

2 Boosting investment in affordable housing in Latvia: The potential of a revolving fund scheme

This chapter provides an overview of the housing affordability and quality gaps in Latvia, and assesses the investment needs to address these gaps. It summarises the main steps taken by the Latvian authorities to establish the Housing Affordability Fund and the key features of the Fund. The chapter also presents views from a broad cross-section of Latvian stakeholders on both the potential and risks relating to the implementation of a revolving fund scheme for housing in Latvia.

This chapter makes the case for the establishment of a Housing Affordability Fund in Latvia. It begins by highlighting investment needs in affordable housing in Latvia in order to address persistent housing quality gaps and emerging affordability challenges. It then outlines the main legal, institutional and policy steps taken by the Latvian authorities to establish the Housing Affordability Fund to channel investment into affordable housing. The analysis is complemented by the perspectives of a range of Latvian stakeholders who participated in an online survey and follow-up focus groups and in-depth interviews.

2.1. The case for increased investment in affordable housing in Latvia

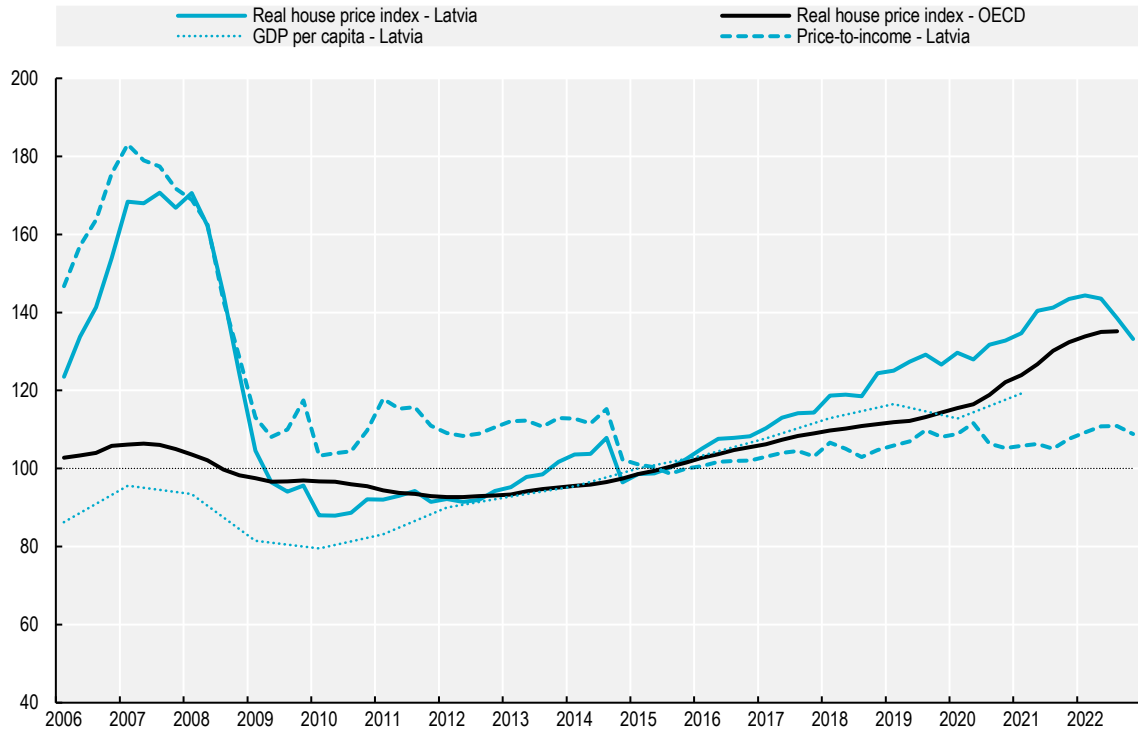
Real house prices have increased considerably in Latvia over the past two decades, in line with the rise in average incomes, and accelerated during the COVID-19 crisis. Even though Latvia households spend, on average, less on housing costs relative to their OECD peers and few households are overburdened by housing costs – many people live in poor quality housing and cannot afford to upgrade their home or move to a better-quality dwelling. There is also a sizable “missing middle” of households that are ineligible for existing public support (such as social housing or housing allowances), yet still cannot reasonably afford a commercial mortgage. Across Latvian stakeholders, the housing situation is widely perceived as unsatisfactory. On the supply side, investment in housing has stagnated in recent decades, the social rental housing stock and the private rental market remain extremely underdeveloped, and the pace of new construction remains sluggish.

2.1.1. Housing prices have increased in Latvia, broadly in line with average incomes

Housing prices in Latvia have been on the rise, on average, in recent years, along with a steady increase in average incomes. Following a sharp drop around the Global Financial Crisis in 2008, real house prices began to pick up again in late 2015 and have steadily increased thereafter (Figure 2.1). There has nevertheless been a slight decline in real house prices in the second half of 2022. In parallel, the steady rise in average incomes over the past decades – with median disposable income more than doubling between 2006 and 2019 – has dampened the impact of rising house prices, as reflected in the relative stability of the price-to-income ratio since 2015. The evolution of real house prices in Latvia over the past two decades has been much more volatile than that of the OECD average.

Figure 2.1. Real house prices have risen steadily in Latvia since the Global Financial Crisis

Real house price index, price-to-income index and price-to-income ratio, Latvia and OECD average, indexed to 2015, 2006-22



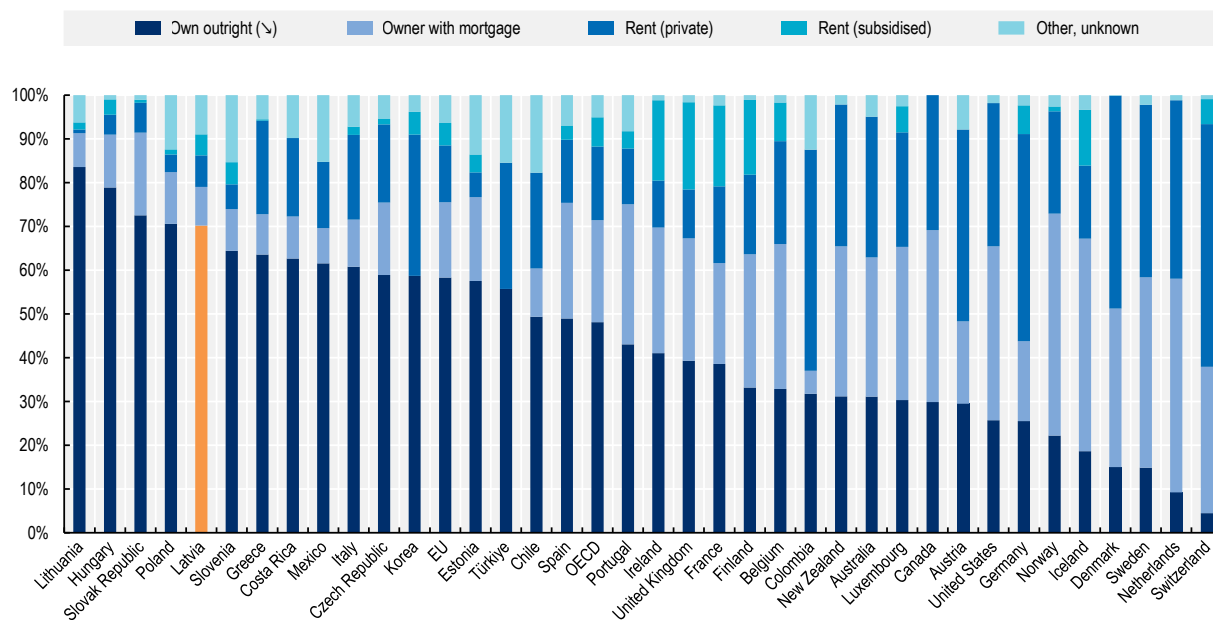
Source: (OECD, 2023^[1]), Analytical house price indicators, https://www.oecd-ilibrary.org/economics/data/prices/analytical-house-price-indicators_cbcc2905-en.

2.1.2. On average, Latvian households spend less on housing than their OECD and EU peers

As reported in OECD (OECD, 2020^[2]), Latvian households are, on average, spending less on housing costs relative to their peers in other OECD and EU countries. The housing market is dominated by homeowners (Figure 2.2), resulting largely from the privatisation of the housing stock in the 1990s. Nearly seven out of ten Latvian households own their homes outright, including more than 70% of households who were at risk of poverty in 2019 (European Commission, 2019^[3]). Average spending on housing among Latvian households (20.9% in 2019) is below the OECD and EU averages (22.6% and 22.0%, respectively), and has generally been declining in recent years (Figure 2.3, Panel A) (OECD, 2022^[4]). Meanwhile, fewer than 3% of Latvian households are overburdened by housing costs (meaning that they spend more than 40% of their disposable income on housing costs), which – is among the lowest shares in the OECD (Figure 2.3, Panel B) (OECD, 2022^[4]).

Figure 2.2. The vast majority of Latvian households are homeowners

Share of households in different tenure types, in percent, 2020 or latest year available

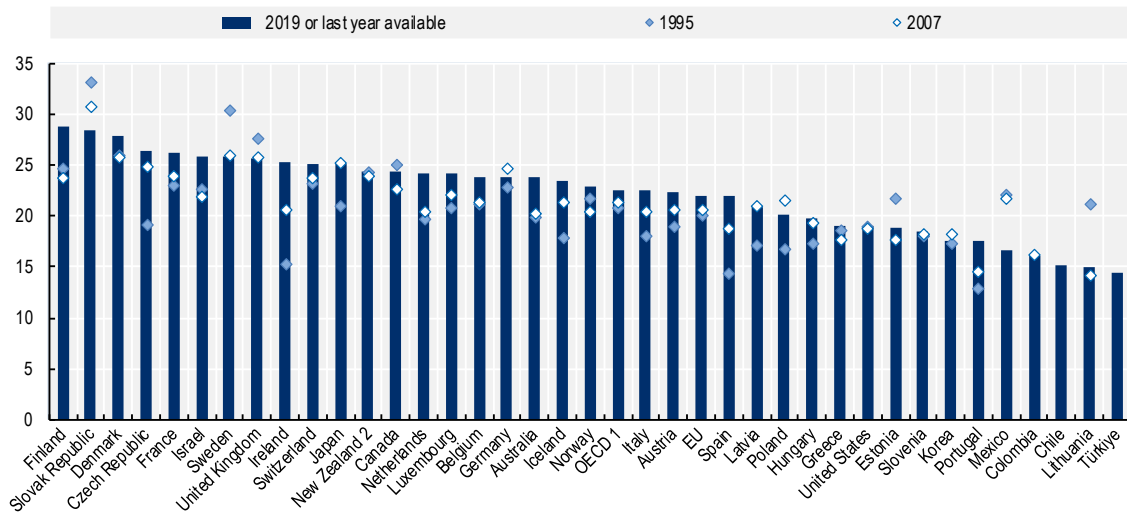


Note: 1. Tenants renting at subsidised rent are lumped together with tenants renting at private rent in Australia, Austria, Canada, Chile, Colombia, Costa Rica, Denmark, Mexico, the Netherlands, New Zealand, Türkiye and the United States, and are not capturing the full extent of coverage in Sweden due to data limitations. 2. Outright owners of homes are lumped together with owners with mortgages in Korea and Türkiye due to data limitations. 3. Data for Germany and Italy refer to 2019, for Canada and Iceland to 2018 and for Chile to 2017. 4. OECD and EU averages refer to countries for which all tenure types are available. 5. See also indicator PH4.2 Social rental dwelling stock in the OECD Affordable Housing Database for additional information.

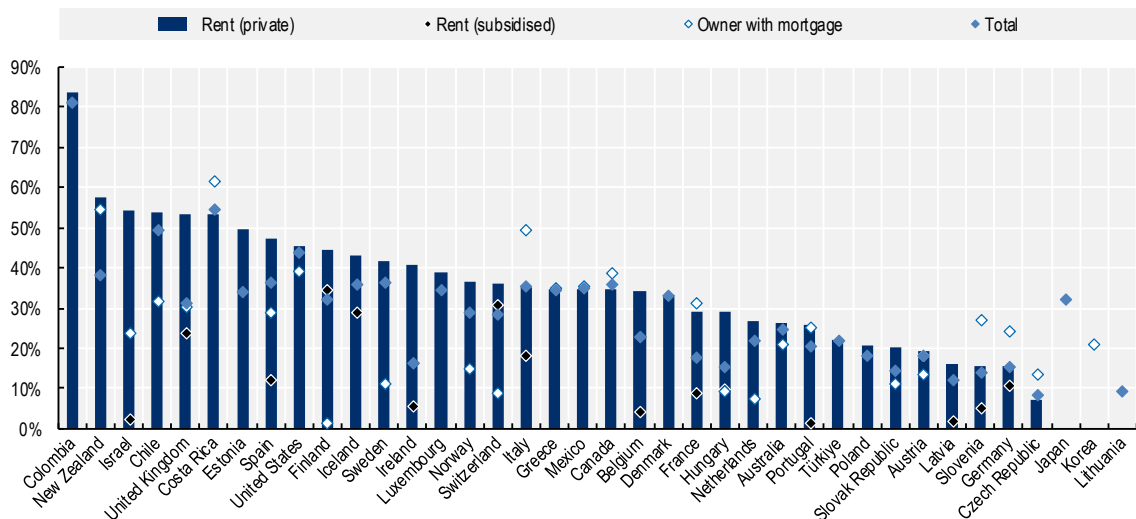
Source: (OECD, 2022^[4]), OECD Affordable Housing Database, indicator HM1.3, <http://www.oecd.org/social/affordable-housing-database.htm>, drawing on OECD calculations based on the European Survey on Income and Living Conditions (EU-SILC 2020) as well as other national sources.

Figure 2.3. Housing costs among Latvian households are among the lowest in the OECD

A. Total housing costs (including housing, water, electricity, gas and other fuels), % of final consumption expenditure of households on the territory, 1995, 2007, 2019 or last year available



B. Share of population spending more than 40% of disposable income on mortgage and rent, by tenure, in percent, 2020 or latest year



Note: Panel A. 1) The OECD average over time is calculated using the data of the countries available for all years. 2) Provisional values for 2019. The present publication presents time series which end before the United Kingdom's withdrawal from the European Union on 1 February 2020. The EU aggregate presented here therefore refers to the EU including the UK. In future publications, as soon as the time series presented extend to periods beyond the UK withdrawal (February 2020 for monthly, Q1 2020 for quarterly, 2020 for annual data), the "European Union" aggregate will change to reflect the new EU country composition. Panel B. 1. In Chile, Colombia, Mexico, Korea and the United States gross income instead of disposable income is used due to data limitations. No data available on subsidised rent in Australia, Canada, Chile, Mexico and the United States. In the Netherlands, Denmark, New Zealand and Sweden tenants at subsidised rate are included into the private market rent category due to data limitations. No data on mortgage repayments available for Denmark Iceland and Türkiye. 2. Results only shown if category composed of at least 100 observations.

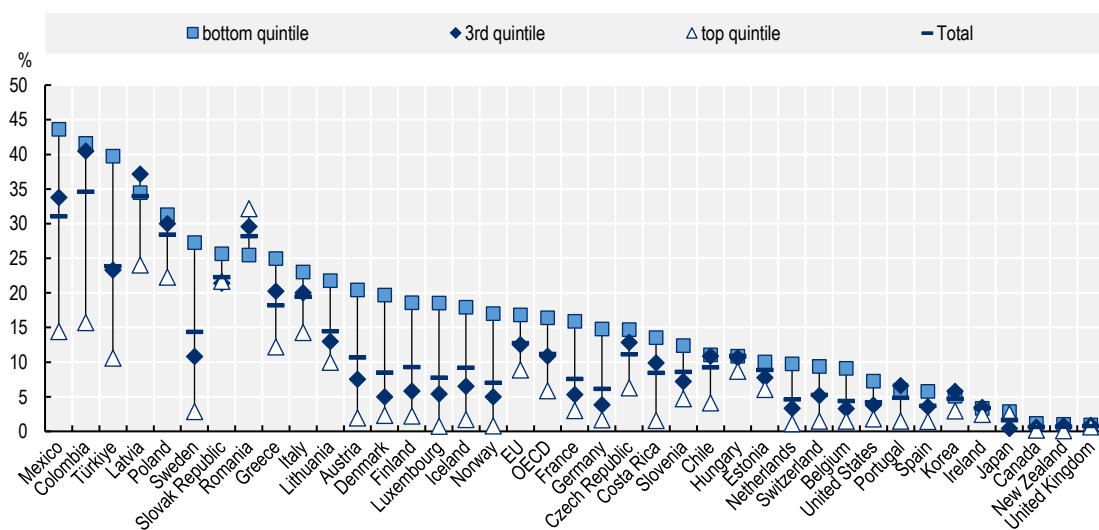
Source: Panel A. (OECD, 2022^[4]) OECD Affordable Housing Database, indicator HC1.1, <http://www.oecd.org/social/affordable-housing-database.htm>. Panel B. (OECD, 2022^[4]) OECD Affordable Housing Database, indicator HC1.2, <http://www.oecd.org/social/affordable-housing-database.htm>.

2.1.3. Housing quality gaps persist, and many households cannot afford to upgrade or move

At the same time, many Latvian households across the income distribution live in poor quality housing. On average, just over one-third of all households live in overcrowded housing conditions, including nearly a quarter of households in the top income quintile – the largest share in the OECD (Figure 2.4). While housing quality has improved over time, almost one in five poor households live in a dwelling without an indoor flushing toilet, and more than 6% of households in the bottom quintile are considered to live in “severely deprived” housing conditions (OECD, 2022^[4]). Housing quality gaps stem in large part from an ageing housing stock: two-thirds of dwellings were built during the Soviet era (when insulation materials were not used during the construction process) and another 22% prior to 1945 (OECD, 2020^[2]), followed by insufficient maintenance and improvements in the decades since construction. More than two-thirds of the population reported in 2020 that housing maintenance expenditures represented a burden on their household financial situation (Central Statistics Bureau of Latvia, 2020^[5]). Representatives from local governments and housing management companies who are on the frontlines of addressing residents’ housing challenges report a lack of available apartments of suitable quality, despite substantial demand.

Figure 2.4. Poor housing quality in Latvia remains a persistent challenge

Share of overcrowded households in Latvia, OECD and EU averages, and selected peer countries, by quintiles of the income distribution, in percent, 2019 or latest year available



Note: 1. For Denmark and the Netherlands, no information on subsidised tenants due to data limitations. See section “Data and comparability issues” of Indicator HC2.1 on limits to comparability across countries due to the definition of rooms. 2. Low-income households are households in the bottom quintile of the (net) income distribution. The present publication presents time series, which end before the United Kingdom’s withdrawal from the European Union on 1 February 2020. The EU aggregate presented here therefore refers to the EU including the UK. In future publications, as soon as the time series presented extend to periods beyond the UK withdrawal (February 2020 for monthly, Q1 2020 for quarterly, 2020 for annual data), the “European Union” aggregate will change to reflect the new EU country composition.

Source: (OECD, 2022^[4]), OECD Affordable Housing Database: indicator HC1.3, <http://www.oecd.org/social/affordable-housing-database.htm>.

Many homeowners cannot afford to maintain or upgrade the quality of their existing dwelling, nor can they afford a commercial mortgage to move to a better-quality home. This is especially a challenge for people in the middle of the income distribution – the “missing middle,” as characterised in OECD (2020^[2]) – who are too rich to be eligible for social housing and the housing allowance, yet too poor to reasonably afford a commercial mortgage. Around 44% of all Latvian households find themselves in the “missing middle,” which is comprised largely of households in the second and third income quintiles, as well as a

disproportionate share of single-person, single-parent and elderly households (OECD, 2020^[2]). An underdeveloped formal rental market further limits affordable housing options, which has been stymied in part by rental regulations that have historically provided few protections to landlords or tenants. Recent legislative reforms have addressed many of these shortcomings. As a result, even if most Latvian households do not “overspend” on housing, most people find themselves stuck in low-quality housing, which creates additional hurdles to labour mobility.

2.1.4. The housing situation is widely perceived as unsatisfactory by Latvian stakeholders

The housing situation in Latvia is widely perceived as unsatisfactory by a range of Latvian stakeholders, especially with regard to housing affordability. According to a series of stakeholder engagement activities conducted by the OECD in the context of this project (Box 2.1):

- 88% of respondents of the online survey reported that it is difficult to access affordable formal rental housing
- 85% of respondents reported that it was difficult to build new housing in their region
- 85% of respondents that rising energy costs are making housing less affordable in their region
- Just 35% of respondents reported that it was difficult to access a mortgage to purchase a home in their region.

Representatives from local governments and housing management companies who are on the frontlines of addressing residents’ housing challenges report a lack of available apartments of suitable quality, despite substantial demand: “There are no apartments available... and the demand is enormous.”

Box 2.1. OECD survey of stakeholders in the Latvian housing market

Two phases of stakeholder engagement

In the first half of 2022, prior to the approval of the Housing Affordability Fund, the OECD conducted two stakeholder engagement activities with a range of actors in the Latvian housing market:

- *Phase 1: An online survey of Latvian stakeholders* (April 2022). The survey consisted of 25 questions. For most questions, respondents were asked to respond to a series of prompts using a Likert scale: *Strongly agree, Agree, Neither agree nor disagree, Disagree, Strongly Disagree*. Participants had the option to complete the survey in English or in Latvian.
- *Phase 2: A series of focus groups and in-depth interviews of Latvian stakeholders* (July 2022). These activities were designed to complement the information from the online survey by providing an opportunity for more in-depth discussions with stakeholders.

Scope and objectives

These activities aimed to collect views from diverse stakeholders relating to:

- The overall housing market context in Latvia, as well as the perceived impacts of the latest global trends on housing affordability (e.g. the COVID-19 pandemic, rising energy prices, and [for the focus groups and in-depth interviews only] Russia’s war of aggression against Ukraine);
- The main challenges to access quality, affordable housing (including, *inter alia*, building new affordable housing, developing affordable rental housing, and renovating the existing stock);
- The availability of resources to finance affordable housing in Latvia; and
- The scope of the investment mandate of the proposed Housing Affordability Fund.

These qualitative research activities were an important tool designed to help inform the development of the proposed *Housing Affordability Fund*, by providing insights into stakeholder perceptions around affordable housing needs and current forms of government support for housing; the scope of the proposed Fund and how it might evolve over time; as well as potential concerns, misconceptions and/or risks relating to the design and implementation of the Fund.

Survey participants

In total, the two phases surveyed between 50-75 Latvian stakeholders overall, representing all six Latvian regions. Twenty-six individuals responded to the online survey; 50 individuals participated in total in five focus group discussions and 12 in-depth interviews. Stakeholders included representatives from the national government; municipal administrations; commercial banks; for-profit, limited-profit and co-operative housing developers; housing management companies; and (for the focus groups, only) households who meet the income eligibility requirements for the housing to be developed through the Housing Affordability Fund. In-depth interviews also included commercial housing developers working in Latvia and Members of Parliament. Given the anonymity of participation in both phases of the stakeholder engagement activities, it is possible that some people participated in both activities.

Results of the stakeholder engagement activities

A number of issues raised by Latvian stakeholders point to specific challenges relating to the *institutional set-up* of the proposed Housing Affordability Fund; the *funding and financing* of the Fund; as well as the *management and monitoring* of the Fund and of the units developed through the Fund. These issues were explored in greater depth in subsequent phases of the OECD project, for instance in the review of good international practices in the establishment of revolving fund schemes, as well as a series of knowledge exchange events with international experts from Austria, Denmark, the Netherlands and Slovenia.

Limitations of the exercise

There are several limitations to the stakeholder engagement activities:

- *Partial, non-representative sample of the Latvian population:* These activities were not intended to be representative surveys; rather, they aimed to provide illustrative views among key stakeholder groups in the housing sector in Latvia. Efforts were made to balance the geographic representation among the stakeholders surveyed: for example, representatives from Riga and Pierīga region were well-represented in the online survey, whereas the focus groups and in-depth interviews included a majority of representatives from rural areas outside the Capital region. Further, there was a relatively low response rate to the online stakeholder survey.
- *Findings are self-reported:* The aim of this exercise is to better understand people's perceptions of housing affordability challenges, as well as the Housing Affordability Fund. These perceptions are not necessarily in line with the evidence base. Further, participants in the stakeholder engagement activities had varying levels of familiarity with the design and aims of the government's proposed Housing Affordability Fund, which could affect the accuracy of the findings relating to the perceived effectiveness of the Fund.

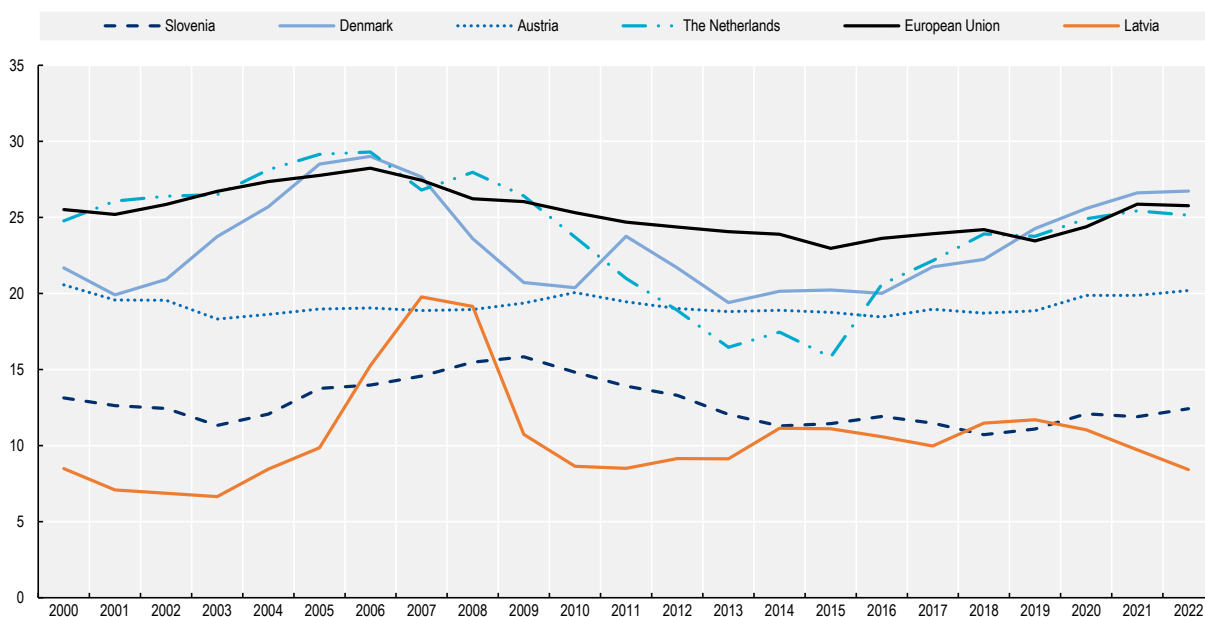
2.1.5. Investment in housing has been stagnating

Overall investment in housing (gross fixed capital formation, GFCF) has been stagnating in Latvia and remains well below the OECD average. In 2022, investment in dwellings in Latvia accounted for just over 8% of total investment (gross fixed capital formation) – compared to an EU average that was around three times the share (26%) (Figure 2.5). By contrast, Austria, Denmark and the Netherlands invested between 20 and 25% of total investment in dwellings in 2022. Apart from a significant jump in housing investment just before the Global Financial Crisis, where GFCF reached nearly 20% of total GFCF in 2007 and 2008, respectively, Latvia has averaged just under 11% of total investment towards dwellings over the past two decades, compared to an EU average of over 25% over this period. Meanwhile, at less than 2% of the overall housing stock, Latvia has one of the lowest shares of social rental housing among OECD and EU countries (Figure 2.6) (OECD, 2022^[4]).

According to the stakeholder survey, there is a consensus that decades of underinvestment in housing have contributed to the current state of poor-quality housing in Latvia. There has been no largescale public investment programme in housing since the 1990s. Most support instruments introduced by local governments have remained small (e.g. financial incentives to improve multi-apartment buildings, such as the renovation of courtyards, waste disposal sites, historical buildings and their facades). Further, they have tended to target households that are considered solvent, while public supports for the most vulnerable populations (e.g. limited housing allowances and support to partially cover utility costs) have not fundamentally addressed their housing challenges. Public support for energy efficiency upgrades and repair loans, provided via Altum, are available, but also small in scale.

Figure 2.5. Housing investment in Latvia is low relative to peer countries

Gross fixed capital formation in dwellings, as a share of total gross fixed capital formation, 2000-22, Latvia and selected peer countries

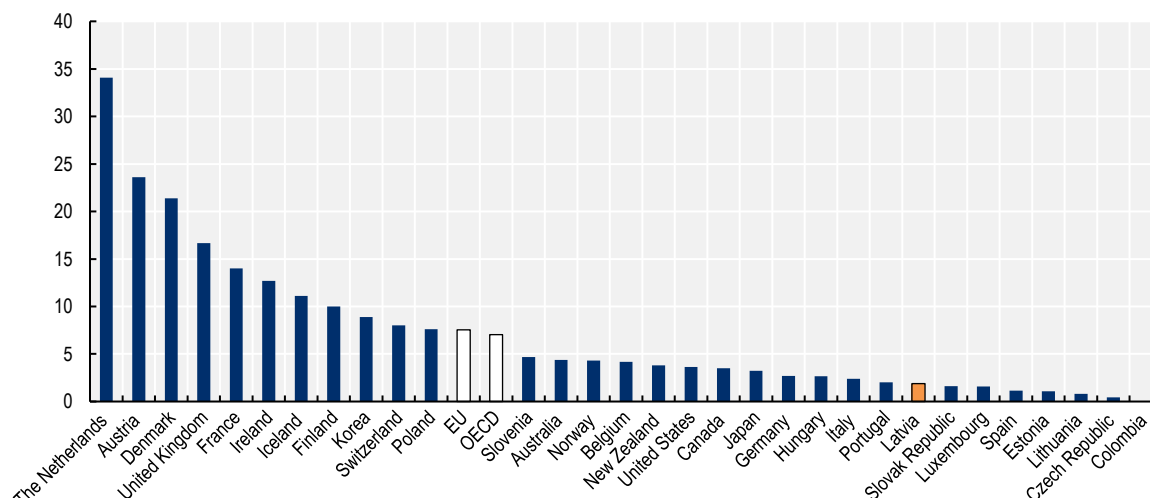


Note: Gross fixed capital formation (GFCF), also called “investment”, is defined as the acquisition of produced assets (including purchases of second-hand assets), including the production of such assets by producers for their own use, minus disposals. The category “dwellings” excludes land. All OECD countries compile their data according to the 2008 System of National Accounts (SNA).

Source: (OECD, 2023^[6]), Investment by asset (indicator), <https://doi.org/10.1787/8e5d47e6-en> (accessed April 2023).

Figure 2.6. Latvia has one of the smallest shares of social rental housing in the OECD

Number of social rental dwellings as a share of the total number of dwellings, 2020 or latest year available



Note: 1. For the Netherlands, the social dwelling stock is estimated based on rent levels charged by landlords as provided by the Ministry of the Interior and Kingdom Relations. These figures include units in private rentals provided below market rent and units provided by housing associations, excluding those provided at market-rate. 2. For Austria, data only refer to the main residence dwellings. 3. For Iceland, data might also include student housing rent from family members for free or at reduced rate. 4. For Australia, Estonia, Iceland, Latvia and Spain, data are based on responses to previous QuASH rounds. 5. For Norway, data only contains dwellings provided by municipalities (about 75% of all social housing). 6. For New Zealand, data refer to the number of social housing places (public housing) that are funded through central government, and do not include social housing provided by local authorities. 7. For the United States, the social housing stock includes public housing, subsidised units developed through specific programmes targeting the elderly (Section 202) and disabled people (Section 811), as well as income-restricted units created through the Low-Income Housing Tax Credit (LIHTC) programme; the number of public housing units as well as section 202 and 811 dwellings financed through the LIHTC programme have been adjusted to avoid double-counting, following OECD correspondence with the US Department of Housing and Urban Development. The data are preliminary. 8. For Canada, data exclude units managed by the *Société d'habitation du Québec* (SHQ) for the Province of Quebec. 9. For Spain, the figures may also contain other types of reduced rent housing, e.g. employer-provided dwellings. 10. For Lithuania, the share of social housing is calculated based on the previous years' total dwelling stock due to data limitations. 11. For the Czech Republic, data only contains dwellings provided by the central government. 12. For Colombia, data only refers to social rental housing produced since 2019 in the *semillero de propietarios* programme.

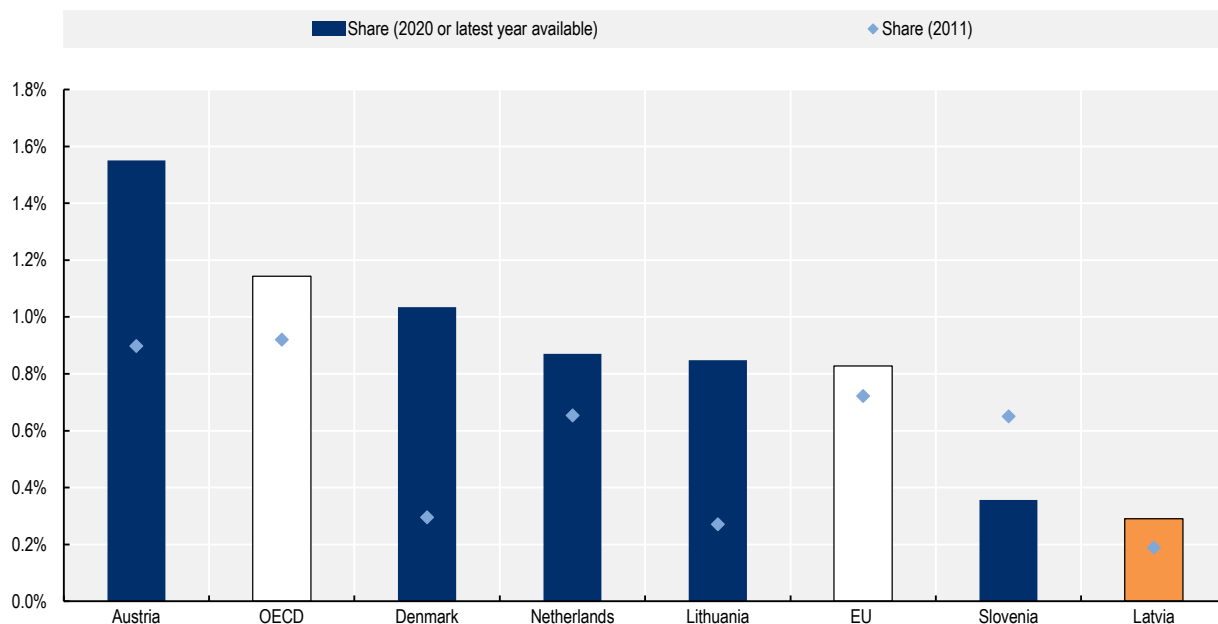
Source: (OECD, 2022^[4]), OECD Affordable Housing Database, indicator PH4.2, <http://www.oecd.org/social/affordable-housing-database.htm>.

2.1.6. The pace of new housing construction is sluggish, with construction concentrated in the capital region

Moreover, the pace of new housing construction is sluggish and well below the OECD average, with most new construction concentrated in the capital region. While demand for new housing exists also outside the capital region, this demand is often not met because of the lack of financing and the perceived higher risk of investing in regions. New dwellings represented just 0.3% of the total stock in 2017 – one of the lowest shares in the OECD (Figure 2.7) (OECD, 2022^[4]). Almost all new residential buildings are developed in Riga and Pierīga. The pace of housing renovations remains slow, averaging roughly 60 multi-family apartment buildings annually between 2001 and 2013 (Altum, 2021^[7]). According to the stakeholder survey, real estate developers cite access to finance, burdensome administration and access to qualified labour and affordable construction materials as additional barriers to affordable housing development. Moreover, public procurement procedures and development approval processes are viewed by developers as inflexible.

Figure 2.7. The pace of new housing construction in Latvia is sluggish compared to OECD peers

Share of new dwellings completed in the year, as a percentage of the total existing housing stock in Latvia, OECD and EU averages, and selected peer countries (around 2011 and 2020 or latest year available)



Note: For Latvia, the latest data are from 2017; for Slovenia, it is 2018; and for Lithuania, it is 2019.

Source: (OECD, 2022^[4]), OECD Affordable Housing Database: indicator HM1.1, <http://www.oecd.org/social/affordable-housing-database.htm>.

2.1.7. There are big differences in housing quality and affordability across regions, which struggle to attract housing developers and commercial lenders

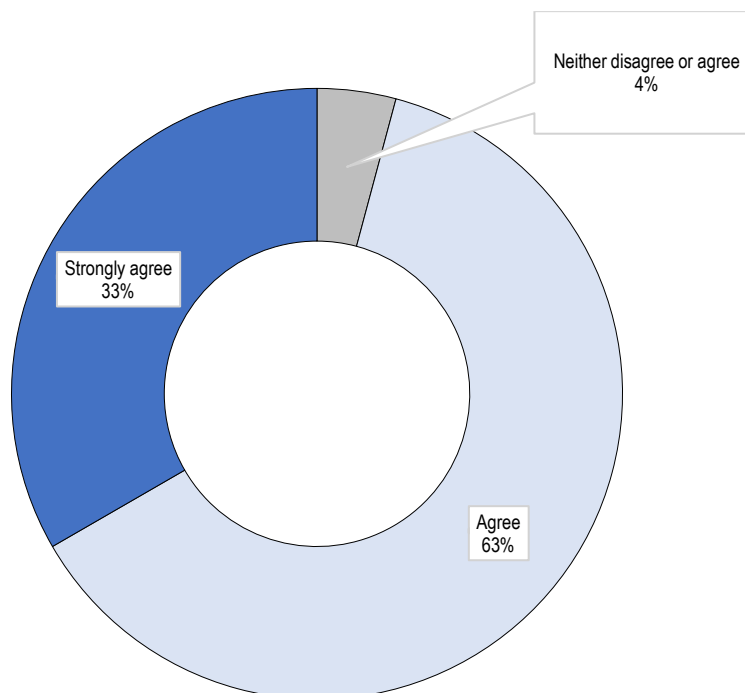
While quality and affordability gaps are widespread, the local housing context – in terms of the size, age and type of housing – differ considerably across regions. As a result, local authorities consider that they could benefit from greater flexibility to design and implement affordable housing projects that respond to clearly assessed local needs, rather than a “one-size-fits-all” approach. Among the main barriers to improving housing quality and affordability, Latvian stakeholders highlighted several decades of underinvestment in housing, and the small scale of current public support for housing, with insufficient incentives for developers to invest in affordable housing. Some stakeholders perceive that banks and developers are loath to invest in the regions, due to limited economic activity, low household incomes, and infrastructure gaps.

2.2. A dedicated revolving fund scheme for affordable housing

The establishment of a revolving fund scheme to channel investment into affordable housing could thus help to address a gap in the existing policy framework, characterised by decades of low levels of investment in housing, an ageing housing stock, an underdeveloped rental market, and the “missing middle” households who do not have access to public supports for housing, yet still cannot reasonably afford a commercial mortgage. Findings from the stakeholder survey support this finding: there is near universal agreement among stakeholders surveyed that the Housing Affordability Fund can help address Latvia’s housing challenges (Figure 2.8). Further, participants in the focus groups viewed national involvement in the affordable housing solution as “long overdue and very necessary.”

Figure 2.8. There is near universal agreement among stakeholders surveyed that the proposed Housing Affordability Fund can help address Latvia's housing challenges

"The establishment of a dedicated fund to support investment in affordable housing has the potential to address some of the current housing challenges in Latvia."



Note: Participants responded to the prompts using a Likert scale: *Strongly agree*, *Agree*, *Neither agree nor disagree*, *Disagree* or *Strongly Disagree*.

Source: 2022 OECD Stakeholder survey: Investing in affordable housing in Latvia.

2.2.1. Legal, institutional and policy steps to establish the Fund

Since the publication of the 2020 OECD report (OECD, 2020^[21]), the Latvian authorities have set the groundwork to establish the Housing Affordability Fund through a series of legal, institutional and policy steps (Box 2.2).

Box 2.2. Key steps in the establishment of Latvia's Housing Affordability Fund

Key activities relating to the establishment of the Housing Affordability Fund:

- **Informal agreement on the State aid regulation framework for the support programme with the European Commission**, kicking off the co-ordination process (20 January – 10 June 2021).
- **Public consultation period** of the draft Regulation on *Support for the construction of residential rental houses* (30 August – 13 September 2021).
- **Submission of draft Regulation** on *Support for the construction of residential rental houses* to co-ordinate with the European Commission on the State aid regulation framework (14 September 2021); closure of co-ordination process (30 August 2022).
- **Approval of the Regulation of the Cabinet of Ministers No. 459** (14 July 2022; the Regulation came into force on 20 July 2022): Rules on support for the construction of residential rental houses in the framework of the 3.1 reforms of the Plan of the European Union Recovery and Resilience Facility and the investment axis “Regional Policy” 3.1.1.4.i. Investment “Establishment of a financing fund for the construction of low-rent housing. The Regulation sets out the general provisions of the establishment of a financing fund for the construction of low-rent housing, within the framework of the Recovery and Resilience Facility (RRF). It outlines the form of support to be provided through the Fund and the conditions for granting such support; the roles and responsibilities of different actors; the initial funding sources of the Fund; quality conditions for the rental units; the eligibility conditions and application process for prospective tenants; conditions for the lease agreement and other provisions relating to the development and operation of the Fund.
- **Creation of a public information portal on the Housing Affordability Fund on the website of the Ministry of Economics** (14 October 2022). The website includes documentation relating to the Fund; Recommendations to municipalities relating to household eligibility criteria; model guidelines for compensation of developers; and rental agreement templates for housing developers and building managers.
- **Organisation of a public webinar for housing developers, municipalities and other interested parties** to present the Fund and inform about programme conditions, rules on renting out affordable dwellings, eligibility conditions, monitoring activities and the compensation and overcompensation calculation methodology (20 October 2022).
- **Call for tender to housing developers to apply for funding to build 700 apartments, including 300 apartments by June 2026, made available to the public** (22 November 2022). The call will remain open until all funding is contracted out; the final date for closure of the loan agreement is 30 June 2026.

Source: (Cabinet of Ministers (Latvia), 2022^[8]), Regulation of the Cabinet of Ministers, <https://likumi.lv/ta/id/334085-noteikumi-par-atbalstu-dzivojamo-ires-maju-buvniecibai-eiropas-savienibas-atveselosanas-un-noturibas-mehanisma-plana-3-1>; (Ministry of Economics (Latvia), 2023^[9]), Creation of a financing fund for the construction of low-rent housing, www.em.gov.lv/lv/finansesanas-fonda-izveide-zemas-ires-majoklu-buvniecibai; (Altum, 2022^[10]), Call for tender: New state support programme for the construction of low-rent houses in the regions of Latvia, www.altum.lv/22-novembri-sakas-pieteikumu-pienemsana-zemas-ires-namu-buvniecibas-projektiem/.

In parallel, the Latvian authorities have introduced other important reforms relating to housing, including:

- **The expansion of the housing guarantee programme** to provide more support for large families and new specialists: Specialists are eligible to receive guarantees since February 2018. The loan guarantee for large families (families with four or more children) was increased to 30% of the loan since June 2020; these families can apply for the loan more than once to meet changing housing needs, if they have additional children.
- **The introduction of a new housing subsidy, *Balsts***, for large families to purchase or build a home (November 2020): Families with three or more children can receive a housing subsidy of up to EUR 12 000 (up to 50% of the total cost home purchase) for the purchase of a new home.
- **Reforms to the housing benefit** to increase the generosity and reach of the scheme:
 - From 1 January 2021, the guaranteed minimum income threshold was raised, as was the amount of the benefit, drawing on a revised eligibility formula. In the winter of 2022, further adjustments to the calculation formula were introduced to reach an even larger share of the population.
 - From 1 July 2021, national regulations established the formula for calculating the housing benefit amount, income testing procedure and minimum thresholds of housing expenditure, harmonising these across municipalities; the housing benefit was also renamed, *Mājokļa pabalsts*.
- **Approval of a new law on residential tenancy** (March 2021; came into force in May 2021), which aims to balance protections between of landlords and tenants, simplify the previously long litigation process in cases of landlord-tenant disputes, and promote investment in the rental market, thereby stimulating labour mobility.
- **The introduction of a support programme for the renovation of multi apartments and their surroundings**: As of July 2021, individual homeowners (or landlords that are legal entities that own the building) may apply for a loan issued by Altum to cover the costs of construction and improvements to multiapartment buildings and the immediate surroundings.
- **Support for energy efficiency improvements of single-family houses**: As of February 2021, families with children who own single-family dwellings can apply for support for technical assistance (up to EUR 1 000) and a grant to upgrade the energy efficiency of a single-family dwelling (up to EUR 5 000).
- **The expansion of Altum loan and mezzanine-loan programme**: Since the end of 2021, support is available for real estate developers of residential construction projects for rent and sale at market conditions.

2.2.2. Initial scope and conditions of the Fund

The Housing Affordability Fund, approved through the Regulation of the Cabinet of Ministers No. 459 on 14 July 2022, was established to support the construction of new affordable rental dwellings that meets minimum construction standards and energy efficiency requirements, to be developed outside the capital region in a first phase. Rental dwellings are defined in the Regulation as a building with at least three apartments that are leased in accordance with the new rental regulations. To incentivise development of affordable dwellings, the Fund will facilitate the provision of long-term loans to developers, as well as a capital rebate for the partial repayment of the loan principal, under specific conditions set out in the Regulation. The scope and conditions of the Fund are summarised in Table 2.1, Table 2.2 and Table 2.3.

Table 2.1. The scope and conditions of Latvia’s Housing Affordability Fund: Institutional set-up

<i>Institutional set-up</i>	
Framework conditions	
Structure	A dedicated housing fund
Enabling legislation	Regulation of the Cabinet of Ministers No. 459 on <i>Support for the construction of affordable rental houses</i> , approved on 14 July 2022
Policy environment	A forthcoming national housing strategy, the <i>Housing Affordability Guidelines</i> (Box 3.1)
Scope of activities financed	
Types of housing activities	Development of new affordable rental housing and their maintenance
Geographic scope of intervention	<ul style="list-style-type: none"> • In a first phase, dwellings must be built outside Riga and neighbouring municipalities. • It is envisaged to potentially expand the geographic eligibility to include Riga and neighbouring towns in a subsequent phase if justified by a market gap analysis.
Actors and expertise involved	
National-level ministry responsible for the Fund	The Ministry of Economics is the primary decision-making body on the use of the <i>Housing Affordability Fund</i> . It is responsible for overall housing policy making; establishing the Regulations that govern the establishment, functioning and financing of the Fund; and monitoring compliance with the provisions of the Regulation.
Other actors at the national level (including implementing bodies)	Altum, a state-owned development finance institution, is responsible for the administration of the Fund; selecting viable housing projects to be supported; monitoring the use and repayment of loans; and transferring the repayments of the principal and interest payments to the Fund. The Possessor, the State’s public asset manager, is responsible for monitoring after the commissioning of the affordable dwelling and the granting of the capital rebate to developers.
Municipalities	Municipal authorities are responsible for developing territorial plans, setting land use objectives, and solving housing issues of residents. Regarding the <i>Housing Affordability Fund</i> , they must establish an entrustment act with the real estate developer that defines the public service to be provided by the developer. They must also establish and monitor a queue of eligible tenants for the units.
Housing developers	For-profit, as well as non- and low-profit housing developers are eligible to benefit from public incentive schemes; however, non- and low-profit developers are not widespread in Latvia.
Tenants	In addition to paying rent, tenants are responsible for making utility payments, real estate tax and insurance payments, and covering maintenance and management expenses.

Table 2.2. The scope and conditions of Latvia's Housing Affordability Fund: Funding and financing arrangements

Funding and financing arrangements	
Land use policies	There are no minimum targets to leverage land-use planning policies to develop affordable housing.
Access to infrastructure	Costs for infrastructure investments must be directly attributable to individual construction projects to receive funding (e.g. for necessary utility connections and communication infrastructure). The Fund can finance infrastructure improvements such as gardens, playgrounds and parking related to the dwellings.
Housing tenure considerations	Rental housing accounts for 12% of the Latvian housing stock (OECD, 2020 ^[2]). Latvia has approved a new law on residential tenancy that aims to foster the development of the rental market through, <i>inter alia</i> , strengthening tenant protection, simplifying litigation, promoting investment in the rental market, and stimulating labour mobility.
Model of intervention	
Funding sources	<p>Primary source of initial capital:</p> <ul style="list-style-type: none"> Latvian Recovery and Resilience Plan (RRP) (EUR 42.9 million), in addition to a potential State loan contracted by Altum (up to EUR 10 million) <p>Other expected project funding sources:</p> <ul style="list-style-type: none"> Own investment from developer (minimum 5% of the eligible project costs) Loan from Altum (up to 95% if a commercial bank does not co-finance the project) Commercial bank loan (approx. 50% if project is co-financed with Altum) (Conditional) Grant as capital rebate for the partial repayment of Altum loan: up to 25% of total eligible project costs for the partial repayment of the Altum loan for projects put into operation after 31 August 2026; or 30% for projects put into operation by 31 August 2026. Rental income (conditional upon repayment of the Altum loan)
Revolving elements	<p>During loan repayment period:</p> <ul style="list-style-type: none"> Repayment of the principal by the beneficiaries of the financing mechanism (e.g. the real estate developers) Tenants in the affordable rental units must make monthly payments into a savings fund (EUR 0.25/m²) to finance building improvements <p>After repayment of the loan issued by Altum:</p> <ul style="list-style-type: none"> Contributions from the monthly rental income of the affordable rental housing equal to 50% of the rent
Impact on state budget	The impact on the state budget is limited to the amount of national co-funding. There are no direct investments and guarantees from the state and municipalities
Financing instruments	
Financing terms	30-year maturity for loans issued by Altum (deferred repayment is permitted under certain conditions). Within the framework of the Fund, Altum loans may be combined with commercial loans and/or from other international financial institutions, in which case, the Altum loan is subordinate and requires lower collateral.
Financial incentives for providers	Conditional grants in the form of a capital rebate on the Altum loan, of up to 25% (for affordable housing projects put into operation after 31 August 2026) or 30% (for projects put into operation by 31 August 2026). The rebate amount is calculated by Altum, in accordance with EU rules on overcompensation. To be eligible for the rebate, the real estate developer must meet all stipulations of the Regulation and the Altum loan agreement. The capital rebate is granted once the affordable rental housing has been put into operation, appropriate housing quality standards are met, and at least 90% of dwellings have been leased (100% for buildings of up to 9 flats).
State Aid considerations	The Fund's regulation addresses EU State Aid rules. The total amount of compensation to real estate developers is limited to an annual average of EUR 15 million within an administrative territory. Latvia's Regulation distinguishes between executing agents' SGEI and non-SGEI activity to determine a project's eligibility for public financing; and defines target groups for affordable housing through income ceilings. Developers are only eligible for public grants in the scope of the Fund if the constructed dwellings meet the affordable housing requirements.

Table 2.3. The scope and conditions of Latvia’s Housing Affordability Fund: Management and monitoring

Management and monitoring	
Management of the affordable rental units	
Eligibility criteria for affordable rental units	<p>Eligibility for affordable units is based on income: average monthly net income in the previous tax year cannot exceed:</p> <ul style="list-style-type: none"> • EUR 1 150 for a one-bedroom apartment • EUR 1 918 for a two-bedroom apartment • EUR 2 874 for an apartment of three or more bedrooms (apartments with three or more bedrooms must be allocated to households with at least two people) <p>Eligibility criteria are outlined in the Regulation on <i>Support for the construction of affordable rental houses</i> (Cabinet of Ministers (Latvia), 2022^[8]) and will be adjusted annually in line with inflation.</p>
Queue of eligible tenants	<p>Allocation of units via a waiting list. Municipalities manage the queue in their administrative area, including for units developed by housing co-operatives (if applicable). Dwellings are allocated by the developer according to the waiting list. Dwellings developed by housing co-operatives can be rented out only to their members. Municipalities may identify priority groups.</p>
Rent setting	<p>Rent levels must not exceed a fixed amount per square metre (EUR 5.87/m²) per month. Rent increases are permitted once every year in line with annual national inflation. In addition to the rent, the tenant pays: real estate tax and insurance costs; utilities and charges (e.g. management expenses); a monthly fee (EUR 0.25/m²) for repairs; a security deposit equivalent to two months’ rent.</p>
Management of the units	<p>A building manager – appointed by the housing developer (the developer can also self-appoint as building manager)– is responsible for the day-to-day operations and maintenance of the affordable rental units. The building manager must be selected through an open selection procedure every five years.</p>
Maintenance and improvements	<p>In addition to monthly rent payments, tenants in the affordable rental units must also make monthly payments into a savings fund (EUR 0.25/m²), which is opened in a payment institution and specific to the real estate developer, to finance building improvements. Tenants are also required to pay maintenance management expenses (e.g. relating to visual inspection, technical inspection, as well as everyday maintenance and including the remuneration of the maintenance manager).</p>
Monitoring, auditing and control of affordable housing financing and actors	
Monitoring and control	<p>The Ministry of Economics is responsible for monitoring the compliance with the RRP (including semi-annual checks on RRP relevant monitoring indicators).</p> <p>Altum, as the administrator of the Fund, monitors the use and repayment of loans until the commissioning of the dwelling and the granting of the capital rebate.</p> <p>The Possessor is responsible for conducting inspections and regular supervision once the rebate is granted and verify that contributions from rental income have been made into the Fund. It also monitors overcompensation every three years and at the end of the entrustment act in line with State Aid regulation (European Commission Decision 2012/21/EU).</p> <p>According to RRP regulation, monitoring costs cannot exceed 3% of the RRP funding allocation.</p>
Auditing	<p>Auditing of Altum’s financial statements.</p>
Tenant protection	<p>Specific provisions are in place to address tenant complaints in the affordable housing units. Tenants will have access to the same remedies for tenant protection under current legislation (civil courts). Residential Tenancy Law enables municipalities to establish a pre-trial institution, in the form of a tenancy board, to review tenant complaints. Tenancy boards would comprise three representatives from tenants and three from landlords.</p>

2.2.3. Expected outcomes of the Fund

With the initial funding envelope of the Fund, the Latvian authorities aim to achieve the following targets through 2026:

- **By the end of Q4 2024:** Approve the development of 300 affordable rental apartments
- **By the end of Q3 2026:** Approve the development of 700 affordable rental apartments (of which 300 apartments will have been built).

Certainly, given the scale of housing affordability and quality gaps in the country, Latvia’s housing investment needs to extend beyond the initial scope of the Fund. The Latvian authorities aim to focus on affordable *rental* housing in order to stimulate a new segment of the housing market by developing a “proof of concept” to private investors and developers, given that such projects have been slow to develop without

government support. The objective of this work, and namely the engagement with peer countries, has been to distil lessons from more mature revolving fund schemes for housing, enabling the Latvian authorities to scale up the Fund, ensure its sustainability well beyond the initial funding envelope and address the significant affordable housing needs faced by the country.

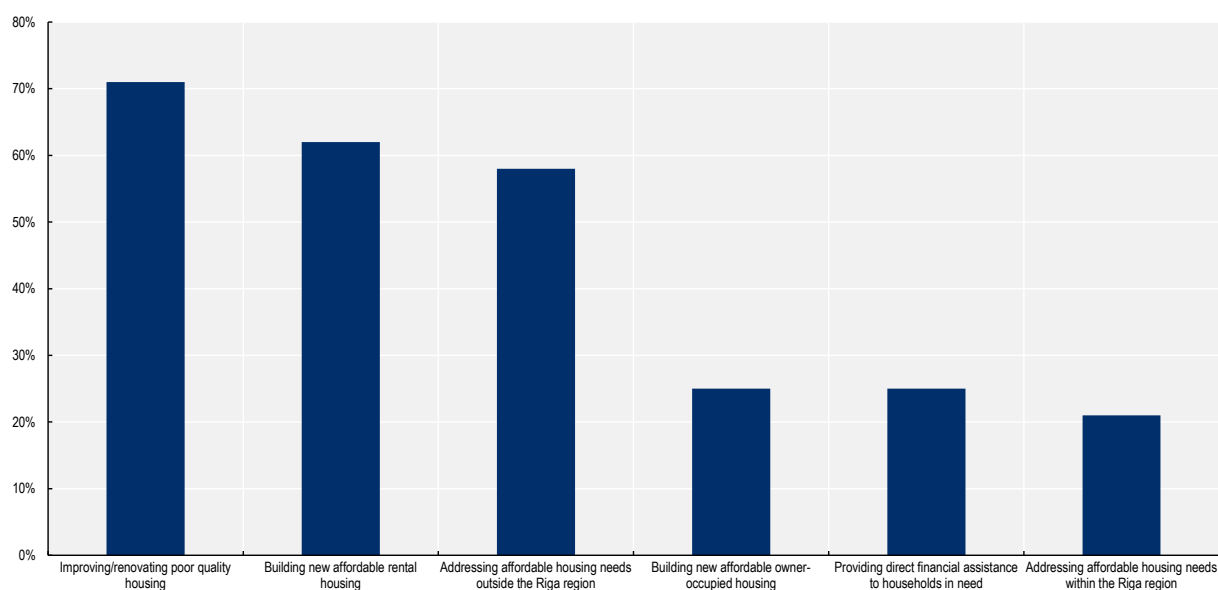
Indeed, from the perspective of Latvian stakeholders, the Fund is broadly expected to help address Latvia's housing challenges. The top three priorities for the Fund, according to stakeholders, should reportedly be to improve the quality of the housing stock, to build new affordable rental housing, and to address affordable housing gaps outside the Riga region (Figure 2.9). Meanwhile, many stakeholders agreed that the scope of the Fund could, over time, be expanded to facilitate support for housing renovations and could include projects in the capital region.

2.2.4. Potential risks associated with the Fund that will need to be mitigated

Nevertheless, stakeholders pointed to a number of potential risks associated with the Fund and its activities that should be anticipated and mitigated by the Latvian authorities. For instance, rising energy costs and geopolitical uncertainty risk weakening the investment appetite of banks and developers. Managing the rising costs of construction and labour will be another top challenge, particularly in the current context of strong inflationary pressures and the cost-of-living crisis. A shared concern among many real estate developers was the need to ensure that necessary infrastructure will be in place to support the new residential developments produced through the Fund. Others suggest that attracting developers to take part in the scheme is not guaranteed, nor is the necessary co-operation among the different public and private actors, which will be key to the Fund's success. Finally, there are considerable capacity gaps that require attention: both in terms of limited and uneven capacities within State and local institutions, which are important risks to the effective management and monitoring of the Fund, as well as limited professional building management capacity, which poses a substantial risk to the production and maintenance of the affordable units through the proposed Fund. These issues require attention and mitigation efforts by the Latvian authorities.

Figure 2.9 Improving housing quality and building new affordable rental housing are viewed as top priorities for the Fund

Share of respondents indicating “yes” to each of the following options in response to the prompt: “What are the most urgent priorities that should be addressed through a revolving fund to channel investment in affordable housing in Latvia?”



Source: OECD 2022 Stakeholder survey: Investing in affordable housing in Latvia.

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