Hungarian forint per sq.m.. Since the transition, house prices in Budapest have increased about 10-15% yearly.

Commercial - Most of the commercial space is owned and leased by local government. Tenants must buy out the lease with a so-called "lease right", and after must pay monthly rent to the local government. While there is a considerable amount of movement in this market, at this time there is little opportunity for ownership or for flexible leases.

Offices - The office supply in Budapest this year is balanced with demand and prices have declined significantly. Demand is mainly for offices with areas of 100-200 sq.m. and 1,000-2,000 sq.m..

Industrial Properties - Large supply and small demand is characteristic of this market. Generally, properties being offered for sale have deteriorating infrastructure and conditions are very poor. There is some demand for properties with areas of 1,000-10,000 sq.m., although there are a large number of properties available that have a much greater area with little demand.

Forecast of Expectations in the Real Estate Market

- In the near future, continued stagnation is expected within the real estate market.
- The increase in the cost of land will generally follow the inflation rate, although demand for land will not decline.
- Characteristics of the market will not change for another 4-5 years.
- Once living standards begin to rise in 5-10 years, demand will increase for better quality, mid-sized homes.
- Commercial property will continue to move but prices and rent will decline.
- Movement in the office space market will become settled in 1-2 years and an increase in business activity is expected in smaller urban centres.
- The sale of industrial properties will remain low and prices will decrease.

Possible Opportunities

- Shopping centres
- Mid-range economy hotels
- Office space in smaller regional urban centres
- Inner city rehabilitation
- Mid-size homes
- Renovation of neglected old manor-houses and country estates

Development and Government Regulations

The complexity and length of the private development process in Budapest varies depending on land ownership, existing tenancies and planning approval requirements. The most straightforward situation involves privately-owned vacant land for which only planning approval is required. At the present time, although growing, only a very small fraction of land is in this category.

The vast majority of land is publicly owned, most of which is now in the control of the District Governments. Some land relating to regional infrastructure is owned by City Hall and some sites, such as major industries, by the State. Land acquisition for private development, therefore, usually involves negotiation with the District - and, to be specific with the local politicians, usually a Deputy Mayor. Price is established by negotiation. Professional property appraisals are virtually non-existent. The sale of public land is seen by local governments as being a potentially significant source of revenue in a revenue-starved environment. Consequently, joint ventures with prospective investors are seen as attractive opportunities and many such negotiations are currently underway in Budapest.

The vagaries associated with an embryonic free market in land, combined with negotiations for purchase or joint ventures with neophyte process. For example, ad hoc negotiations with more than one investor at a time respecting the same site are reported. The eagerness of local governments to raise revenue through land sales and joint ventures in the absence of the checks and balances inherent in a well-established market system may create a climate in which "bad deals" or even abuses could occur.

Planning Documents and Regulations

The planning and approvals process in Budapest is outlined below. Land use planning and development in Budapest is governed by three levels of planning documents, the Budapest Master Plan prepared by City Hall, and Detailed Plans and Zoning both of which are administered by the Districts.

(i) Common Organizational Plan (ART)

Long range Master Plans (15 years or more) for communities specifies planning rules through the use of mandatory regulations. The modification process is long, costly and complicated.

Budapest Master Plan - At a scale of 1:25,000, the Budapest Master Plan is a generalized physical land use and transportation plan. Land use is set out in the following categories:

- Residential - high, medium and low density
- Industrial - heavy, light
- Downtown - high
- Central Areas - medium density mixed-use
- Open Space
- Institutional

The Transportation component indicates major roads, rail lines and public transit (lines and stations). There is no specific category for commercial uses, inasmuch as prior to the new regime, the state constructed this type of development and the need for local control was not recognized.

(ii) *Zoning*

At a scale of 1:5,000, the zoning plans administered by the Districts establish the land use guidelines in greater detail than the Master Plan. Maximum densities, heights and site coverage are set out.

District councils should not zone land in a manner at variance with the Master Plan and changes to zoning are referred to Budapest City Hall for approval. Current legislation setting out the powers of Budapest City Hall and the Districts does not appear to establish this relationship between the Master Plan and the Zoning with any clarity. Consequently, this increases the probability of disputes and ongoing confusion.

(iii) *Detailed Plans*

At a scale of 1:1,000, Detailed Plans (RRT's) prepared by the staff of the local government districts indicate public rights-of-way, lot lines, and building outlines, including specific setbacks. Details Plans currently in existence cover portions of the Districts.

The issuance of a building permit requires conformance with Zoning and, if the proposed development is on a site greater than 3,000 sq.m., conformance to a Detailed Plan. If no Detailed Plan exists for the area, one must be prepared, covering the proposed site and the surrounding area (i.e. at least the block containing the site or larger, depending on the scale of the proposal). At the present time there is uncertainty as to who is responsible for preparing and/or paying for the Detailed Plan, the District or the applicant (developer).

Where the proposal conforms with both the Zoning and the Detailed Plan, a building permit can be issued administratively within two or three weeks. Where a proposal conforms with zoning, but requires a Detailed Plan, the process requires approval of the Plan by the District Council and usually takes months.

The relevance and utility of Detailed Plans (RRT's) in a market-driven development environment seems questionable. Their preparation by the local government based on the speculation by planners and architects as to possible future detailed building configurations appears more appropriate in the previously centrally government controlled environment.

It is also a reflection of the very nature of the planning profession in Hungary. Planning has been regarded as a technical, design-oriented undertaking, relating virtually exclusively to the built environment. There has been a pre-occupation with design details and little, if any, recognition of the social and economic forces which inevitably determine the relevance of the planner's work. In short, planning has been viewed as an end-state design exercise, and not an ongoing process involving other disciplines, the public, and the politicians in a dynamic arena of ever-changing circumstances.

The continued existence of the large state-controlled planning agencies offering services to local government is an impediment to the change in approach to planning which will be required as a response to democracy and a market economy. Local governments should have their own planning staff which will be more responsive to local needs and more effective in adapting to changing circumstances. The practice of preparing detailed plans (RRT's) should be abandoned.

Consideration should be given to the establishment of Development Permit Areas within which the local governments would establish design guidelines for future development. Applicants for development, rather than the District planning staff, would then prepare detailed plans for their proposals in conformance with the guidelines. These Development Permit areas should be identified in the Budapest Master Plan and be applied to areas of special sensitivity such as Downtown, historic districts, the Danube banks and local centres.

Government Subsidies in Housing

The existing forms of housing-related assistance include special interest credits; non-refundable assistance; social assistance program based on number of children in the family; and refunds from the general purchase tax.

In 1993, the largest change related to assistance was with the restriction on the general purchase tax refund. Until 1992, 25% of the general purchase tax (15% for transportation) could be claimed. However, for 1993 and 1994, the amount that can be claimed has risen to 60%, with a maximum possible refund of 400,000 Hungarian forints. In 1995, it is the government's intent to cancel all such refunds. According to some reports, loss of this refund may be compensated with higher government social assistance.

National Housing Budget (Hungarian Forint - Millions)

Recipient	1992	1993
Private Sector New Housing	25.5	26.6
Local Government Sector New Housing	5.0	7.0
Local Government Sector Housing Renovations	-	3.0
Military Sector New Housing	1.7	1.4
Low-interest Credit Assistance	40.4	33.7
Total	75.3	71.7

While the national housing budget in 1993 allows for a total of 71.7 million Hungarian forints to be spent, only 35 million Hungarian forints is actually scheduled for building new homes. In addition, there is the possibility that the national housing budget will be reduced in the near future.

The annual volume of new housing construction is expected to decrease to 15,000 homes per year if an increase in financial assistance is not offered to homebuilders and consumers. The situation is complicated by the fact that residential prices (building construction expenses) in Hungary are becoming more and more compatible with those in developed Western countries. At the same time, however, the average income in Hungary remains well below related Western average incomes. The impact on consumers is clear given that national income levels and purchasing power continue to drop.

A new national housing association, which is currently being developed, will serve to better address the housing problem in Hungary in the future. The establishment of this association is being developed with the coordination of the Ministry of Public Welfare and a number of other Ministries including the Ministries for the Environment and Regional Policy, Industry and Commerce, Finance, and the Interior.

Local governments have the power to provide non-refundable assistance and special interest rate credits for housing as well as assistance for public works. Local government's most effective means for raising capital is by selling municipal property. Of 110 local municipalities surveyed regarding the local housing situation, responses showed that municipal officials hoped to sell municipally-owned property at a profit, but that the prospects for such gains were highly unlikely. They indicated that they did not expect any extra capital through such means and that, in response, their housing budgets for 1993 would be the same as in 1992.

NOTES FROM FACT FINDING MISSION TO HUNGARY³

A fact-finding mission in Budapest was hosted by A.B. Building Trade Information and Marketing Office. Miklos Francsics, Varga Denes and Klara Fekete participated in our visits and meetings.

Meeting: A.B. Building Trade Information and Marketing Office

A.B. Building Trade Information and Marketing Office is a real estate consulting firm experienced in preparing marketing research studies as well as regular housing forecasts. Their quarterly report on the Domestic Building Market is widely circulated to banks, various governments and other interested institutions.

³ This section consists of observations and notes on meetings attended by Gordon Thompson, President of Candev Building Corporation, and Colin Hefferon, Vice-President of Masthead Properties.

- The firm acts as a clearing house for tenders and contracts and provides a real estate brokerage service. Information is collected by a number of agents around the country and then sold to the firm's clients. Last year they sourced over 2000 tenders totalling over 10 million forints.
- Standard commission rates are 2-3%.

Expo 1996 Overview

- Considerable construction activity is anticipated as Expo 1996 approaches.
- Early planning has not gone well and the fair is already scaled down from the original plan.
- The civil works pre-qualification tender was out last week so plans are now underway.
- In general, the consultants at A.B. were very cynical with regards to the fair and any anticipated benefits that it might bring. Their feeling on the subject of Expo 1996 is that one should not build a business plan around something like a fair.

Housing Overview

- A.B. is forecasting 20,000 housing starts in Hungary in 1992.
- There is very little land speculation going on but there may be in the near future.
- The government has paid very little attention to housing over the last 4 years, mainly because they have been preoccupied with the change to democracy and the shift to a market economy. Further, there are too many theoretical people in government housing departments that don't understand how to market housing.
- Government is now taking the housing problem very seriously and has set up a special housing group within the finance ministry. The government along with the private sector is setting up a housing finance system.
- Housing starts during most of the 1970s were 5 times the current levels. Much of this housing is panelled high-rises and is sub-standard in today's market.
- The average housing unit in Hungary is inadequate.

- All of the housing built during the Communist regime was done by 20 state-owned contractors, with one for each district. Generally speaking contractors looked after themselves and their friends. Most of these state-owned contractors are in serious trouble and are being replaced by private contractors.
- There now exists over 1500 building companies in Hungary.
- 2000 forints (C\$35) per month is the average rent for government housing. Utilities add another 4000 forints for a total monthly household cost of 6000 forints (C\$105).
- On first look, wages in the industry appear very low. It must be remembered, however, that these workers live in subsidized state-owned housing units. As market housing becomes the norm, upward wage pressures will occur.
- Average salaries are 11,000 to 12,000 forints per month or \$210 CDN. Companies must pay 100% of a worker's wage as tax to government for social services, pension and similar government services. Workers pay a 30% income tax and a value-added tax (VAT) of 25%.
- The structure of the single family housing industry over the past several decades has been that of a cottage industry; one man-one house, mostly in rural areas, and often constructed much like a "barn raising".
- The trend for single family home construction is clearly with private builders doing 20-30% of new houses. Average single family house size is 110 sq.m. and sells for 50,000 forints per sq.m., or \$70,000.
- Impossible in today's economy for the average worker to buy his own home.

Meeting with Pal Cseh, Senior Ministerial Counsellor, Hungarian Ministry of Finance.

- Mr. Pal Cseh position was equivalent to the Canadian Minister of Housing.
- He was very open in his view that government would continue to build housing until the market was able to provide housing for other than the luxury segment.
- It was his view that, while gross wages were high with inflation running at 28%, and interest rates at over 36%, it would be a while before market housing could fulfil demand. The gap between wages and costs needs to narrow before any market housing can succeed.
- The Minister also pointed out that the country could no longer afford the current

levels of subsidies.

- The trade unions blocked the VAT on housing for a period of 2 years to give some breathing space.
- He made the point that every week someone comes to him with new technology or ideas, mostly foreigners, but in his view this is not the problem or the solution.
- It was in the Canadian mission's opinion that the Minister was a person very aware of the serious problems facing Hungary, but who perhaps still carries the baggage from the old regime.

Meeting: Rosemary Bointon, Senior Partner, McKenna & Co. Solicitors.

- This firm is a large British law firm with offices around the world, particularly in Eastern Europe. The mission met with Rosemary Bointon, a senior partner in the Budapest office. In her practice, she handles a number of real estate companies being set up by foreign investors.
- It is very possible for foreign companies to buy land and to do transactions in Hungary.
- This is often achieved by buying a Hungarian company and then buying the land through that company. Shell companies are also used to get around legal issues.
- It helps if you have a Hungarian partner. It also unofficially depends on what country you are from.
- It is her experience that Hungarian banks are more willing to lend against land than foreign banks. Foreign banks are nervous of the changing political climate. Foreign banks are also reluctant to lend because, in the event of default, they cannot take the land back as they are subject to the same rules with respect to foreign ownership of land.
- There are, however, ways to get around these problems such as registering land and buildings separately.
- Registration of land can take a very long time. This is not because of the process, but because of the many problems that have to be solved along the way.

- In the majority of deals, land is being acquired that government or some other public body such as the Railroad has a direct interest in.
- It is often the case in privatization deals that the local authorities will retain an 8-10% ownership position to ensure they have some control until the change of use is granted.
- Most of the body of law that exists relates more to large state-owned companies and, therefore, law for small business is still evolving.
- If you are buying a parcel of land that is part of a larger plot, you must receive the approval of all the other land owners. This often requires the payment of money to get them on your side.
- Legislation was passed in Hungary giving previous owners of land the right to cash settlements or shares in the new enterprise but not the right to reclaim the land.
- The process always takes longer than planned and this is a mistake many foreigners make. Often foreign companies in their rush don't check things out thoroughly enough.
- Foreign companies also are not careful enough in picking a good Hungarian partner. Hungarian partners often oversell to foreigners their political connections.
- Trade or industry associations don't exist in the way we know them. With only 5% of business privatized, there is little need for a trade association.
- Top end apartments rent for \$2000 per month in Budapest.
- There is an acute shortage of good quality office space. A number of new ones are being built (business centres) and they can sustain themselves at market rents.
- It is Ms. Bointoner's advice to never pick government bodies to be partners or tenants.

Site Visit to ELSO MAGYAR, Private Builder (BUDAPEST)

- This company is owned by Mr. Berenyi Janos and has been in business for 1.5 years. Mr. Janos is a former pilot with LOT airlines.

- His private building company has been very successful, due mainly to a unique financing scheme he developed. Basically it is a savings program where all houses are pre- sold. The period of the program extends through the pre-sell period, and construction. From the time the first deposit is made until you take possession is roughly 50 months. The person with the largest down payment gets the first house, followed by a random draw.
- Construction costs for these townhouses is 26,000 to 36,000 forint per sq.m..
- Unit sizes range from 45 to 110 sq.m.. The unit layouts are very flexible and are changed to suit the buyers' lifestyle. The units are very adequate and some of the units we saw were quite high end by Canadian standards.
- The project contains land for 120 units and he has another site nearby for 90 more.
- Mr. Janos has noticed that there is strong demand for the least expensive units and the very high end. The future is very good for this kind of housing.
- His company also recently completed a small strip-type mall and sold all the units very quickly.
- He has also discovered that there is a good market in renovating old apartment buildings in Budapest where the tenants have purchased the building. No one wanted to fix things up when the building belonged to the government. He was recently awarded a contract to do a building where the previous tenants are now the owners and they are turning the basement and the ground floor into retail shops. These shops will be sold and the money used to pay for the renovations on their flats. The attic is being turned into offices for rent.
- He is also in the planning stages of building an Expo Village that will be rented before and during the Expo and later sold to individuals.
- He said that capital was the only thing slowing him down; the opportunities are endless.
- He feels Hungarian banks are too rigid and often require 200-300% collateral on a loan.
- This owner was, in the mission's opinion, the most entrepreneurial person they had met in Hungary.

Meeting: Dr. Gellert K. Kuba, Associate Professor, Technical University Budapest

- Dr. Kuba is very active in the fields of energy efficient housing and Bio Architecture.
- His main body of work is based on the theory that it takes too much energy to build a house and then too much energy to sustain it.
- Much of what he designs involves earth energy and solar energy.
- He has designed a house in the Sudan that stays cool without the use of air conditioning.
- He is also the architect for the Expo Villages that will be energy- and eco-efficient.
- The concepts he plans to demonstrate include solar, wind, earth bricks, bio manure, photo voltaic cells, solar energy storage systems, rain water collection systems, recycled sewage, and bio construction technology (allow more light in for people).
- He feels housing architecture should emphasize comfort rather than elevation. Very critical of North American housing.
- He made the point very forcefully that wood-frame housing was not for Hungary. It does not suit energy flow and is probably the worst method for house construction.
- The mission however was not able to debate this point with him and discuss the merit of the R2000 program in Canada.

Meeting: QUO VADIS MARKETING ES MANAGEMENT BT.

- This firm is a privately owned planning consulting company. They were the original planners hired for the Expo site. We met with Peter Gauder and Gyorgy Kerekes.
- They are no longer the firm doing the Expo site as their plans included more than an exposition. It was their vision that the site be an ongoing trade fair, university of technology, and recreation area. Quo Vadis wished the structures to remain and not be torn down after the fair. Now that plans have been scaled down, they are no longer associated.

- In their view, Budapest still needs more 2 and 3 star hotels. These hotels should not all be located downtown.
- Budapest has 20,000 beds and needs 40,000 more. New hotels should provide a variety of accommodation; from family hotels to luxury hotels.
- Restaurants are also badly needed.
- Parking lots are badly needed all over Budapest and even without Expo are economically viable. The city is very receptive to any plans to get cars off the street. At present, it is very difficult to visit Budapest by car because there is no place to park.
- The new official plan for Budapest includes many new areas for housing.
- Office space and business centres are needed but it is very hard to get approval for high rise structures.

Meeting: Dr. Krisztina D. Kiss, Operations Officer, World Bank, Hungary Office.

- Dr. Kiss was educated and grew up in Hungary. Prior to working for the World Bank she was employed by Coopers & Lybrand. She is very knowledgeable about current economics and housing.
- The housing market in Hungary is stagnant as a result of the lack of an appropriate financing mechanism. In addition, people who have money are reluctant to spend it on housing because savings deposit interest rates are so high at the Bank.
- An equity market (stock market) was established but it is not working very well yet.
- The World Bank's proposed program to solve housing financing will not be in place for another two years.
- The World Bank has lent \$3.2 billion since 1982 for 28 separate deals.
- The government selected the 12 most profitable state-owned companies to sell. To date not one has been sold. In her view, there is too much confusion and bureaucracy. Decisions on deals generally frustrate prospective buyers until they give up and back off.
- Coopers & Lybrand is managing a large reconstruction project in the 6th and 7th Districts and is currently looking for developers to be joint venture partners.

THE CZECH & SLOVAKIAN HOUSING SECTORS

ANALYSIS OF THE HOUSING MARKETS IN THE CZECH REPUBLIC & SLOVAKIA¹

Introduction

There is an absolute housing shortage in relation to the number of households and it is being exacerbated by changes in household demographics and rural to urban migration. Further, the housing construction sector has been experiencing a serious decline in output since 1990. This decrease in volume relates to declines in both new investments in housing stock and repairs/upgrading to existing buildings and structures. In 1991, the total volume of construction in the former Czechoslovakia (CSFR) dropped to below 70% of the volume attained between 1989-90. A general decline in investment in housing construction and related infrastructure is particularly evident in 1992 and 1993. The following table represents the drastic reduction in new housing starts since 1986:

Reduction in Housing Starts (000's)

CSFR	Total	Blocks of Flats	Cooperative	Communal Enterprise Stand-by	Private One-family Houses
1986-90	399.0	270.8	167.8	103.0	128.2
1989	88.5	61.7	36.6	25.1	26.8
1990	69.3	41.8	27.1	14.7	27.5
1991	62.5	45.9	30.4	15.5	16.6
Czech Republic					
1986-90	246.5	167.4	98.3	69.1	79.1
1989	55.1	38.8	21.0	17.8	16.3
1990	44.6	27.4	17.0	10.4	17.2
1991	41.7	31.3	19.5	11.8	10.4
Slovak Republic					
1986-90	152.5	103.4	69.5	33.9	49.1
1989	33.4	22.9	15.6	7.3	10.5
1990	24.7	14.3	10.0	4.3	10.4
1991	20.8	14.6	10.9	3.7	6.2

¹ Some caution must be exercised as many of the figures presented here are only estimates provided by government statistical authorities and the federal Ministry of Economics.

This reduction can also be seen in the number of dwelling units which have been built by contracting firms:

Reduction in Housing Starts by Contracting Firms (000's)

Average	1986-90	1990	1991	First Half of 1992
CSFR Total	93.2	98.9	16.8	5.9
One-family houses	32.2	59.7	10.8	4.4
Block of flats	61.0	39.2	6.0	1.5
Czech Republic total	57.5	61.0	10.9	3.3
One-family houses	19.0	32.6	6.4	2.3
Block of flats	38.5	28.4	4.5	1.0
Slovak Republic total	35.7	37.9	5.9	2.6
One-family houses	13.2	20.1	4.4	2.1
Blocks of flats	22.5	17.8	1.5	0.5

Despite this decline in investment, the importance of new housing construction, in addition to other critical development issues related to transport and telecommunications infrastructure, the construction of schools and health facilities, and the progress of public works projects, is still recognized as critical to the country's economic growth. The main barriers to developments in construction activity are:

- A serious lack of capital funds available for private construction investment.
- The loss of government funding and subsidies for construction.
- New methods of housing construction are being considered in response to the severe criticism and distaste for the previous system of precast panel building.

Nonetheless, a small level of activity is emerging in the private sector. In 1991, small private firms, which made up 7% of the total number of enterprises with 25 or more employees, captured 7% of the total volume of construction works.

Distribution of Construction Activity

Until 1990, housing construction in Czechoslovakia was carried out by either state-owned firms, cooperatives or private interests. State and cooperative construction of communal and cooperative housing represented nearly 65% of total housing construction volume. These Comprehensive Housing Construction programs were managed by state Regional Investment Departments who also managed the construction of public works facilities and utilities, roads, schools, shopping centres, and health centres. These Departments eventually completely deteriorated after the abolishment of the Regional National Committees in 1990.

Decline in Government Investment

Since 1990, lack of investment into the housing sector has been rooted almost exclusively in the reduction of subsidies granted by the state. Moreover, any grants received from either of the Republics or previously from the Federation budget were inadequately valorized to new price levels. As a result of the state's reduced subsidy policy, the volume of investment in Comprehensive Housing Construction dropped in 1991 to 50% of the volume of 1990, and was expected to drop a further 40% in 1992 from 1991 figures. Only the buildings which were previously under construction are being completed.

Local government continues to remain responsible for developing modern and efficient urban infrastructure and public utilities. While this responsibility for provision is not debated, the key problem is the provision of sufficient capital to fund the construction. At the same time, the municipalities must also address the requirements of environmental remediation, the restructuring of local industry, and other similar problems; all these issues are extremely urgent and will require substantial amounts of already scarce funding.

It must also be noted, however, that any real change in the way the property market runs will also require modifying the general attitude toward promoting property as a private, marketable commodity instead of a government-supplied service. Furthermore, it will be necessary to break the popular conviction instilled for decades, that it is the duty of the State to provide acceptable housing for all and ensure adequate maintenance of the housing stock.

Cooperative and Private Activities

Until 1990, part of the financing for new co-operative housing programs was done through small capital contributions by members of co-operatives and long-term bank credits which constituted a rudimentary mortgage system. However, these contributions only represented 30-35% of the total cost with the remainder paid from the state budget.

The majority of single family homes, comprising 32% of the total volume of housing construction, was generally constructed by the private sector and individuals. Private interests were also responsible for having built a small number (3%) of temporary and business units.

Full financing of housing construction by potential owners is not yet possible as consumer purchasing power dropped in 1991 to below 70% of its 1989 level.

Housing Quality Characteristics

It is estimated that more than 30% of all dwelling units are considered unsatisfactory due to their location, age, size, or quality of construction.

In the following table, the housing stock has been classified into 4 categories describing the quality of the unit's facilities.

Quality of Permanently Inhabited Dwelling Units (000's):

	CSFR	Czech Republic	Slovak Republic
Total	5324	3706	1618
1st category	3819	2591	1228
2nd category	945	795	150
3rd and 4th categories	560	320	240
In Rural Communities:			
Total	1323	859	464
1st category	694	443	251
2nd category	321	263	58
3rd and 4th categories	308	153	155
In Urban Communities:			
Total	4001	2847	1154
1st category	3125	2148	977
2nd category	624	532	92
3rd and 4th categories	252	167	85

The 1st category indicates housing stock having central, district, in-house heating or an electric stove; a bathroom (or a shower cubicle) and a toilet. The figures indicate that over 70% of the dwelling units in total (70% of the Czech and 76% of the Slovakian units) respectively fall into the 1st category.

Housing stock falling into the 2nd category either has one of the latter types of heating, along with inadequate sanitary facilities, or has adequate sanitary facilities along with inadequate heating.

Finally, the figures indicate that less than 11% of the total housing stock (9% of Czech and 15% of Slovakian units), fall into the 3rd and 4th categories which pertains to housing stock provided with only local heating along with inadequate or no sanitary facilities.

Most dwelling units built in recent years (with some exceptions) have been provided with bathrooms and are connected to municipal power grids. Almost all homes are provided with some form of heating as well as drinking water through the public water supply. However, there are still a large number of homes reliant on well water.

Currently, with regards to single-family homes, only 21% of new houses in Czech Republic and 29% in Slovak Republic are connected to a natural gas supply. Particularly incomplete is the connection of single family houses to the public sewer system; in Czech Republic the number is estimated at 47%; in Slovak Republic, 21%.

The standard of sanitary facilities and the methods of heating provided for the current housing stock in both the Czech Republic and Slovakia is considered satisfactory.

Living Area

In comparison with West European countries, living area in new dwelling units is low and insufficient. Dwelling units built between 1986-1990 are characteristic of the following:

Dwelling Characteristics

	CSFR	Czech	Slovak
One-family houses:			
One-room/studio/flats	0.1%	0.1%	0.1%
Kitchen + 1 room	1%	1%	1%
+ 2 rooms	6-9%	7-11%	4-6%
+ 3 rooms	18-23%	22-27%	10-16%
+ 4 rooms	67-75%	60-70%	77-85%
and over			
Avg. rooms per dwelling	4.0	3.8	4.1
Living area (m ²)	70-75	69-73	73-76
Apartment Blocks (including cooperatives):			
one-room/studio/flats	3-4%	4-6%	1-5%
kitchen + 1 room	10-15%	13-16%	5-13%
+ 2 rooms	15-17%	15-16%	12-19%
+ 3 rooms	55-58%	50-54%	56-68%
+ 4 rooms	11-14%	12-15%	9-13%
Avg. rooms per dwelling	2.7	2.7	2.7
Living area (m ²)	42-47	42-47	42-48

Spatial Characteristics of Housing Stock

	Housing Stock	One-Family Houses	Blocks of Flats
CSFR			
Living area per dwelling (m ²)	46.3	56.2	38.5
Living rooms per dwelling	2.72	3.18	2.35
Persons per dwelling	2.91	3.09	2.77
Per capita living area (m ²)	15.9	18.2	13.9
Czech Republic			
Living area per dwelling (m ²)	45.9	56.8	38.2
Living rooms per dwelling	2.66	3.18	2.29
Persons per dwelling	2.75	2.92	2.66
Per capita living area (m ²)	16.5	19.5	14.4
Slovak Republic			
Living area per dwelling (m ²)	47.3	55.2	39.3
Living rooms per dwelling	2.85	3.17	2.53
Persons per dwelling unit	3.24	3.40	3.08
Per capita living area (m ²)	14.6	16.2	12.5

The number of dwelling units per 1,000 inhabitants in the CSFR is about 20-40% lower than in most Western nations and the mean living area of a dwelling unit is substantially lower. In apartment blocks, including co-ops, only 30% of flats have only 1 to 2 rooms plus a kitchen; 65% of flats have 2 or 3 rooms plus a kitchen; and 5% of flats have more than 3 rooms.

Overall, housing stock is deficient when the average living area of dwelling units both in single-family homes and in apartment blocks is compared to Western standards. Although the average living area of a dwelling unit has increased by 33% and the per capital living area by 64% in the past 30 years, it is still not equivalent to Western standards.

Precast Concrete Panel Construction

The precast panel system for housing construction has been in use since the end of the 1950s. In the 1970s-1980s, the use of precast concrete in Czechoslovakia reached a level unparalleled in West European countries.

When this technology was initiated at the end of the 1950s, its' purpose was to satisfy housing demand while reducing labour requirements on-site. Precast panel buildings are, however, afflicted by architectural uniformity, standardization, and low market value.

Almost two thirds of the total number of dwelling units built in the CSFR after 1945 were built using the precast concrete building system technology. In total, 1.75 million dwelling units (33% of all dwelling units and almost 60% of dwelling units in apartment blocks) in the former Czechoslovakia are precast panel buildings.

Recently, there has been growing interest in alternative methods of construction that might utilize a greater variety of techniques, products, and materials. Any transition to other, more diverse and combined forms of construction using brick and wood for new construction will be a complex and long-term process. In the near future, it is expected that load-bearing structural brick techniques will prevail in the construction of single family homes and that panel technology will be continued in the building of apartment blocks:

Composition of Load-bearing Walls (%)

	Stone	Bricks	Panel	Wood	Unfired Bricks	Other and Unascertained Materials
<u>Single family houses:</u>						
CSFR	5	86	1	2	6	-
Czech Republic	5	88	1	2	4	-
Slovak Republic	5	82	-	3	10	-
<u>Blocks of flats:</u>						
CSFR	-	40	59	-	-	1
Czech Republic	-	46	53	-	-	1
Slovak Republic	-	25	74	-	-	1

It is worth noting that, despite existing aversion to the precast panel system, the technology should not be entirely rejected given the necessity to maintain existing precasting plants.

The plants will still be required for maintenance and modernization of existing precast buildings which will become an even more complex and exacting process in the future. Maintenance and modernization of the existing stock will particularly involve structural improvement to the buildings' roofs and support walls.

Modernization and Repair

There is an immediate need to address the unsatisfactory level of maintenance and the state of disrepair of old apartment blocks and of older housing stock. Virtually the entire housing stock requires modernization especially the Soviet-style apartment blocks as well as many of the self-built single family homes. Modernization includes improvements to indoor plumbing, heating systems, energy efficiency and design. A need also exists to rehabilitate the external environment of housing developments; improve exterior facades, physical amenities, existing parks and create new greenspaces.

In order to raise standards comparable to those of Western countries, it is estimated that the cost of necessary repairs and maintenance to the former CSFR's building stock is of the order of several hundred billion Kčs. However, with the exception of some privately-owned buildings (most being single family homes) and memorial and cultural buildings, the problem of sub-

standard construction is compounded by the fact that only the minimum necessary maintenance and emergency repairs have been performed on older buildings, which has led to serious structural and interior deterioration.

This general disregard toward quality and maintenance over the years has not only left the country's housing stock in a poor state of affairs, but has particularly advanced the decline of older sections of smaller towns and other communities. Neglect to infrastructure has also resulted in the emergency state of a considerable number of structures and utilities, particularly the water and gas supply network.

Government officials expect to solve the question of the reconstruction and modernization of the community housing stock through the privatization of existing dwelling units. It is assumed that a considerable part of the previous state housing stock will be offered for sale to present residents. However, this will not mitigate the responsibility of the local government for the reconstruction and modernization of housing for lower income groups.

Characteristics of Housing Stock and Household Composition

Changing Household Demographics

Since 1950, although the number of dwelling units has increased by almost 50% and the population has increased by only 25%, there still remains a constant shortage of dwelling units in relation to the total number of households. A higher divorce rate and a declining number of children per family has contributed to the continuously decreasing size of the average census household.

Average Number of Persons Per Census Household

	CSFR	Czech Republic	Slovak Republic
On December 1, 1970	2.96	2.79	3.37
On November 1, 1980	2.76	2.66	3.01
On March 3, 1991	2.65	2.54	2.88
In 2000 estimated		2.45	2.75

Thus, it can be seen that housing needs are growing more rapidly than the population.

Detached and Joint Census Households (000's)

	CSFR	Czech Republic	Slovak Republic
Total Number of Census Households:	5884	4052	1832
In a Separate Dwelling Unit:	4815 81.8%	3388 83.6%	1427 77.9%
Jointly with Another Census Household:	944 16.0%	598 14.8%	346 18.9%
Jointly with More than One Household:	112	58	54
Outside the Housing Stock	13	8	5

The number of census households choosing and wishing to co-habitate with other households in the same dwelling unit, known as joint-management households, is about 238,000 (4% of CSFR or 3.3% in Czech Republic and 5.7% in Slovakia).

The difference between the number of census households and the number of permanently inhabited dwelling units amounts to about 560,000, or about 346,000 in the Czech Republic and 214,000 in the Slovak Republic. The difference between this number, 560,000, and the total number of joint-management households, about 238,000, equals 322,000 and represents the present minimum unsatisfied housing demand. This takes into consideration neither inadequate housing conditions nor living area being experienced by present resident households.

The housing supply is further aggravated by the fact that, in a number of cases, the rightful users of dwelling units use them for temporary sub-leases to foreigners and tourists, and for trade or business operations.

Estimated Future Housing Demand (000's)

	Czech Republic	Slovakia
Est. Pop.in 2000:	10400	5500
Est. Increase of Census Households:	290	170
Est. Number of Dwellings Needing Replacement:	190-300	80-120
Current Unsatisfied Housing Demand:	210	110
Estimated total housing need (000's)	690-800	360-400

The present development of housing construction through 1991-1993, however, substantially fails to meet these housing needs. Taking into consideration the experience of its more developed neighbours, Germany and Austria, it will not be possible for either the Czech or Slovakian state to ensure adequate housing for the families of low-income groups (young couples, pensioners) without some form of state subsidy. A solution to this common problem will require a combination of market and governmental cooperation to produce social housing in accordance with local needs and conditions.

Uninhabited Dwellings

On March 3, 1991, a national census which included population and housing stock characteristics was carried out with the following results (000's):

Number of Inhabited and Uninhabited Dwellings

	CSFR	Czech Republic	Slovak Republic
Total number of flats	5,846	4,077	1,769
Permanently inhabited flats:	5,823	3,706	1,618
in one-family house	2,337	1,526	811
in blocks of flats	2,950	2,150	800
in other buildings	37	30	7
Uninhabited flats:	522	371	151
in one-family houses	393	270	123
in blocks of flats	122	95	27

The number of flats listed as uninhabited is considered high and temporary. Some reasons given for the number of uninhabited apartments include change of ownership, judicial proceedings, and reconstruction or modernization. However, the large number for uninhabited flats is never expected to be entirely eradicated as some 60% of those listed as uninhabited are flats not yet formally exempted from the housing stock inventory, such as recreation cottages, and flats considered unfit and intended for demolition.

Declining Rural Population

The continued trend toward urbanization in cities is resulting in an increase in the number of communities and regions in rural areas which are in decline or have lost their initial function. In these areas, part of or even the majority of buildings are now being used only for recreational purposes by the local population. This development is highlighted in the following figures demonstrating the decline of rural communities of up to 2000 inhabitants.

Permanently Inhabited Dwelling Units (000's)

	CSFR	Czech Republic	Slovak Republic
December 1, 1970	1735	1102	633
November 1, 1980	1563	943	620
March 3, 1991	1323	859	464

Data is unavailable for comparing separate rural communities due to boundary changes which have occurred between 1970 and 1991. Boundaries have fluctuated between communities either as a result of municipal amalgamations or the division of one community into two. Generally, there is a marked trend toward the loss of housing functions in rural areas. This trend will probably continue into the future, although at a slower rate.

Age of Housing Stock

There are significant differences between the Czech Republic and the Slovak Republic in the age of the housing stock. In the Czech Republic there is a higher proportion of older single-family homes located in the rural communities with the oldest apartment blocks located in urban centres such as Prague.

Distribution of Housing Stock by Age (%)

	pre-1919	1920-45	1946-70	1971-90
<u>CSFR</u>				
Single family houses	27	27	25	21
Blocks of flats	9	10	31	50
In rural communities	30	21	26	23
In urban communities	13	16	29	42
<u>Czech Republic</u>				
Single family houses	35	32	15	18
Blocks of flats	12	12	32	44
In rural communities	39	24	16	21
In urban communities	17	19	27	37
<u>of which: Prague</u>				
Single family houses	14	55	15	16
Blocks of flats	19	25	21	35
<u>Slovak Republic</u>				
Single family houses	13	17	44	26
Block of flats	2	3	31	64
In rural communities	14	15	45	26
In urban communities	4	8	35	53

Housing Construction Costs

Cost of Land

Until 1990, all land was considered State property². It was neither priced nor sold. However, it was lent for use to private persons for construction of single family homes or recreational facilities. This situation was changed by legislation in 1990 and 1991.

Presently, the pricing of land is governed by the Decree of the Ministry of Finance of the Czech Republic (and a similar Decree of the Ministry of Finance of the Slovak Republic No. 393/1991 CoL).

In comparison with land prices in Germany (Statistisches Jahrbuch, 1990), the rates are very low. The price of developable land is specified by the government as follows:

Distribution of Land Prices (Kcs per sq.m.)

1700	Prague - capital city.
800	Statutory cities, Františkovy Lázně (Franzabad) and Mariánské Lázně (Marienbad).
500	Český Krumlov, Jáchymov, Jeseník, Karviná, Luhačovice, Poděbrady and Teplice.
150	Communities with populations over 15,000.
100	Communities with populations over 5,000.
70	Communities with populations over 2,000.
20	Communities with populations less than 2,000.

These basic rates have been modified by a reduction of 30-60% in some cases where parts of towns or communities are not contiguous with the community proper or where an amalgamation with the community had occurred after January 1, 1965. Also introduced, has been a surcharge of 10% for connection to gas mains, 15-25% for land to be used for the construction of hotels, office buildings, department stores, exhibition facilities, and parking, and as much as 100% for land adjoining thoroughfares or squares in the city centre.

Government-set pricing of land is observed in most cases although market-driven land prices in Prague often escalate costs to about \$251 per sq.m.³ In other Czech and Slovakian cities, the

² Exceptions included land on which single family homes already existed, and minor gardens and orchards which were privately owned before 1948. However, this land could not have been sold or purchased separately, but only as supplementary value in the event of a purchase or sale of a building erected on that land.

³ An extreme case was recorded in Prague where land was sold at the rate of \$9,420 per sq.m.

actual market cost of land is also 3-4 times as high as the official price. In rural communities, the actual market price is usually 2-3 times the official set price.

General Construction Costs

Based on 1992 prices, with respect to housing construction performed by contracting firms (primarily using the panel system), the average price of a dwelling unit with 45 sq.m. of mean living area, not including external utilities, roads, landscaping and civic amenities, is about 330-350,000 Kčs. This represents specific costs of 7,500 Kčs per square metre of living area and 1100-1200 Kčs per cubic metre.

Cost Structure for Contracting Firms (%)

	CSFR	Czech Republic	Slovak Republic
Building Materials	38.1%	38.6%	40.0
Fuels and Energy	8.0	7.7	8.6
Depreciation of Fixed Assets	4.6	4.6	4.6
Wages/Labour Services	16.5	15.8	17.6
Financial Costs, & Overhead	29.2	29.8	28.3
Profit	2.6	3.5	0.9

With respect to single family homes completed in 1991, mean costs and technical parameters were as follows (* The mean ratio of dwelling units/home is 1.067):

Costs for Single Family Homes

Costs	Per House	Per Dwelling Unit
Total costs in (000's Kcs)	650-700	610-655
Average living area per dwelling (m ²)	-	79
Average volume (m ³)	674	630
Estimated avg. costs per m ² of living area (Kčs)	-	8000
Estimated avg. costs per m ³ (Kcs)	1000	-

Construction Wages

The labour component of production costs is influenced considerably by the generally low level of wages in the former CSFR and in the construction industry in particular. Until 1989, the average wage in construction had always been at least 10% higher than the national average wage, however, construction wages are now in line with general wages.

Mean monthly wages (000's Kcs)

	CSFR	Czech Republic	Slovak Republic
1990 Average wage, total	3.285	3.286	3.281
In construction 3.567	3.607	3.495	
Mutual ratio 1.086	1.098	1.065	
1991 Average wage, total	3.784	3.792	3.766
In construction 3.993	4.057	3.879	
Mutual ratio 1.055	1.070	1.030	
January - September 1992			
Average wage, total	4.382		
In construction 4.637	4.771	4.413	
Mutual ratio 1.058			

The low wages and the "cheap labour" in the former CSFR have their roots in the Communist price and wage policies that had been in place since the currency reform of 1953. These policies were based on the gradual reduction of consumer prices for basic necessities (in particular housing, water, energy, public transport, principal foodstuffs, etc.) to their very disappearance once "the communist society had been built".

The prices for these necessities were kept artificially low, and the increasing costs associated with goods and services were compensated by subsidies from the State budget or were disregarded. Consequently, a relatively low level of nominal wages⁴ was maintained which represented the economic equivalent of the price level for consumer consumption.

As a result of these policies, there are significant disproportions in the relation of prices of individual products and services with wages in the CSFR as compared with West European countries.

Credit Rates

Prior to 1989 interest rates for Government loans were about 5%. In 1990, interest rates marginally increased to an average of 6.16%. However, in 1991, interest rates for state enterprises⁵ increased to an average of 15.22%, while rates for private firms increased to an average of 16.96%. Interest rates are expected to continue to rise.

⁴ For example, increases in nominal wages in 1986/1970 were: CSFR 1.51, FRG 2.64, USA 2.67, Austria 3.67.

⁵ The differences are due to the different weight of short-term credits (mean rate of interest 16%) and long-term credits (11%).

Macroeconomic Conditions

The following are figures representing the macro-economic conditions for the Czech and Slovak region of Central Eastern Europe.

Gross Domestic Product (current prices, Kcs billions)

	1989 CSFR	Czech Republic	1990 Slovak Republic	CSFR
Generated GDP in market prices	758.7	526.4	232.3	811.3
Private consumption	368.0			415.9
Administrative and social structure consumption	163.5			165.7
Generation of gross fixed capital	210.2			244.8
Increment of stocks and reserves	9.2			18.6
Domestic use of GDP	741.7			826.4

Taking inflation into account, however, significantly alters these figures. Given a common price index, one can see that GDP is decreasing substantially.

Gross Domestic Product of the CSFR (price level of January 1 1984, Kcs billions):

1989	1990	1991	Index 91/90
730.0	727.0	611.4	0.841

In 1992 the GDP continued to drop in comparison with the averages of the individual quarters of 1989 (=100%) as follows:

1st quarter, 1992	78.6%
2nd quarter, 1992	77.8%
3rd quarter, 1992	73.5%

In comparison with 1989 quarter averages (=100%), the following declines occurred:

	Personal Consumption	Real Wages	Investments
1st quarter, 1992	70.7%	69.9%	52.1%
2nd quarter, 1992	74.4	75.5	69.8
3rd quarter, 1992	72.1	77.2	69.7

With the exception of the GDP figure for 1989, data for the Czech Republic and the Slovak is not available. A general idea can be provided by data on Gross National Income:

Gross National Income (Kčs billions)

	Current Prices			Price Index (100=1984)		
	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>
<u>CSFR</u>						
Generated GNI	699.5	752.8	923.5	669.3	662.0	561.8
Consumption of Popl'n.	340.1	380.0	386.6	321.3	331.00	223.5
Services	128.8	134.5	222.9	133.3	130.9	128.1
Accumulation fund, gross	210.2	244.8	261.5	214.3	228.3	159.6
Used GNI	679.1	759.3	871.1	668.9	690.2	511.2
Net export	13.5	-14.4	41.7	-5.2	-35.6	44.3
Losses	6.9	7.9	10.7	5.5	7.4	6.4
<u>Czech Republic</u>						
Generated GNI	485.3	529.8	652.1	469.2	467.3	386.9
Consumption of Popl'n.	231.9	259.7	261.5	219.1	226.2	158.1
Services	89.5	94.8	163.1	92.5	91.6	95.9
Accumulation fund, gross	140.5	163.3	169.4	143.6	149.6	103.1
Used GNI	461.9	517.8	594.0	455.2	467.4	357.0
Net export	21.9	5.7	48.6	13.5	-6.1	39.9
Losses	4.9	5.5	7.6	3.7	5.2	4.8
<u>Slovak Republic</u>						
Generated GNI	214.2	223.0	271.4	200.1	194.7	165.0
Consumption of Popl'n.	108.2	120.3	125.1	102.2	104.8	65.4
Services	39.4	39.8	59.9	40.7	39.3	32.3
Accumulation fund, gross	69.7	81.5	92.2	70.8	78.7	56.5
Used GNI	217.2	241.6	277.1	213.7	222.8	154.2
Net export	-8.4	-20.1	-6.9	-18.6	-29.5	4.4
Losses	2.1	2.4	3.1	1.8	2.2	1.6

Given the price index, with values based against constant 1984 values, the decline in GNI is clearly evident.

Decline in Industrial Production as compared with 1989 (%):

	CSFR		Czech Republic		Slovak Republic	
	1990	1991	1990	1991	1990	1991
Industry, Total	96.5	72.7	96.7	73.2	96.0	71.6
Fuels extraction and processing	93.3	88.2	92.8	88.6	97.7	81.9
Power industry	97.8	94.3	96.8	94.1	100.2	94.4
Ferrous metallurgy ⁶	99.2	77.3	97.9	73.1	102.6	89.2
Non-ferrous metallurgy	94.5	53.7	94.3	51.1	95.2	62.5
Chemical and rubber industries	91.3	70.5	92.9	71.5	89.1	69.1
Engineering industry	96.8	67.5	97.5	69.4	94.5	61.3
Electrical engineering Industry	92.7	56.5	91.8	56.2	94.5	57.2
Building materials	93.9	63.2	95.6	67.0	91.1	56.8
Woodworking industry	97.9	73.0	98.0	73.8	97.9	71.6
Paper and cellulose industry	100.9	82.2	101.2	80.9	100.3	84.3
Glass, ceramics, porcelain	101.2	75.0	99.8	72.5	108.0	88.1
Textile industry	100.4	64.9	100.3	65.2	100.6	63.9
Ready-made clothing	95.2	62.3	98.9	65.1	97.7	57.4
Leather-working industry	98.5	62.3	98.9	65.1	97.7	57.4
Printing industry	107.8	78.9	107.8	66.2	107.9	107.7
Foodstuffs industry	98.0	81.7	97.6	80.8	98.9	83.8
Others	101.7	81.5	102.7	88.1	100.0	71.1

⁶ Includes iron ore mining.

The decline in industrial production continued in 1992. In the first three quarters, industrial production dropped to 82.7% of its volume in the same period of 1991: 82.5% in the Czech Republic and 83% in the Slovak Republic.

In 1992, the largest annual declines in the Czech Republic were observed in the manufacture of wooden goods, down to 71.4% of previous volume, the manufacture of machines and instruments to 70.2%, electrical and optical instruments to 67.5% and transport down to 63.5% of volume. Slight increases in production volume took place only in coking and crude oil refining (100.9%).

Similarly, in the Slovak Republic, the greatest drop in production took place in the manufacture of machines and instruments to 61.6% of volume, electrical and optical instruments to 72.7%, and transport to 73.2%. No sector of the Slovakian production sector experienced any improvement.

Unemployment

The rate of unemployment reached its peak in January 1992 when it exceeded 7% (4.5% in the Czech Republic and over 12% in the Slovak Republic). Since that time, it has been dropping continuously to a little over 5% at the end of 1992 (2.6% in the Czech Republic and slightly over 10% in the Slovak Republic). A unique situation exists in Prague, where there were 20,000 jobs available as compared with 3,000 registered unemployed.

However, the rate of unemployment is expected to grow in the course of 1993. A number of enterprises presently undergoing privatization are retaining many employees simply out of speculation; there is much uncertainty with respect to what future stockholders (particularly those representing several dozen large privatization funds which have now acquired over 70% of the shares of privatization vouchers) will decide concerning changes to management, changes to production processes, and other similar structural modifications.

Once the shares of these newly privatized enterprises are handed over to their new owners in the second quarter of 1993, fundamental decisions will be made and it is likely that a number of present employees will be let go. Furthermore, the excessive number of people employed in the industrial sector as a whole is testified by the fact that the sector's productivity of labour, in 1991, was 15% lower than in 1989 and, in the third quarter of 1992, it dropped by another 5% as compared with the same period in 1991.

Inflation Rate

Until 1990, prices were mostly state-controlled. On January 1 1991, prices were liberalized, with the exception of necessary goods and services (particularly rents in communal flats, fuels, telecommunication and some transportation services) for which the government retained its control function.

Inflation accelerated as two devaluations of the Czechoslovak currency (Kčs) occurred in relation to "hard" currencies in the last quarter of 1991. Wage increases have lagged behind and consequently, a marked reduction in real wages has taken place. Differences in price index values between the Czech Republic and the Slovak Republic are negligible.

Some examples of price increases for the former CSFR are included in the following table:

Former CSFR Price Index Increases

	Base (Jan 1 1984=100)		Base (Jan 1 1989=100)	
	1989	1990	1991	Sept 1992
Total Consumer Prices	104.9	110.4	174.3	195.9
Foodstuffs	104.0	110.8	161.0	175.8
Industrial Products	104.5	111.1	191.3	212.1
Public Catering	114.6	110.1	172.9	189.3
Services	101.4	107.5	150.1	191.4
Total Industrial Prod'n:	101.0	103.3	175.5	192.6
Engineering Industry	91.5	100.9	168.7	204.0
Construction Works	97.8	106.4	157.6	172.9
Materials Used in Construction Works	103	101.9	166.8	179.3

Government Housing Policy and Regulations

The codification of the rights and obligations for capital construction is provided by Act No. 50 (1976) on Physical Planning and Building Codes, partly amended by Acts No. 103 (1990) and No. 262 (1992). These Acts concern the legal aspects of physical planning, authorization to design operations and construction operations, granting of planning permits and building permits and changes to, maintenance, approval and removal of buildings and structures and other activities.

It is supplemented with a number of implementation decrees, in particular the Decrees of the former State Commission for Scientific, Technical and Economic Development that concern:

- General technical requirements imposed on development,
- Physical planning data and physical planning documents,

- Planning procedure and building codes; certification of suitability of building materials,
- Construction design, and
- Authorization of persons for design operations.

The Decrees of the Federal Ministry of Economy, the Ministry of Industry of the Czech Republic and the Ministry of Development and Construction of the Slovak Republic concern the rules for awarding construction contracts.

In the course of construction project preparation and implementation, the following schedule is to be followed:

- Drafting of various types of physical planning documents for broader territorial units, for settlement formations (towns, committees) and detailed physical plans for parts of communities (zones, housing estates, residential districts),
- Brief (investor's document, defining the purpose of the project, its' principal parameters, conditions for the preparation and execution of construction and user's requirement),
- Planning decision of the Building Authority on the siting of the project,
- Design of the building or structure,
- Construction procedure and issue of the building permit,
- Conclusion of contracts with contractors concerning construction,
- Actual construction phase of the project,
- Documentation of the project "as built", and
- Approval and issuance of the occupancy permit by the Building Authority.

Some of these activities may be deleted or combined with others (e.g. the planning permit and the building permit).

The economic policy of the State in the field of housing in 1990-1992 was concerned primarily with the following problems:

- Restitution, i.e. return of blocks of flats to their previous owners who were forced by economic circumstances to hand over their property to the State. This was as a result

of previous taxation policy and low rents, which made it difficult to continue the operation and maintenance of privately owned property.

- Efforts to privatize blocks of flats owned by communities and partly by housing cooperatives (the transformation of state cooperatives into cooperatives consisting of owners); this process has not yet been fully clarified by necessary legislation, expected to be enacted in the near future.
- Protection of tenants of communal and private blocks of flats against unsubstantiated notices and against unauthorized rent increase.
- State subsidies promoting cooperative and individual construction of single family houses were abolished and the previously very low rates of interest of credits for cooperative and private housing construction were substantially raised.

Presently, government has no ideal model for the development and improvement of housing standards for construction or materials in either the Czech Republic or Slovak Republic. Further, there is a strong need to improve low housing standards and building codes in the Czech and Slovak Republics to levels comparable with Western countries.

CANADIAN AND MULTILATERAL ASSISTANCE

FEDERAL PROGRAMS

External Affairs and International Trade Canada (EAITC) is the main federal agency responsible for Canada's international trade and export development. Through its International Trade Centres, Sector Trade Divisions, Trade Commissioners and the former USSR and Eastern Europe Trade Division, the EAITC provides current information and assistance in identifying potential export markets, and in arranging participation in trade fairs and visits by foreign buyers. Canadian Embassies in CEE capitals all maintain commercial sections and administer Canadian aid programs. The EAITC also assists Canadian exporters interested in pursuing multilateral business opportunities and can provide information and advice on available Canadian government-funded assistance programs and any industry-related international shows or exhibitions being organized by the federal government. EAITC also financially supports Canadian technical assistance to the CEE region. For more information contact:

- Bureau of Assistance for Central and Eastern Europe
External Affairs and International Trade Canada
125 Sussex Drive
Ottawa, Ontario, K1A 0G2
Tel: (613) 992-7820
- Financial and Business Services Division
External Affairs and International Trade Canada
125 Sussex Drive
Ottawa, Ontario, K1A 0G2
Tel: (613) 996-2858

Renaissance Eastern Europe

Renaissance Eastern Europe (REE), a trade and industrial program, is intended to increase the involvement of Canadian companies in Eastern Europe and the former Soviet Union. The fundamental objective of REE is to increase Canadian trade with the region and create an awareness of Canadian private sector products and services. REE recognizes the inherent disadvantage Canadian companies have geographically compared with the traditional trading links enjoyed by European companies. REE also recognizes that the market is changing in the region and that there is a need for local models of successful private enterprises. Accordingly, certain business development costs associated with market penetration through new business cooperation arrangements are shared through this program.

Renaissance Eastern Europe is not meant to be a duplication of the Program for Export and Market Development (PEMD), but a supplement to the marketing support program. There must

be a commercial purpose to the cost-shared activities which themselves must have a demonstrated potential to increase future trade and provide industrial benefits for Canada. At the same time there must be illustratable benefits for the target market consistent with the development of a market economy and modernization of industry or agriculture.

Eligible markets include the new republics of the former Soviet Union, Poland, the Czech and Slovak Federal Republics, Hungary, Rumania, Bulgaria, Lithuania, Latvia, and Estonia. The region comprising the former Yugoslav republic is also eligible for funding, although UN sanctions placed on Serbia and Montenegro will limit investment into these republics. Due to the fluidity of events occurring in the region, current information on government policy would be best confirmed with External Affairs.

Projects for funding can be proposed by the Canadian private sector and can include venture-specific front end studies or enterprise-specific training. Government initiated projects include proposals to support newly established representative and viable bilateral business councils, increased business information programs and seminars, and incremental funding for trade fairs and missions programs. To qualify for support under Renaissance Eastern Europe the applicant must be an incorporated business, an independent firm of professionals such as architects or engineers, a private sector non-sales trade association, or profit-oriented Crown Corporation, Crown-owned company, provincial or municipal agency.

For more information about program eligibility and project possibilities contact :

Central and Eastern Europe Trade Development Division
External Affairs and International Trade Canada
125 Sussex Drive
Ottawa, Ontario, K1A 0G2
Tel: (613) 996-2858 / Fax (613) 995-1277

Program for Export Market Development

The Program for Export Market Development (PEMD) is made possible through External Affairs' Financial and Business and Services Division. The financial assistance to exporting firms available through the PEMD program for export market development is intended to aid in various types of promotional activities by sharing the cost of trade fairs, visits, creating marketing agreements, project bidding, and the establishment of permanent sales offices abroad. PEMD is intended to assist Canadian businesses which are export-ready and capable of undertaking sustained export activities. This necessitates that the potential exporter have both an established export program and sufficient capital needed for expanding their markets. Before preparing and submitting an application for consideration, applicants should ensure that adequate information has been obtained from the target market. It is recommended that a market plan be produced which demonstrates the potential need for the product.

As a service to Canadian businesses, the EAITC has created an InfoExport Centre offering suggestions on how to start exporting and advice on export programs and services. The Centre helps with questions on export problems, acts as a resource base for EAITC's trade information network and distributes copies of specialized export publications. For information on the services of InfoExport Centres, contact at Tel: 1-800-267-8376 or in the National Capital Region at Tel: (613) 995-7251.

The EAITC has also created a computer-based information service designed to help trade development officers abroad match foreign needs to Canadian capabilities, called the World Information Network for Exports (WIN Exports). For more information about registration in the data base, contact at Tel: (613) 996-5701.

Export Development Corporation

The Export Development Corporation (EDC) provides mixed credits (concessionary loans in addition to regular commercial EDC export credits) and foreign investment insurance to exporters. Direct loans are usually given to foreign buyers of Canadian export goods in the form of medium and short-term lines of credit. Credit notes may also be purchased payable to Canadian suppliers, effectively providing the exporter with cash sales. In addition, the program offers feasibility and engineering studies and project financing. The types of loans include general loans, multiple-disbursement-agreement loans, lines of credit and note-purchase agreements, and note-purchase agreements and specialized credits.

The EDC also offers export insurance to protect Canadian exporters from nonpayment for the sale of licensing of patents, trade marks and copyrights, leasing contracts, advertising, and consulting and management fees. Losses are covered up to 90% from specified commercial and political risks. Comprehensive global insurance is available to protect exporters against most causes beyond the control of either the buyer or exporter including:

- Nonpayment due to insolvency or default of the foreign buyer,
- Repudiation,
- Additional handling charges resulting from the interruption or diversion of voyage outside of North America,
- Blockage of funds or transfer difficulties,
- Cancellation or non-renewal of import or export permits,
- War or revolution in the buyer's country, and
- War between Canada and the buyer's country.

The EDC bases its loans on the Corporate Account and the Canada Account. The Corporate Account receives its funds from international capital markets from which it re-lends the money to Canadian firms wishing to export. The Canada Account is intended to provide capital to assist in the export of goods and services supplied by Canadian firms. The loans are applied for through the national bank of the recipient country and the request is forwarded through to the

EDC. Once the loan has been accepted, the contract tendered, and the goods or services supplied, the Canadian firm is paid through the EDC accounts. The capital never actually leaves Canada. For more information contact:

- Export Development Corporation
151 O'Connor Street
Ottawa, Ontario, K1A 1K3
Tel: (613) 598-2500

Federal Business Development Bank

The Federal Business Development Bank (FBDB) promotes the creation and development of small and medium size businesses in Canada through the provision of a range of flexible financial and management services to their owners. For those firms considering expanding their business through exports, the FBDB offers a range of financial services including loans and loan guarantees, acquisition of fixed assets and the purchase of existing businesses. Working capital loans can be granted to assist in the finance of increasing services. To assist in the cash flow situation of the exporting firm, the FBDB can guarantee financial institutions the export receivables of these firms. On a management level, the FBDB can offer strategic planning, financial planning and counselling services that can assist exporters with their projects.

The Federal Business Development Bank is based in Montreal but has a network of offices across Canada. For more information contact:

- Federal Business Development Bank
800 Victoria Square
Montreal, Quebec, H4Z 1L4
Tel: (514) 283-5904

The FBDB also administers Counselling Assistance to Small Enterprises Program. For more information contact:

- Counselling Assistance to Small Enterprises Program
280 Albert Street, 3rd Floor
Ottawa, Ontario, K1P 5G8
Tel: (613) 995-5068

Canadian Commercial Corporation

The Canadian Commercial Corporation (CCC) acts as an intermediary between Canadian businesses and foreign governments and international agencies. Typically this includes the preparation of contracts for both sides and can include defense goods as well as commercial

transactions. The government to government contracting ability of the CCC allows it to simplify export procedures and formalities, particularly for smaller Canadian firms. The CCC's support can also enhance the credibility of those less well known to potential client governments and international agencies outside of Canada. For more information contact:

- Canadian Commercial Corporation
50 O'Connor Street, 11th Floor
Ottawa, Ontario, K1A 0S6
Tel: (613) 996-0034

Provincial Trade Centres

External Affairs and International Trade Canada and Industry, Science and Technology Canada have established International Trade Centres in all provinces to assist first-time and experienced Canadian exporters by providing export publications, recruiting participants for trade fairs and missions and providing a range of services to companies seeking export counselling, technology transfer or joint ventures with foreign investors. This network of offices is summarized below:

- Newfoundland - 215 Water Street, Suite 504
St. John's, Newfoundland, A1B 3R9
Tel: (709) 772-5511 / Fax: (709) 2373
- PEI - 134 Kent Street, Suite 400
Charlottetown, PEI, C1A 7M8
Tel: (902) 566-7400 / Fax: (902) 566-7450
- Nova Scotia - 1801 Hollis Street
Halifax, NS, B3J 2V9
Tel: (902) 426-7540 / Fax: (902) 426-2624
- New Brunswick - 770 Main Street
Moncton, NB, E1C 8P9
Tel: (506) 851-6452 / Fax: (605) 851-6429
- Quebec - 800 Victoria Square, Suite 3800
Montreal, PQ, H4Z 1E8
Tel: (514) 283-8185 / Fax: (514) 283-8794
- Ontario - One Front Street, 4th Floor
Toronto, Ontario, M5J 1A4
Tel: (416) 973-5053 / Fax: (416) 973- 8161

- **Manitoba -** 330 Portage Avenue, 8th Floor
Winnipeg, Manitoba, R3C 2V2
Tel: (204) 983- 4099 / Fax: (204) 983-2187
- **Saskatchewan -** 1955 Smith Street, 4th Floor
Regina, Sask., S4P 2N8
Tel: (306) 780-5020 / Fax: (306) 780-6679
- **Alberta -** 9700 Jasper Place, Room 540
Edmonton, Alberta, T5J 4C3
Tel: (403) 495-2944 / Fax: (403) 495- 4507
- **British Columbia -** 900 - 650 West Georgia Street
Vancouver, BC, V6B 5H8
Tel: (604) 666-0434 / Fax: (604) 666-8330

PROVINCIAL AND TERRITORIAL PROGRAMS

Each province or territory provides a package of financial and non-financial incentives which complement, and in some cases duplicate, those offered by the federal government. In some cases, the provincial incentive programs are underwritten in part by federal government funds through General Development Agreements. Provincial governments support the international commercial endeavours of resident enterprises to a greater or lesser degree and Alberta, Ontario and Quebec are particularly active in this regard in the CEE region.

The federal and provincial governments have a system of communication to prevent the practise of "grant stacking". Grant stacking occurs when similar assistance is received on the same project from a variety of government sources. While the general policy is not to allow grant stacking, it is nevertheless permitted in some circumstances, particularly with high technology cost-sharing programs. The possibility of acquiring both federal and provincial assistance should be examined.

Alberta Economic Development and Trade Expansion

Available services and support programs cover most operational and financial aspects of business operation including management, research, and financial support for business expansion. Support for business planning in exporting to international markets is available through a variety assistance efforts. The first is through its network of offices and contacts abroad, its trained personnel, and activities organized for Alberta businesses. For more information contact:

- Alberta Economic Development and Trade Expansion
Business Finance Department
9940 - 106th Street, 7th Floor
Edmonton, Alberta, T5K 2P6
Tel: (403) 427-3300
- Federal and Intergovernmental Affairs
International Division
2200 - 10025 Jasper Avenue
Edmonton, Alberta, T5J 1S6
Tel: (403) 427-6543

Alberta Economic Development and Trade Expansion provides the following programs for resident firms:

- *Alberta Export Services Support Program* - Encourages the pursuit of projects outside of Alberta by covering up to 50% funding to a maximum of \$150,000 per project.
- *Alberta Loan Guarantee Program* - Assists Alberta-based manufacturers and processors in obtaining export sales by guarantees of loans up to a maximum of \$5 million.
- *Market Development Assistance Program* - Supports expansion into new export markets by providing financial assistance for making trips, trade show participation and similar activities.
- *Market Feasibility Studies* - Alberta Economic Development and Trade helps entrepreneurs to undertake market feasibility studies for up to 50% of the costs or a maximum of \$5,000.

Alberta International Marketing Program

The program is intended to promote the development of export marketing operations and provides graduates with an opportunity to gain work experience. The program is organized by Alberta Career Development and Employment for unemployed post-secondary graduates. The program will reimburse wages on a 50/50 cost basis on a set maximum.

British Columbia Ministry of Regional and Economic Development

Services and support programs encourage the development of business in BC and include programs to encourage investment and expansion of activities. Assistance to firms interested in exporting abroad can utilize the province's network of offices and contacts abroad, its trained personnel, and activities organized for BC businesses. For further information contact the British Columbia Development Corporation, in Vancouver at Tel: (604) 844-1900 or, if in British Columbia, toll-free at 1-800-972-2255.

New Market Development Program - Assistance includes the cost-sharing of trade shows, market investigations and similar activities for firms resident in British Columbia. Assistance is only granted once a year per applicant.

Manitoba Industry, Trade, and Tourism -- Industry and Trade Division

Manitoba Industry, Trade, and Tourism -- Industry and Trade Division -- provides financial assistance to aid in the expansion of existing Manitoba businesses. Assistance to firms includes negotiated cost sharing for feasibility studies and development assistance in the form of loans, guarantees, equity and similar financial aids. Manitoba firms interested in exporting abroad can also utilize the province's foreign network of offices and contacts and its trained personnel and programs. For more information contact the Manitoba Trade Branch for International and Domestic Trade, at Tel: (204) 945-3172 / Fax: (204) 957-1793.

Manitoba Financial Programs - These programs aid Manitoba businesses by providing activities such as consulting, cost-shared feasibility studies, seminars, publications, and financial assistance. The programs are organized by the Department of Business and Tourism.

New Brunswick Department of Commerce and Technology

The New Brunswick Department of Commerce and Technology encourages the establishment or development of manufacturing or processing industries. Support is given through direct loans, loan guarantees, or acquisition of shares. Firms interested in expanding to exporting abroad can also utilize the province's network of offices and contacts abroad, its trained personnel, and activities organized for New Brunswick businesses. For more information, contact the Financial Programs Division in Fredericton at Tel: (506) 453-2474.

Newfoundland and Labrador Development Corporation

The Department of Development and Tourism administers the *Newfoundland Market and Production Development Program*. This program provides marketing and product development assistance for companies planning to market goods and services outside the province. Financial

assistance is available for up to 50% of eligible project costs to a maximum of \$50,000. For more information, contact the Department of Development and Tourism in St. John's at Tel: (709) 596-3184.

Nova Scotia Small Business Development Corporation

Assists small business in Nova Scotia through the provision of loans from \$5,000 to \$250,000 at fixed interest rates.

Ontario Ministry of Industry, Trade and Technology

The Ontario Ministry of Industry, Trade and Technology (MITT) conducts a variety of programs to assist small and medium-sized companies by reducing the risk level and information costs associated with exporting and investing overseas. MITT supports both group and solo trade missions, assists firms with participation in foreign trade shows and helps host incoming buyers. For more information contact:

- Ontario Ministry of Industry, Trade and Technology
Hearst Block, 900 Bay Street
Toronto, Ontario, M7A 2E1
Tel: (416) 325-6666

Trade Expansion Fund - The Trade Expansion Fund, which is administered by the Trade and Investment support branch of MITT's Industry and Trade Expansion Division, is intended to support marketing activities not normally covered under other export assistance programs. The Fund supports the creation of new markets in developing countries by providing matching grants for six different export marketing activities:

- Market research and export planning.
- On-site assessments.
- Product modification and package design.
- Merchandising and promotion.
- Export manager for hire program.
- First time participation in a trade show or exhibition outside of Northern Ontario.

Ontario International Corporation

The Ontario International Corporation (OIC) markets Ontario's private and public sector expertise in business, professional, and capital project services in the international arena. It deals with a broad range of established contacts including governments and ministries, private

sector promoters of international capital projects, UN agencies, the World Bank and similar development institutions.

The OIC also administers the International Projects Fund (IPF) which is a financial assistance program designed to assist Ontario firms and organizations to enter foreign markets and secure international contracts. The IPF provides loans to help Ontario firms market their services more effectively as well as pursue specific international projects. IPF loans are granted on a shared basis against the set costs of pursuing an identifiable international project and are repayable if the contract for the project is obtained. For more information contact:

Ontario International Corporation
56 Wellesley Street West, 7th Floor
Toronto, Ontario, M7A 2E4
Tel: (416) 314-8200 / Fax: (416) 314-8222.

Prince Edward Island Department of Industry

The Prince Edward Island Department of Industry's main purpose is to create or maintain employment in the province for companies in manufacturing and process servicing sectors through various incentives. Major programs include small business assistance through research and management services and industrial services and infrastructure support programs.

Prince Edward Island Development Agency

The purpose of the Prince Edward Island Development Agency is to stimulate economic growth for PEI companies through grants, tax rebates on share purchases, and loans. For more information contact the PEI Development Agency in Charlottetown at Tel: (902) 454-6800 / Fax: (902) 566-4030.

Quebec Industrial Development Corporation / Societe De Developpement Industrial

The Quebec Industrial Development Corporation (QIDC) is the principal body authorized to grant financial assistance to businesses wishing to locate in Quebec or expand their facilities. Export development is one of the five areas defined by the QIDC assistance program to facilitate business expansion in Quebec. The QIDC also assists business with all aspects of their investment projects. For more information contact:

Quebec Industrial Development Corporation
770 Sherbrooke West, 9th Floor
Montreal, Quebec, H3A 1G1
Tel: (514) 873-4375

Ministere des Affaires Internationales

The Ministère des Affaires Internationales (MAI) offers two types of assistance for Quebec business interested in expanding abroad. The first is through its network of offices and contacts abroad, its trained personnel, and its' organized activities. Secondly, the MAI also assists with most international legal, technical, investment, and information-based aspects of business operations. For more information contact:

- Ministry of International Affairs
5020 St. Antoine West
Montreal, Quebec, H2Y 3X7
Tel: (514) 499-2171

Aide a la Promotion des Exportations

The Aide a la Promotion des Exportations (APEX) program offers Quebec business a range of financial programs, including the following:

- Individual missions and exhibitions, per project (\$8,000 and \$10,000).
- Consultants' fees for studies and strategies, per project (50% of cost to \$15,000).
- Market adaptation relating to expenses incurred in translation and adoption of technical and promotional material, per project up to \$20,000.
- Consultants' fees for tender preparation for a foreign market, per project (50% of cost to \$15,000).
- Salary for marketing expert for international marketing efforts, (50% of salary for two years to \$50,000).

For more information contact Ministère des Affaires Internationales, Programme Apex, in Montreal at Tel: (514) 449-2171.

Saskatchewan Economic Development Corporation

Saskatchewan Economic Development Corporation supplies financial assistance for the establishment or expansion of industrial enterprises in the province. Mortgage loans and working capital loans, loan guarantees, leasing and equity are available to primarily industrial enterprises engaged in manufacturing and processing. For more information, contact the Saskatchewan Economic Development Corporation in Regina at Tel: (306) 787-7200 / Fax (306) 787-7297 or in Saskatoon at Tel: (306) 933-6296 / Fax: (306) 933-8200.

Saskatchewan Department of Trade and Investment

The purpose of the Saskatchewan Department of Trade and Investment is to attract investment into the province and increase the sale and export of products made in the province. The Department runs assistance through several different programs to Saskatchewan firms. *The Export Marketing Assistance Program* assists firms attempting to establish international exports, or experienced exporters attempting to penetrate new export markets or market a new product. Assistance comes in the form of shared costs for high cost immediate trade promotional costs. The Saskatchewan Department of Trade and Investment can be contacted in Regina at Tel: (306) 787-0904 / Fax: (306) 787-2198.

Northwest Territories Department of Economic Development and Tourism

The purpose of the Northwest Territories Department of Economic Development and Tourism is to help finance any type of new business or business expansion for existing businesses in the Northwest Territories. The assistance is available in the form of loans and guarantees with programs similar to that provided by the Federal Business Development Bank. For more information contact the Business Services Division, Department of Economic Development and Tourism in Yellowknife at Tel: (403) 873-7388.

Yukon Loan Assistance Program and Business Development Fund

The Loan Assistance Program provides loan guarantees for business that could not proceed without government support. *The Business Development Fund* encourages the creation and growth of small business with loans up to \$500,000 for firms with less than \$5 million gross revenue and fewer than 100 employees. For more information contact Yukon Economic Development and Tourism in Whitehorse at Tel: (403) 667-5811.

MUNICIPAL PROGRAMS

To help increase awareness of international opportunities and also help expand the potential trade area of their local businesses, municipalities will often engage in a twinning relationship with a foreign city of similar size, economic background, historic ties, etc. The following Canadian cities are listed by the Federation of Canadian Municipalities as having twinning agreements with CEE cities:

Courtney, British Columbia
Brantford, Ontario
East York, Ontario
Inuvik, NWT
Kingston, Ontario

Rovinj, Croatia
Osijek, Croatia
Skopje, Macedonia
Kola, Russia
Yaroslaval, Russia

North York, Ontario
Thompson, Manitoba
Toronto, Ontario
Vancouver, British Columbia
Windsor, Ontario
Winnipeg, Manitoba

Warsaw, Poland
Aldan, Russia
Kiev, Ukraine & Warsaw, Poland
Odessa, Ukraine
Ohrid, Macedonia
Kiev/L'vov, Ukraine & Torun, Poland

With the exception of international twinning, the municipal involvement is limited to the individual needs of the municipality. Municipal assistance to businesses expanding abroad is usually information-based and conducted through the municipality's economic development office in co-operation with the local Board of Trade or Business Association. A few pro-active municipalities have "Strategic Alliance" programs that actively help promote local firms globally. These municipalities are adopting the role of facilitator for creating alliances by actively seeking interested international partners in target sectors.

CANADIAN NON-GOVERNMENT ORGANIZATIONS

A number of Canadian NGOs and trade associations are currently working with decision-makers in the CEE region. The contacts that have been established by the following organizations are potentially useful and worth exploring:

- Canadian Bureau of International Education
- Canadian Executive Service Organization
- Canadian Urban Institute
- Federation of Canadian Municipalities
- Canadian-CEE Chambers of Commerce

Various Canadian firms are currently conducting business in the CEE region and they are often willing to share information. Information on these firms can be secured through housing industry associations including:

- Canadian Home Builders' Association
150 Laurier Avenue West
Suite 200
Ottawa, Ontario, K1P 5J4
Tel: (613) 230-3060; Fax: (613) 232-8214
- Canadian Real Estate Association
320 Queen Street
Place de Ville, Tower A
Ottawa, Ontario, K1R 5A3
Tel: (613) 234-3372; Fax: (613) 234-2567

- Canadian Manufactured Housing Institute
150 Laurier Avenue West
Suite 200
Ottawa, Ontario, K1P 5J4
Tel: (613) 563-3520; Fax: (613) 232-4635
- Canadian Housing and Renewal Association
251 Laurier Avenue West
Suite 304
Ottawa, Ontario, K1P 5J6
Tel: (613) 594-3007; Fax: (613) 594- 9596
- Urban Development Institute of Canada
c/o 2015 Peel Street
Montreal, Quebec, H3A 1C8
Tel: (514) 843-3625; Fax: (514) 843-6795

MULTILATERAL ASSISTANCE SOURCES AND RELATED AGENCIES

Between 1991-1995, more than 80% of the aid committed to Eastern Europe will come from multilateral agencies. The multilateral agencies provide funds for the sale of goods and services as well as provide investment capital for companies wishing to establish joint ventures and start new businesses in the CEE region. These funds, representing a significant source of potential capital for Canadian companies, are currently difficult to obtain. The procurement process for these funds is very competitive and bids are internationally tendered to a wide number of firms.

The World Bank Group

The World Bank is the largest aid agency in the world. Disbursement of funds for Eastern Europe is expected to grow to over \$2 billion per annum. Of the \$7.5 billion committed to Eastern Europe for a three year period which ended in mid-1992, most of the contracts were tendered by international competitive bidding and characterized by fierce competition. Further, OECD-based companies are being challenged by Third World firms, whose costs are lower, for contracts.

Based on a World Bank source, the Economist Intelligence Unit suggests the Bank's Strategy for Eastern Europe has five elements:

- Aid for reforms through Structural Adjustment Loans (SAL) for financial sector development, enterprise restructuring, and provision of a social safety net.
- Specific operations such as investment in agricultural reform and modernization.

- Investment for infrastructure such as telecommunications, roads, and railways,
- Lending for environmental remediation and protection.
- Mitigate worst social effects of reform while fostering social policy frameworks such as health care, pensions, and education.

The Economist Intelligence Unit lists World Bank consulting contracts as often including:

- Feasibility studies,
- Design and supervision of capital projects,
- Provision of technical assistance,
- Assessment of economic sector/program requirements,
- Development and improvement of government administrative and accounting procedures, and
- Evaluation of completed projects.

The World Bank Group consists of two agencies and a third affiliated operation:

- International Bank for Reconstruction and Development (IBRD),
- International Development Association (IDA), and
- International Finance Corp (IFC).

IBRD and IDA loans produce three types of contracts: goods, public works and consulting. The IDA provides highly concessionary loans to the poorest developing countries and will not likely become involved in Eastern Europe. The IBRD also provides loans but on more stringent credit terms than the IDA although less strict than commercial lenders. The IBRD has accounted for about three quarters of the World Bank's spending.

The IFC supports and provides financing for private investment and lends directly to the private sector entering Eastern Europe without the use of government guarantees. The IFC also assists in the development of local capital markets, provides financial and technical services to business and advises governments on investment incentives and privatization.

For more information, contact the World Bank in Washington D.C. at Tel: (202) 473-2675 / Fax: (202) 473-5455. Nation-specific inquiries can be made to individual country officers.

European Community

The European Community (EC) is the largest donor of grant aid to Eastern Europe. The EC program of aid to the region began in 1990 with an allocation to Hungary and Poland of 300 million Ecu; the program was entitled the Polish and Hungarian Assistance for Economic Reconstruction (PHARE). The original allocation was raised to 500 million Ecu and expanded to include the former East Germany, Czechoslovakia, Yugoslavia, and Bulgaria.

The PHARE Program is governed by a principle which restricts non-EC firms from entering the tendering competition unless the company has a subsidiary operating within the EC. The principle states that "participation in invitations to tender and contracts shall be open on equal terms to all natural persons and companies from Community and East European states."

The European Investment Bank (EIB) is an independent development bank established by the EC to finance capital investment projects both within and outside the EC. Most of the funds are raised on capital markets and then lent out at just above cost on a non-profit basis. The EIB is now involved throughout the East European region and is the third largest provider of development finance following the World Bank and the PHARE program.

The EIB offers loans for specific projects which will produce a financial return and as such excludes social infrastructure projects such as health or general education. Although EIB-supported projects offer some contract opportunities for contractors and consultants, it is the suppliers of capital goods who have the most to gain from its project financing in Eastern Europe. EIB industrial projects usually have a life span of 10-12 years and up to 15 years for infrastructure projects. Following the competitive procurement ground rules set by the EC, participation in the EIB tendering process also generally requires that the competitive bidder be an EC or East-European based firm. To tap the EIB "global" loans, companies are recommended to make contact with firms and banks in Eastern Europe that are making purchasing and financing decisions.

European Bank for Reconstruction and Development

The European Bank for Reconstruction and Development (EBRD) is a combination of a public-sector development bank and a traditional private-sector merchant bank. It has no precedent within the community of international financing institutions. The EBRD, created in May 1990, was established on the principle that it would support the transition to market-based economies in Eastern Europe and promote private-sector development in the region. The EBRD also sets out explicit political conditions to its lending activities that stipulate the borrowing country maintain a commitment to "multiparty democracy, pluralism, and market economics". Lending is also committed to promoting sustainable development and environmentally sound activities.

The loans (a minimum of 5 million Ecu) will be focused initially on seven broad areas of activity including infrastructure development, privatisation, financial sector reform, promotion of new business, industrial restructuring, foreign investment promotion and environmental protection. A large portion of funds will initially be channelled to performing technical aid in recipient countries. The EBRD has dedicated the largest portion of the development budget for infrastructure-related operations. Eight priority sectors have been identified for infrastructure-related operations including the creation of lending institutions for the housing sector; investment strategies to improve energy efficiency, trade, production and environmental conservation; and municipal management training and technical assistance to overhaul regulations and financial services. Since Canada is a contributing member to the EBRD, Canadian businesses are eligible for any tenders procured by the bank as well as to submit funding proposals.

For more information contact the G-24 Coordination Unit in the EC headquarters in Brussels, at Tel: (32.2) 235-9862 / Fax: (32.2) 236-4251. The PHARE operational service can be contacted in Brussels, at Tel: (32.2) 235-1110 or (32.2) 235-6634. The Brussels-based Canadian representative to the G-24 can be contacted at Tel: (32.2) 735-9126 / Fax: (32.2) 735-3383.

United Nations

There are a number of agencies in the United Nations which play a significant role in delivering technical assistance and specialized expertise to the countries of the developing world. However, in Eastern Europe, the UN has not yet been able to fulfil its potential as it suffers from a shortage in funding and is hampered by government bureaucracy. Nonetheless, some opportunities exist through the United Nations Development Program (UNDP) and the United Nations Industrial Development Organization (UNIDO).

The United Nations Development Program (UNDP) is the largest provider of technical assistance in the UN system. At the present time it is leading UN activities in the CEE region and is in the process of developing country-specific programs for each East European state. For more information contact the UNDP in New York at Tel: (212) 906-5471.

The United Nations Industrial Development Organization (UNIDO) is responsible for the coordination of all industrial activities in the UN system and specializes in the provision of technical assistance and investment promotion services. The UNDP is the main source of funding for UNIDO, providing 70% of its East European budget. There are some limited contract opportunities offered by UNIDO for consultants and suppliers of industrial goods. For more information contact UNIDO in Vienna at Tel: (43.1) 237-401.

APPENDIX: METHODOLOGY AND CONTRIBUTORS

INTRODUCTION

The study was conducted between September 1992 and March 1993. Most of the information and data was collected through primary research, such as interviews and fact-finding missions.

The research approach was determined by the following factors:

- There is lack of verifiable statistical data.
- Market conditions are in a state of uncertain evolution.
- The socio-economic and political situations are unique and complex.
- There is a lack of Western experience in the housing sectors of the CEE.

As a consequence, a substantial portion of this report is derived from empirical research. Reports were written by and interviews were conducted with prominent Canadian and Eastern European professionals involved in various capacities in the CEE's housing sectors.

This research approach has created a study which is hoped to be:

- Useable by the Canadian housing industry in its broadest sense.
- Provide the Canadian housing industry with *specific and practical* information with respect to market feasibility and risk assessment.

OBJECTIVES

The objectives of this report were to produce a document which would:

- Describe and analyze the structure and requirements of the housing sectors in the CEE region.
- Examine the feasibility of Canadian involvement in the housing sectors of the CEE region.
- Provide practical information to the Canadian housing industry on how to enter the CEE markets.

SCOPE OF WORK

The scope of work for the study included:

- (i) ***The Canadian Housing Industry*** - Analysis of the Canadian housing industry and its current involvement in Central and Eastern Europe.
- (ii) ***Central and Eastern Europe's Market Requirements*** - Description of the essential features and functioning of the housing sectors in the CEE region as well as an analysis and forecast of housing demand/needs and supply in selected CEE countries.
- (iii) ***Opportunities and Recommendations*** - Identification of potential export opportunities for Canadian firms as well as recommendations which will help Canadian organizations determine the feasibility of entering the CEE markets.
- (iv) ***Canadian and Multilateral Programs Facilitating Investment and Trade in the CEE Region*** - Identification of resources that can assist Canadian organizations to enter the CEE markets.

CONTRIBUTORS

This study was researched, compiled, and written by a core group of four Canadian Urban Institute staff members.

- **Dr. Tibor Frank**, European Programs Director, was the principal investigator and leading force in providing direction for the study.
- **Greg Kasting**, European Programs Coordinator, coordinated the logistics of resource and data collection activities and writing of the report.
- **Mark Piorkowski**, Project Coordinator, assisted in researching and the writing of the report.
- **Paul Csagoly**, Project Coordinator, assisted in writing and editing of the report.

Written contributions were elicited from the following private consultants:

- **Judith Egressy**, Commercial Director for Komplex Trading, a Hungarian firm that is being privatized and has enter into a joint venture with Abitibi-Price, wrote a report on the potential opportunities for Canadian building materials in Hungary.
- **Lilka Elbaum**, Principal of Strategic Decisions Associates and former Principal

& Director Eastern Europe, Ernst & Young Management Consultants, wrote a report that detailed the current and forecast the future situation of the Polish housing industry.

• **Stefan Gramelwicz**, Engineer, wrote a report on the opportunities and barriers for the introduction of Canadian building materials and technologies into Poland¹.

• **Colin Hefferon**, Vice-President of Masthead International Properties, toured Poland and Hungary for a period of two weeks to assess the market and to identify opportunities for the Canadian building industry. He travelled with Gordon Thompson.

• **Gordon Thompson**, President of CANDEV Building Corporation and former President of the Canadian Home Builders Association, toured Poland and Hungary for a period of two weeks to assess the market and to identify opportunities for the Canadian building industry. He travelled with Colin Hefferon.

• **A.B. Information and Marketing Bureau of Construction**, a Hungarian Real Estate Marketing and Professional Services firm, wrote a report on the housing situation in Hungary.

• **Trema gestion conseil inc.**, Management Consultants, provided resources and reports on the strengths of the Canadian housing industry and government assistance programs.

• **USI Praha/Czech Building Information Institute**, wrote a report on the current housing situation in the Czech Republic & Slovakia.

INTERVIEWEES

Interviews were conducted with the following people:

Canadian Interviewees:

Joe Augé, Ferguson, Simek, Clark, Groves, & Manasc - Designed a prefabricated village (housing, school, fire hall...) for Yakutsk, Siberia.

ATCO Enterprises Limited - Supplying workcamps for oil fields in Russia and establishing a factory in Hungary. Interviews were conducted with:

¹ Mr. Gramelwicz travelled twice to Poland on CESO missions to determine the feasibility of incorporating North American building technologies into Polish construction methods. He travelled a third time to Poland to attend a major construction trade show.

- Walter Kmet, Vice-President, Business Development, and
- Gordon Weiland, Senior Sales Representative.

Marian Bielec, Groupe Capital. Owner of a Canadian firm building homes in Poland.

Lon Brisco, Travco Industrial Housing Limited. Sent Canadian built modular homes to Arctic camps in Russia.

Stefan Gramlewicz, engineer - Spent two CESO missions in Poland initiating the transfer of Canadian construction materials technology.

Bruce Kippen, President of CanAm Poland Housing Corporation.

John Lindsay, President of Purdy's Wharf Development - Investigating the building of diplomatic housing and renovation of apartments in the Baltics Region.

Medhurst, Hogg and Sobottka - Establishing factory for the production of pre-fab homes in East Germany. Interviews were conducted with:

- David Medhurst, President,
- Michael Azlen, Vice-President Finance,
- John Sobottka, Senior Vice-President and Technical Director, and
- Sheldon Duff, Investment Banker.

Jim McKellar, Director of Program in Real Property Development, Faculty of Administrative Studies, York University.

Andre Molnar, President of Molnar Developments and honourary Hungarian Consulate.

Frank Parzych, Commercial Officer - Canadian Embassy in Warsaw.

John Ratzcy, President of Parkside Holdings - Mobile home builder.

Tom Schwartz, President of IntraUrban Projects.

Sefri Construction International Limited. Developing commercial property in Hungary. Interviews were conducted with:

- George Vari, President,
- Paul Baross, Hungarian Project Manager, and
- Steven Hasko.

American Interviewees:

Burton Goldberg, Economic and Policy Analysis Division, National Association of Home Builders' Research Institute.

Miles Haber, Real Estate & Construction Consultant, working in Poland for National Association of Home Builders' Research Institute.

Hank Henward, PADCO, Privatization specialist.

Steven Lewis, Executive Director, American Polish Home Builders Institute.

David Lucas, a U.S. builder. Owner of a company has the Polish rights to a building technology owned by TRONCO also of the U.S.

Steve Mayo, World Bank, Director of Housing Indicators Program for Eastern Europe.

Mike McIntyre, Vice-President, American Home Builders Institute.

Al Van Huyck, Executive Vice-President, Eastern European Real Property Foundation. A Division within National Association of Realtors.

Sarah Wines, Director of Regional Housing and Urban Development Office for Eastern Europe, U.S. Agency for International Development.

Polish Interviewees:

Budimex Engineering & Construction H.O. Warsaw - Budimex is the largest construction company in Poland and is in the process of being privatized. Interviews were conducted with:

- Stefan Bekir Assanowicz, Executive Director of Marketing and Development,
- Grzegorz W. Paprotny, Promotion Development and Commercial Division, and
- Pawel Warzocha, Commercial Expert.

Government of Poland and World Bank Housing Finance Project. Interviews were conducted with:

- Irena Stocka, Project Manager,
- Edward Kozlowski, Housing Specialist & Office Manager, and
- Jacek Taszek, Financial Advisor.

Mayor Jozef Grzegorzczak, City of Olsztyn.

Henryk Hajduk, Housing Research Institute.

Krzysztof Herbut, Deputy Director Capital Privatization Department, Ministry of Privatization.

Tadeusz Mackowiak, Owner of M.T. Team Corporation Ltd. A private building firm.

Andrzej Starkiewicz, Owner of a private land development and building company.

Andrzej Stryjewski, Director, Budimex Engineering & Construction (a state owned company).

Mayor Jerzy Tytz, Town of Olsztynek.

Hungarian Interviewees:

A.B. Information and Marketing Bureau of Construction. Interviews were conducted with:

- Miklos Francsics, Construction Industry Specialist,
- Varga Denes, and
- Klara Fekete.

Janos Berenyi, Elso Magyar. Owner of a private building firm.

Rosemary Bointon - McKenna & Co. Solicitors, senior partner of the Budapest office. She handles a lot of real estate companies being set up by foreign investors.

Pal Cseh - Senior Ministerial Counsellor, Hungarian Ministry of Finance. His position is that of the equivalent to our Minister of Housing.

Judith Egressy - Director of Komplex and Hungarian representative for Abitibi-Price.

Dr. Janos Gyurko - Minister for the Environment and Regional Policy.

Dr. Krisztina Kiss, World Bank, Operations Officer for Hungary Office.

Dr. Gellert Kuba, Associate Professor of the Technical University Budapest. He is very active in the fields of energy efficient housing and Bio Architecture.

QUO VADIS Marketing es Management Budapest - private planning consulting company. Interviews were conducted with:

- Peter Gauder, and
- Gyorgy Kerekes.

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