

CHAPTER 6. HOUSING FINANCE IN LATVIA

by
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1. Macroeconomic Characteristics

Reforms accomplished in Latvia and integration in the European Union have left a positive impact on economic development of the country.¹ In the period from 1996 till 2003 Latvian gross domestic product (GDP) has grown on average by 6.1% annually. Among the other European countries only Ireland had higher growth rates in the same period of time.

Despite the slowdown of global economy since 2000, Latvian economy continues to develop at a speedy pace. In 2001 GDP in Latvia went up by 8%, in 2002 – by 6.4%, while in 2003 – by 7.5%. Also the year 2004 has started on a very positive note as the GDP has increased by 8.8% in the first quarter. According to the forecasts of the Ministry of Economics the GDP will go up by 7.5% in 2004.

High domestic demand (private consumption and investments) combined with the ability of Latvian enterprises to find new export markets was the reason for the growth over the past years. Manufacturing, construction, trade, commercial services and transport and communications had been the biggest contributors to the GDP growth.

Dynamic development continues in the construction sector. In 2002 the growth of this sector comprised 10.8%, while in 2003 the growth reached 13.7%. The building of residential houses, highways, roads and other objects goes on at a speedy pace. It is expected that construction sector will continue to grow rapidly also in the future in relation to the development of mortgage lending, increase of economic activity and capital investments, as well as implementation of projects financed by the EU funds.

High domestic demand promotes development of services, especially those concerning wholesale and retail trade (in 2002 this sector grew by 12.7%, while in 2003 the growth reached 11.3%). The dynamics of domestic demand is stable and ensured by the growth of income, stability of the financial system, widening of crediting facilities, accession to NATO and the EU and formation of positive future expectations. It is expected that the households' income increase and widening of consumption loans will foster further growth of domestic trade (especially non-food consumer goods) and other market services, nevertheless the growth rates will be slower than up to now, because of the market saturation. High growth

Economic growth in Latvia has been achieved in conditions of stable macroeconomic environment. The Bank of Latvia, having unofficially pegged the LVL to the SDR currency basket, is implementing

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¹ Ministry of Economics Republic of Latvia "Economic development of Latvia", 2004

a *de facto* policy of fixed national currency exchange rate. This reduces uncertainty, eliminates currency risk exposure and gives entrepreneurs a stable base for planning and price setting.

In accordance with the EU Accession Treaty the new member states will have to join also the European Monetary Union (EMU) and introduce the single currency, the euro, in the nearest future. This is the reason behind the expected changes in the monetary policy of Latvia. The strategy of the Bank of Latvia foresees pegging the lat to the euro and joining the European Exchange Rate Mechanism (ERM II) at the beginning of 2005 and participating in EMR II at least 2 years fulfilling the Maastricht criteria. The Bank of Latvia and the government have established January 1, 2007 as the deadline by which the criteria needed for introduction of the euro should be fulfilled. After the European Council will take a decision that Latvia is ready to participate in EMU the national currency in Latvia will be substituted by the euro and the Bank of Latvia will discontinue to implement an independent monetary policy. This according to the forecasts of the Bank of Latvia could happen at the beginning of 2008. Until then the LVL will remain the national currency of Latvia.

Latvia: Key Indicators of Economic Development

	2000	2001	2002	2003	2004 f
	(changes over the preceding year, %)				
GDP	6.9	8.0	6.4	7.5	7.5
Private consumption	6.3	7.3	7.4	8.6	8.0
Public consumption	-1.9	0.3	2.4	2.5	2.5
Total fixed capital formation	10.2	11.4	13.0	7.8	15.0
Exports	12.0	6.9	6.3	4.3	8.3
Imports	4.9	12.6	4.5	13.1	8.8
Consumer prices	2.6	2.5	1.9	2.9	5.5
	(in percent of GDP, unless indicated otherwise)				
General government budget fiscal balance	-2.6	-2.0	-2.3	-1.6	-2.1
Central government debt	12.2	13.8	13.3	13.4	14.9
Current account balance	-6.4	-9.0	-7.0	-8.6	-9.5
Foreign direct investment (flows)	5.3	2.0	4.2	3.3	4.5
Share of job seekers (% of economically active population, 15-64 years old)	14.6	13.3	12.1	10.7	10.0
Exchange rate of LVL against SDR (end of period)	0.7997	0.7997	0.7997	0.7997	0.7997

f – forecast

During the last four years the average consumer price inflation had been within the limits of 2-3%, reaching 2.9% in 2003. In the first half of 2004 inflation was higher than the price rise level of the previous years. In May 2004 compared to the same month of 2003 inflation increased by 6.2% or the average annual inflation reached 4.1%.

The reason behind higher inflation growth was the combination of several one-time factors, mainly the rise of administratively regulated prices, as well as high import prices in connection with the appreciation of the euro and changes related to the accession to the EU. Also, a temporary factor causing the rise of consumer prices was the “inflation expectations” based on the psychological effect and speculations on the expected price increase as Latvia moved closer to the accession to the EU. To curb inflation and private consumption the Bank of Latvia in March 2004 increased the refinancing rate by 0.5 percentage points and postponed the planned reduction of the reserve requirement till the end of 2004.

The goal of the fiscal policy implemented in Latvia is to secure a balanced economic growth and financial stability. Since 1996, with the exception of 1999 when the fiscal situation reflected the consequences of Russian financial crises, the fiscal deficit of the general government budget was lower than the identified in the Maastricht Treaty (3% of GDP). After Latvia's accession to the EU the compliance to the financial criteria of Maastricht Treaty will be consequently ensured.

One of the main economic development risks of Latvia is a relatively high current account deficit, caused by the high domestic demand, especially by the dynamic growth of investments. In 2003 the current account deficit equalled to 8.6% of GDP, exceeding by 1.6 percentage points the level of the preceding year. The main cause behind the deficit growth is the worsening of trade balance. Approximately a third of it is covered by the positive balance of services.

Since the deficit of the current account is basically covered by foreign direct investments and long-term loans, the level of deficit at the moment is not considered as critical. Net foreign reserves of the Bank of Latvia are growing and fully cover the reserve money.

It is anticipated that growth of exports promoted by structural reforms will bring down the current account deficit in the medium-term. However, the demand for imports will remain relatively high due to the further modernization and the growth of the openness of the economy. It should be noted that after the accession to the euro zone risks related to negative current account deficit (risk of currency crises) will almost fully disappear as stability of the currency and keeping of foreign currency reserves will become the competence of the European Central Bank.

Economic growth stimulates also the growth of wages. Net wages in 2003 in comparison with 1996 had gone up by 89% and by 10.9% exceeded the level of 2002. During this period inflation had increased by 51%, while in 2003 inflation grew by 2.9%. The real income of employees from 1996 till 2003 had grown by 25%, whereas in 2003 the growth reached as much as 7.8%. During the previous two years real wage growth had increased faster, which was fostered also by the growth of the minimum salary. Yet, growth of income is very uneven, polarization of society in terms of income is increasing and the number of poor people in the country is relatively high. Growth of old age pensions is slower than the growth of the income of employees. Gini index, which shows the inequality level of the welfare, has gone up from 0.30 in 1996 to 0.34 in 2002.

The employment and unemployment indicators are gradually improving. However, it should be noted that the improvement of these indicators had been mainly reached at the expense of productivity and, to a lesser extent, due to the higher number of employed people. In 2003 the number of employed persons in the age group between 15 and 64 years had grown only by 6% comparing to 1996. However, in nearly all sectors of national economy there is a tendency that growth does not have a major impact on employment. With the development and strengthening of the private sector also competition becomes stronger forcing companies to look for ways of decreasing costs. With the improvement of management one of the main cost items to be downsized are labour costs, which often results in reduction of the number of employees. These processes are objectively determined for the Latvian economy given its generally low level of productivity. Therefore, future growth will be mostly based on increase of productivity rather than growth of the number of employees.

Economic activity of people (participation in the labour market) is a little bit lower than on average in the EU, while economic activity of women already now has exceeded the average indicators in the EU.

The number of job seekers in the age group between 15 and 64 years had decreased substantially (from 20.5% in 1996 to 10.7% in 2003). However, great differences remain between unemployment rates in

different regions and cities. The lowest unemployment is in the Riga region, whereas the highest – in Latgale. Employment promotion measures and increase of economic activity in many rural areas until now have not resulted in positive changes. The most difficult situation remains in Latgale where unemployment in some regions exceeds 20% of the economically active population (the average unemployment rate registered at the end of 2003 was 8.6%, while the real unemployment (the share of job seekers) reached 10.7%). Also the GDP per capita in Latgale is the lowest in the country, being twice as lower than the average in Latvia.

The economic growth potential is best characterized by the growth of investment. From 1996 till 2003 the gross fixed capital formation annually went up on average by 17%. Investment grew especially rapidly during 1996-1998, fostered by privatisation. Also now despite the completion of mass privatisation total fixed capital formation continues increasing every year at a rather fast rate.

Growth of investment and the share of investment in GDP in Latvia are one the highest among the new EU member states. Investments are promoted by several factors, including stable macroeconomic environment, inflow of foreign investments, reduction of interest rates on loans and strengthening of the banking sector, increase of general economic activity and formation of positive future expectations, etc.

The reforms carried out in the previous decade have strengthened the private sector. Good macroeconomic conditions for the further development have been created and the business environment is improving, too. Accession to the EU will have a particularly positive impact on Latvian economy, strengthening confidence that the growth will be sustainable also in the coming years. If there are no external shocks the annual GDP growth can be expected by 6-8% in the medium-term.

2. Housing Sector Overview

As Figure shows since 1991, construction of new buildings has dwindled to a minimum, and many half-built buildings have been abandoned, especially in Riga. The only buildings built now are those with private investments.

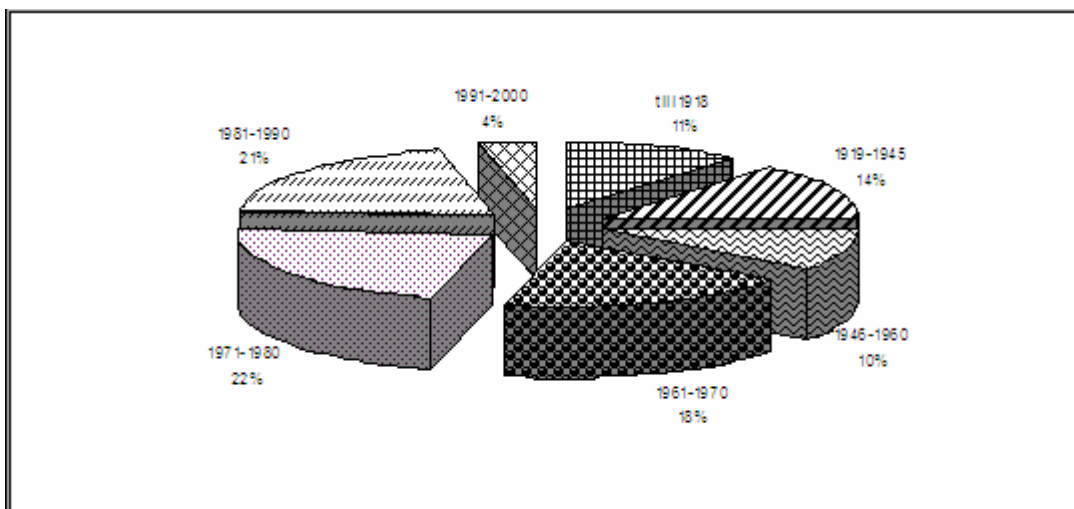
There are problems with heat inefficiency in dwellings built before 1970.

At the end of 2003 the total floor space of the housing stock of Latvia amounted to 55.4 mln m²; of these 16.5 mln m² or 30% were in the city of Riga, according to the Central Statistical Bureau.

Approximately two thirds of the total housing stocks are located in urban areas and one third is in rural area.

One of the main indicators of the housing stock is the total floor space on average per resident inhabitant; it was 19.2 m² in 1990, 22.6 m² in 2000 and 23.9m² in 2003.

Housing Quality



Latvia's housing stock

Apartments with public utilities at the end of 2001 (% of total apartments)

	state	Of which	
		cities	rural
Apartments with public utilities:			
Piped water	94.3	96.4	79.4
Sewerage	93.5	95.7	77.8
Central heating	84.3	88.6	54.4
Fixed bath or shower	84.9	88.1	62.5
Hot water supply	78.1	84.2	35.4
Gas supply	85.7	87.5	73.2

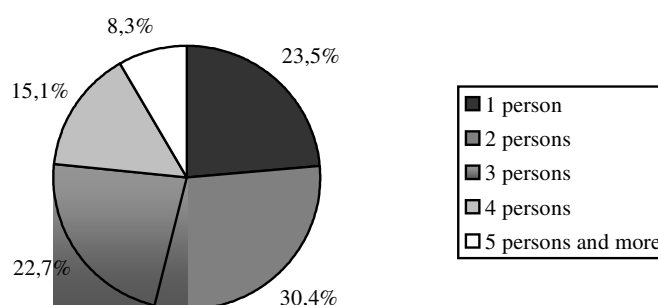
Basic indicators of the housing stock¹

(at end of the year, millions m² of the total floor space)

	1990	1995	2000	2001	2002	2003
Total	52.9	52.7	53.4	53.5	54.9	55.4
of which :						
Public sector	36.6	26.2	12.8	11.0	10.2	9.2
Private sector	16.3	26.5	40.6	42.5	44.7	46.2
On average per inhabitant, m ²	19.2	21.4	22.6	22.8	23.6	23.9
Urban housing stock -	33.8	34.1	34.7	34.8	35.7	36.2
of which :						

Public sector	26.2	22.3	10.1	8.4	7.8	7.0
Private sector	7.6	11.8	24.6	26.4	27.9	29.2
On average per urban inhabitant, m ²	18.3	20.1	21.5	21.8	22.6	23.0
Rural housing stock-	19.1	18.6	18.7	18.7	19.2	19.2
of which :						
Public sector	10.4	3.9	2.7	2.6	2.4	2.2
Private sector	8.7	14.7	16.0	16.1	16.8	17.0
On average per rural inhabitant, m ²	23.3	24.3	25.0	24.8	25.6	25.8

Distribution of households by size



Source: CSB, Household Budget Survey. Note: in 2002, in %

Table 2. Dwellings by size

Floor space	Total housing stock
Up to 20m ²	1.32
20-40 m ²	25.3
40-60 m ²	50.14
60-80 m ²	19.47
80-100 m ²	2.54
>100 m ²	1.23
	100%

Housing and Denationalization

As a result of the denationalization of house ownership and privatization of local government-owned residential buildings the ownership structure of the housing stock has changed. At the end of 1990 the share of the private sector in the housing stock was 31% but by the end of 2003 it had increased to 83%.

In the period between 1992 and April 2003 57 thsd dwellings were privatized in Riga according to the revised data of the Riga City Council. According to the results of the survey "Private tenement houses" conducted by the CSB, 27 thsd tenants lived in denationalized houses in Riga; of these, 20 thsd tenants had been living there before the denationalization of the house.

Housing and Land Privatisation

The privatisation process in Latvia began in 1991 and it is presently in the final stage. Its objective is to reduce State participation in the economy and to create a favourable environment for the development of private capital and initiative². According to the Central Statistical Bureau, about 80 % of Latvian housing will be private property by the end of the privatisation process and municipalities will maintain only 20% of the housing as rental or social housing.

The privatisation process is performed by individual privatisation commissions- established in each municipality- and co-ordinated by the Central Apartment Housing Privatisation Commission. Privatisation certificates³ for the privatisation of apartments have been issued to private individuals based on age, working history, deportation and other factors. Now this institution is abolished and State Agency “Housing Agency” accomplishes the privatization of state dwelling houses in accordance with the Law “On Privatization of State and Municipal Housing”.

There are two types of housing privatisation in Latvia which are the Regular or Full Privatisation and the Accelerated Privatisation. The latter is a temporary stage of the Full Privatisation. In the Regular or Full Privatisation, the entire building is privatised and registered in the Land Book and each apartment, with its respective joint ownership of common areas and land, is registered as a private property in the Land Book. In the Accelerated Privatisation, only the apartment is privatised without any assigned portion of the common areas and land. Ownership of the apartment is only registered in the Cadastre. Once the house is fully privatised, ownership titles of individual apartments and their respective joint ownership of the common areas and land are registered in the Land Book.

According to the Law, “On Privatisation of State and Municipal Apartment Houses”, by April 30, 2002, there have been 25 673 state and municipal apartment houses prepared and assigned for privatisation⁴. These apartment houses represent 480,893 apartments, which equals 96.17% of the total number of flats in Latvia. Privatisation notifications have been sent to 287,346 tenants⁵. There were 150,127 notifications sent, upon the conclusion of purchase agreements, to individuals who had privatised their flats prior to the privatisation of the entire building, and 193,547 flats were assigned for privatisation before privatisation of the building⁶.

3. Housing Finance Market and System

Compared with 2002, the total value of real estate sales transactions in 2003 rose by 38% and was LVL 255 million.

Value of real estate sales transactions in 2003

Kind of real estate	Number of transactions	Value of transactions, mln LVL	Average value per transaction, thsd LVL
Total	21.9	254.9	11.6
of which:			
Buildings with land	4.8	97.9	20.3
Buildings	0.5	18.3	33.9
Dwellings and uninhabitable premises	8.9	64.2	7.2
Land	7.7	74.5	9.7

Mortgage Loan Industry

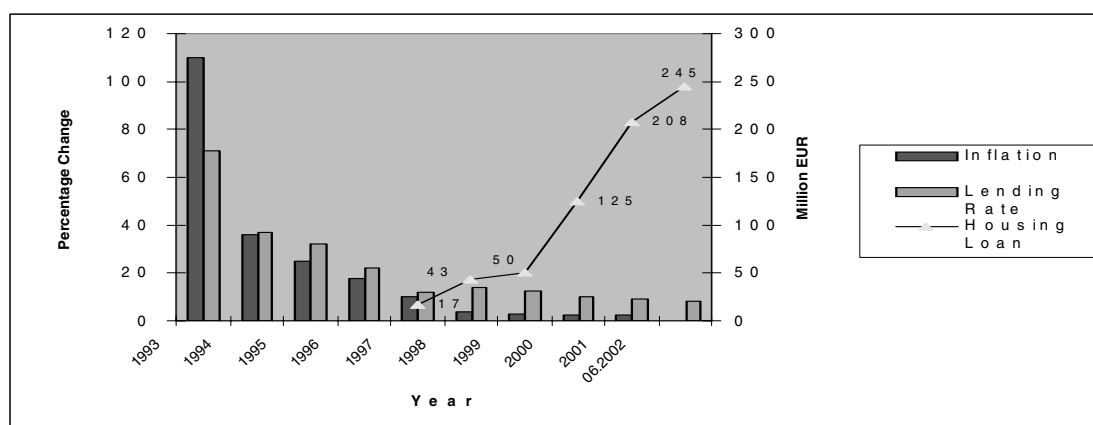
The recent developments in the mortgage loan industry include the decrease of lending rates and the increase of loan maturities and loan-to-value ratios. The main factor that prompted the foregoing developments is that the majority of individuals' incomes are insufficient to comply with existing loan requirements.

Loan terms were typically quite short, but banks have recently started to offer 20 to 40 year mortgage loans. As well, many financial institutions offer fixed and floating interest rates. In the past, banks required down payments that were as high as 30 to 40% of the property value but the recent trend has been towards lower requirements, such as 10 to 20%.

The range of mortgage products is limited in Latvia, which is the case in most transition economies. Loans can be denominated in Lats or in foreign currency.

Between 1993 and 1999, the volume of mortgage lending increased dramatically. The foregoing can be attributed to lower inflation, macroeconomic stability and growing consumer confidence⁷ (Figure below).

Mortgage Volumes and Lending Rates (1993-1999)



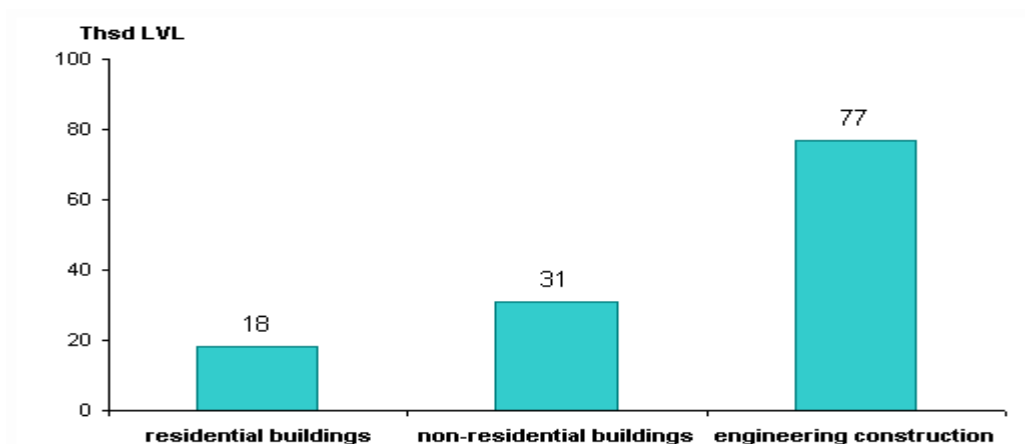
In 1998, the Latvian Parliament adopted the Law on Mortgage Bonds, which provides the legal basis for the issuance of mortgage bonds. Mortgage bonds in Latvia are typically liquid and secure; therefore they are highly demanded by investors.

The Bank of Latvia uses mortgage bonds in their monetary operations, which ensures the bonds' liquidity. Furthermore, all mortgage bond issues are quoted on the Official List of the Riga Stock Exchange. Mortgage bonds issued by the Latvian Mortgage and Land Bank have a rating of A3 (Moody's) which was assigned in November 2001 and confirmed in April 2002.

Despite the favourable developments-in mortgage conditions-to borrowers, banks still consider long-term mortgage lending to be risky due to the low solvency of the majority of residents in Latvia.

The major obstacles for sound growth of the mortgage loan industry in Latvia are the low borrowing capacity of the population and a mental resistance to borrow as a result of the Soviet era, where the majority of investments were financed through personal savings.

Average value per transaction in buildings with land

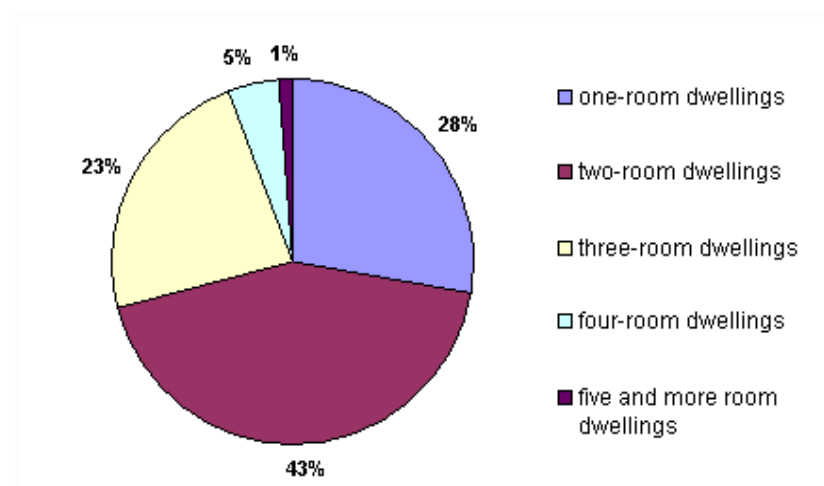


Concerning sales transactions in residential buildings with land the average value of buildings accounted for 79% of the total cadastre value but the value of land represented 21%. By contrast, the value of buildings in sales transactions in uninhabitable premises with land represented on average 57% of the total cadastre value but the value of land accounted for 43%.

The highest average value per sales transaction in residential buildings with land was observed in Riga (LVL 53 thsd), followed by Jūrmala (LVL 43 thsd) and Liepāja (LVL 25 thsd).

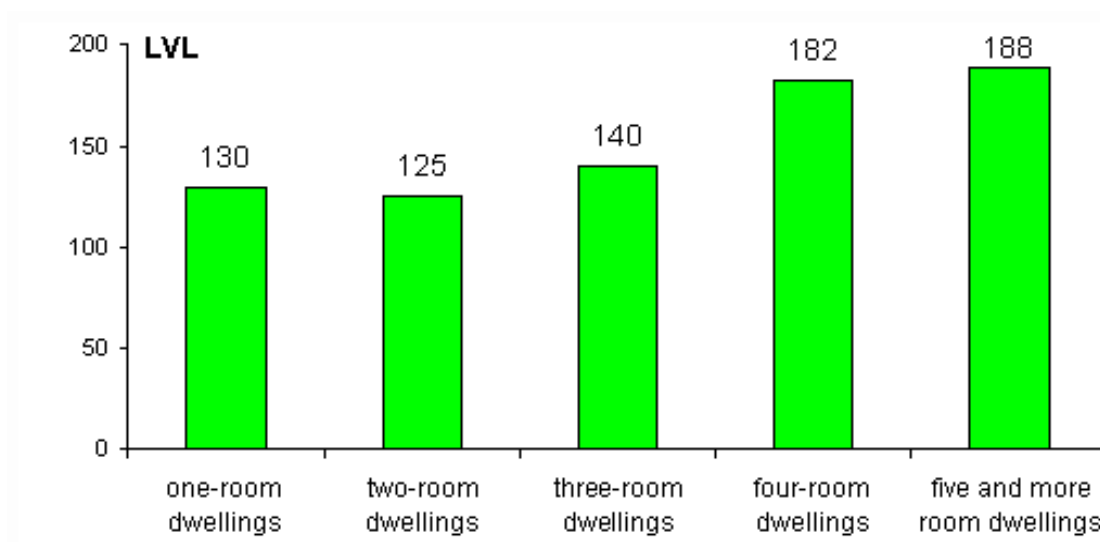
Along with arranging legal relations in real estate trade, the sales volume of buildings (without land) is gradually decreasing. The total value of sales transactions in buildings in 2003 equalled LVL 18 million or 7% of the total amount of real estate transactions.

Dwellings sold in Latvia in 2003 by the number of rooms

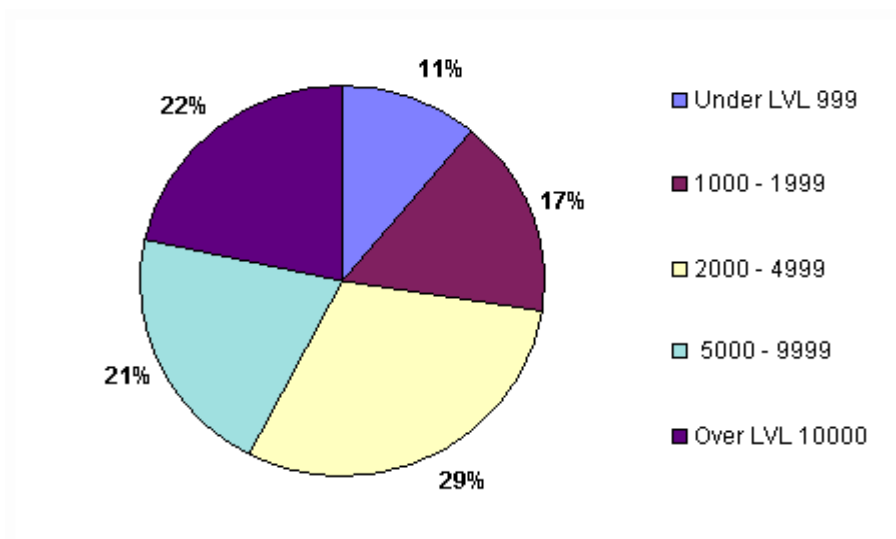


On average there were 2.1 rooms per one dwelling sold with the total floor space equalling 51 square metres.

The price per square metre of the total floor space of dwellings sold in Latvia



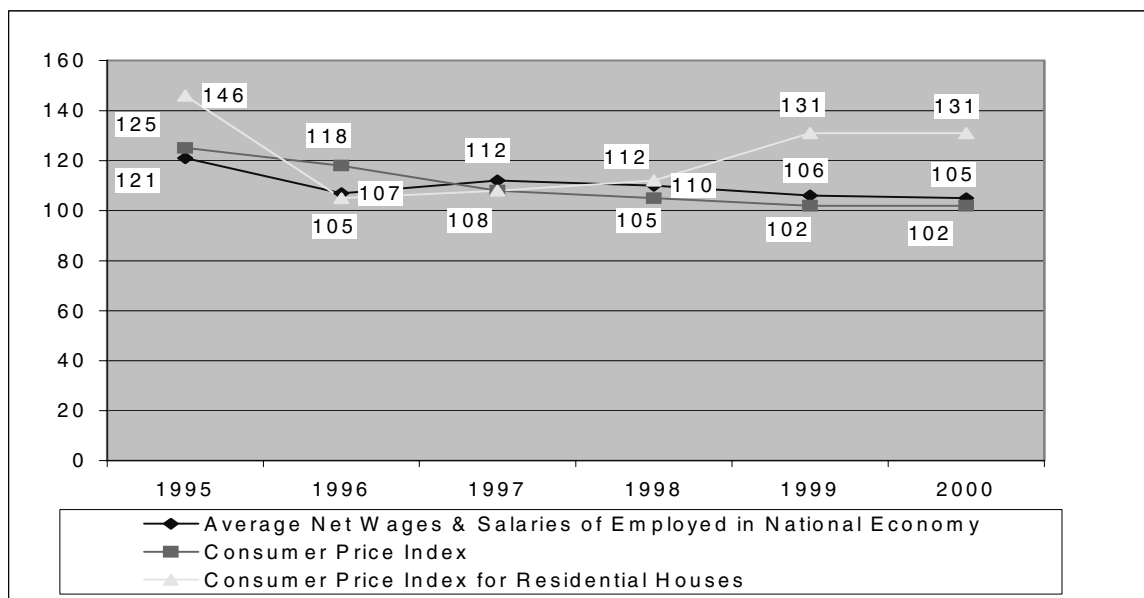
Dwellings sold in 2003 by value of transaction



**The average price per dwelling in Latvian cities and towns
where at least 50 dwellings were sold in 2003⁸**

Cities and towns	Price per dwelling, thsd LVL	Average price per square metre of the total floor space [of the dwelling]
Riga	11.5	220
Jurmala	11.3	200
Ogre	7.3	144
Jelgava	6.6	130
Valmiera	6.0	107
Salaspils	5.5	111
Sigulda	5.3	108
Olaine	4.4	94
Cesis	4.1	82
Daugavpils	3.3	66
Liepāja	2.8	51
Talsi	2.7	66
Liepaja	2.7	54
Ventspils	2.7	55
Tukums	2.7	54
Saldus	2.3	48
Madona	2.2	45
Rezekne	2.1	44
Dobele	2.1	35
Aizkraukle	1.9	43
Kuldiga	1.7	38
Alūksne	1.2	25
Gulbene	1.1	22
Preiļi	1.0	23
Jekabpils	0.9	17
Balvi	0.8	18
Livani	0.4	9

Construction Cost Index



Source: Central Statistical Bureau of Latvia, 2002; 2001

In 2001, merely 4% of all construction in Latvia was construction of housing which was mainly financed by residents. In the same year, the number of construction permits issued to build one-apartment houses (or to reconstruct an existing house) rose to 1606 from 1507 permits in the previous year⁹. Furthermore, there were 34 permits issued for construction of two or more apartment houses in 2001, 16 of which were in Riga¹⁰. As well, real estate developers have announced plans to construct at least 15 single family house villages in suburbs of Riga with a living area of about 200,000 m².

There are a number of factors that impede the construction of residential buildings. Firstly, construction costs are high as compared to the affordability of individuals. As a result, a disproportionate number of luxury houses are built to target individuals with high income. Secondly, renting out housing is not considered a business activity and finally, support from the State is inadequate; however, it is investigating measures to finance the construction of residential buildings. In particular, housing for middle income people. The State is also exploring the creation of incentives to encourage individuals to invest in housing. One of the options is a guarantee system to facilitate and stimulate construction and renovation of housing.

For the moment, government resources for housing will be mainly used to create a social housing fund with small, cheap apartments for urgent cases and specially adapted flats for senior citizens and disabled persons.

4. Housing Policy

4.1. Government Policy for Own Housing

Housing policy since 2003 is framed by The Ministry of Regional Development and Local Governments. The issues of construction in Latvia since 2003 are regulated by the Ministry of Economics. The Ministry of the Environment is responsible for the development of policy from the perspective of environmental concerns. The State Agency "Housing Agency" (established in November of 2002) is responsible for the enforcement of housing policy.

In framing and enforcing policies, the Ministry of Regional Development and Local Government liaises with the Union of Latvian Municipalities, the Association of the Large Cities and the Housing Development Advisory Board.

The State Agency “Housing Agency” is a government institution supervised by the Ministry for Regional Development and Local Governments. The overall goal of the “Housing Agency” is to realize a corporate national policy in the sphere of housing. The State Agency “Housing Agency” was formed by the decision of Cabinet of Ministers on October 1, 2002. The mission of the “Housing Agency” is to enhance the quality of housing, its affordability and opportunities for choice.

The Government has issued a number of housing policy papers. They concern not only public administration institutions and municipalities but also every member of public who wants or needs to improve the housing conditions by means of purchasing new housing, renovating existing one, or developing the neighborhood. This information is intended to disseminate information on fundamental principles and anticipated development trends of the national housing policy among the stakeholders and general public.

According to the Latvia Concept of Housing Policy, which was approved in 1996, housing development in Latvia consists of specific economic, social and housing stock goals.

The social goal of housing development is to provide individuals with the possibility to choose and improve their housing situation. As well, to continue to make social housing available for low-income families.

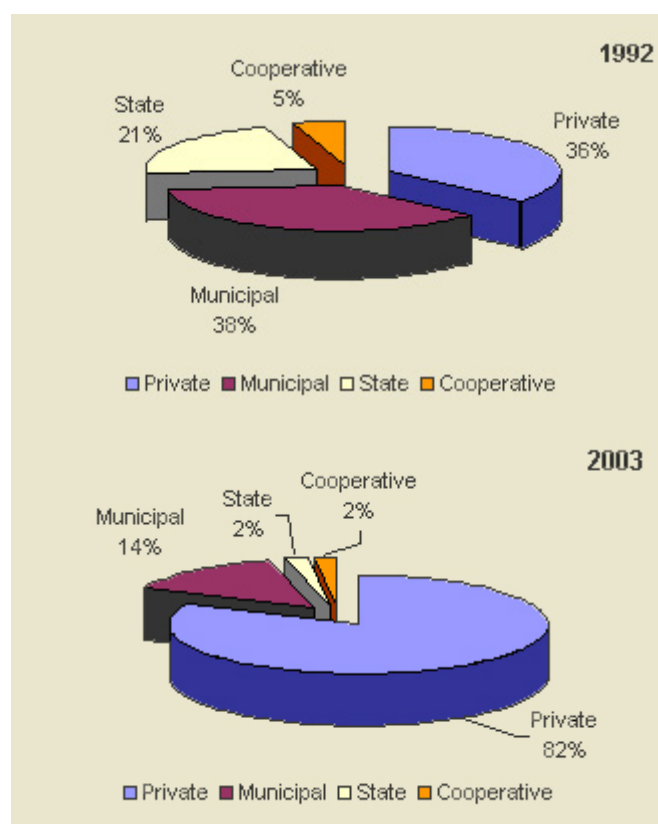
The Concept Paper also lists following tasks, which are equally important:

- Development and maintenance single national housing registry,
- Housing assistance to disadvantaged groups of population in form of municipal homes and housing adapted for people with special needs,
- Establishment of low interest long-term mortgage system for housing development,
- Compensation system for limitations on exercising of ownership in protected areas.

Since 1996 some of the objectives have already been accomplished - legislative framework is established and housing assistance and tenure rights are secured.

The privatization process of state and municipality-owned housing is nearing an end. Picture below shows change in ownership type resulting from processes of real estate denationalization from 1991 and privatization from 1995.

Distribution of housing by type of ownership in 1992 and 2003



Housing policy is a process of gradual development and every stage of development features different problems. Thus, as a direct result from privatization process and private ownership of apartment buildings the following new issues emerged: building management of shared property, including availability of resources for development.

Finally, the Government's housing stock goals are to increase the supply of family houses and multi-apartment buildings with fewer stories and to continue the privatisation process in order to increase the number of apartments inhabited by apartment owners.

Concept Paper on Long-term Low Interest Rate Mortgage System For Housing Development

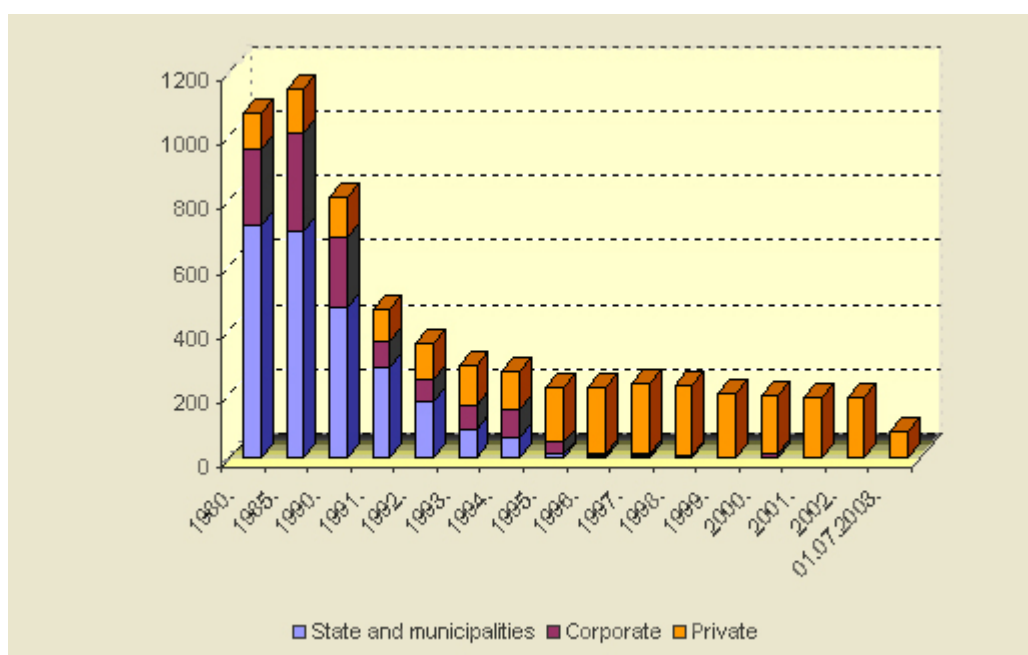
Recent past has seen the gradual decline in new housing building volumes. At the same time there are many families and individuals willing to build new homes or improve existing ones.

Several commercial banks in Latvia offer commercial mortgages and loans for a period up to 7 years at an annual interest rate ranging from 12 to 24%. To address the issue on the national level the Cabinet of Ministers approved the *Concept Paper On Mortgage System For Housing Development* on 19 November 1997.

The Concept Paper foresees establishment of efficient and feasible commercial mortgage system to facilitate housing development in urban, suburban and rural areas through low interest rate and agreeable repayment periods. In addition to mobilization of resources for development the capitalization of savings will be promoted. Mortgage system cannot develop without an appropriate

legislative framework. Currently the framework consists of Civil Law, Land Register Law and Civil Procedure Code, which all together represent an adequate legal base for all mortgage-related issues. Main problem encountered in the process of mortgage system introduction is excessively high price of available credit resources and comparatively short term of availability.

Housing construction in Latvia



The Concept paper declares following core principles:

(a) Priority areas for long-term mortgaging:

- Purchase of dwelling houses and apartments;
- Construction of new housing, with special encouragement for family homes and detached and semidetached developments;
- Renovation and upgrade of state, municipal and private housing, including adaptation for people with special needs;
- Insulation.

(b) Priority reconstruction, upgrade and insulation works:

- Roof repairs and reconstruction of flat roofs;
- Energy saving measures – outer insulation with façade refurbishment, modernization of the heating system, window replacement and double-glazing;
- Redecoration of shared facilities – stairs and entrances, development of basement space;

- Re-designing of the dormitory type houses into modern apartment houses;
 - All works to adapt housing for people with special needs;
- (c) Performance of national target programmes:
- State guarantee as a collateral for mortgage,
 - State guarantee for commercial mortgages,
 - Subsidies towards the mortgage interest,
 - Partial mortgage subsidy from national budget resources,
 - Tax relief.

Housing Development Mortgage Programme, Stages I and II

The supply of the population of Latvia with housing, both in terms of quantity and quality, is not up to par with standards of the European Union. Furthermore, the floor space per dweller practically has not essentially changed during last five years, though the construction rates lately have grown significantly.

Significant factor is lack of state funding for housing development. Mainly funding derives from the private resources and commercial loans. Estimated 1.6 to 3.7 billion Lats have to be invested during a five-year period in order to reach the current EU level in housing sector.

To implement the objectives and reach targets as set in the *Latvian Housing Policy Concept Paper* and *Concept Paper On Housing Development Mortgage Programme*, and to address the complicated issue of inadequate funding, the work on drafting the *Housing Development Mortgage Programme* was started. Mortgage and Land Bank of Latvia was involved in this process. Stage I of the Housing Development Loan Programme was approved by the Cabinet of Ministers on 13 June 2000.

Financial resources allocated for the implementation of the Housing Development Mortgage Programme are managed by Mortgage and Land Bank of Latvia. Mortgage and Land Bank of Latvia re-finances 80% per mortgage issued by commercial bank in accordance with the provisions of this programme, thus providing long-term mortgages for relatively low interest rate. The underlying key principle is to encourage the private homeowners to invest their own savings in reconstruction and renovation of their houses, as well as to build new housing and complete buildings under construction.

Initially it was planned to start with total amount of 20 million Lats and to issue mortgages, covering all regions of Latvia, distributed between priority areas as follows:

- 120 - to renovate block apartment houses,
- 3650 - to renovate and redecorate apartments,
- 1100 - to purchase and renovate apartments,
- 480 - to complete family homes under construction.

The objective of the Programme is:

- to meet the needs of the population for affordable housing, infrastructure and service facilities;
- to create economically viable conditions to attract private savings for the development of housing, to create mortgage system affordable in terms of interest rate and recovery period;
- to facilitate development of the housing market;
- to facilitate the development of construction sector, thus contributing to national economy and, specifically, to development of construction material manufacturing industry, construction industry and related industries;
- to develop mortgage system and relevant financial market instruments.

The Programme consists of two stages, which are implemented through pilot programmes. Stage I includes two sub-programmes: *Housing Project*, which involved development of legislation, institutional development and the development of the system of guarantees, and the *Housing Development Mortgage Pilot programme*.

For each of the pilot programmes funding from various financial institutions is attracted, including the plans to receive state guarantees.

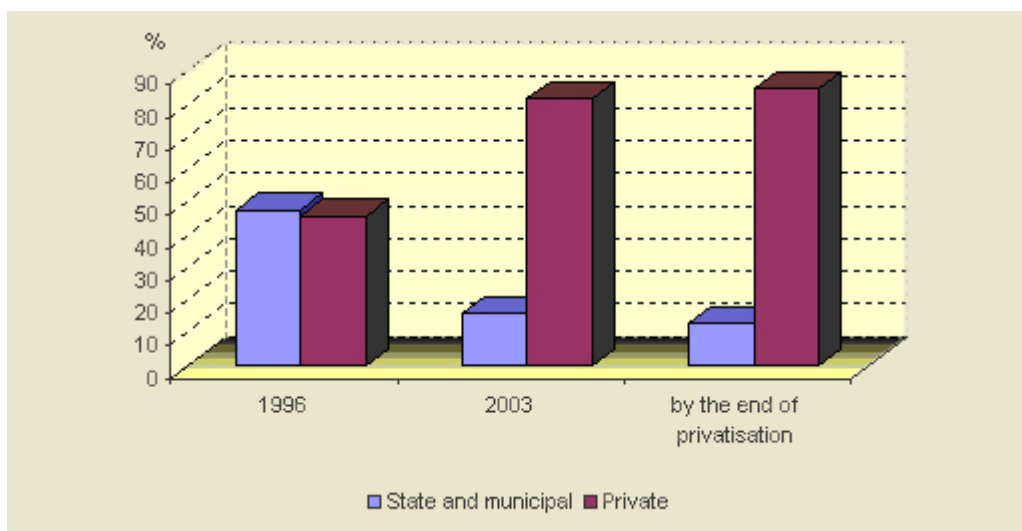
The objective of Stage I of the Housing Development Loan Programme is:

- to evaluate current hindrances to mortgage development and success rate of the sponsored trial ,
- to perform precise estimation of the funding needs for housing development,
- to facilitate upgrading and expansion of the existing housing,
- to provide availability of mortgages with annual interest rate of 9% ,
- to assess the necessity for the state and municipality guarantee schemes and a state co-financing scheme.

Concept paper on legislative and institutional framework on development of housing and tenure

The development of the free market economy in Latvia has brought along principal change in the structure of the housing ownership, while effective legislation and practice fall short on successfully regulating current cases. Privatization of the state and municipality-owned housing and denationalization of buildings has already caused significant changes, which are expected to result in the following distribution between the types of ownership:

Change in the housing structure by ownership type



As the share of privately owned housing increases annually, the Government assessed the tenancy-related legislation and enforcement. The conclusion was that maximum admissible rent, established by municipalities, only partially covers the costs of building management and maintenance, which accelerates overall deterioration of housing. Furthermore, the need for social assistance for accommodation by far exceeds the possibilities to furnish it.

The general principles of housing management are stipulated only in the Civil Law of Latvia, while the management of privatized housing is regulated by the Law on Ownership of Housing, which permits selecting freely the type of management for joint property. Currently there are several types of management of housing: co-operative of apartment owners', non-profit organizations, limited liability companies or shareholding companies, as well as collective agreement of apartment owners; in the cities housing is managed by house management offices or individual house managers. The majority of the house managers do not have professional training or background, which causes problems not only with specific management issues but also with possible funding and mortgages.

Failure to make necessary amendments to laws and other legislative acts can lead to the following consequences:

- further deterioration in quality and a considerable reduction of suitable housing resources,
- municipalities will be not able to supply municipal housing in mandatory cases, due to decrease in available housing resources, resulting from privatization and insufficient building development,
- not viable and unprofessional management of housing will continue to produce deterioration of the housing quality and squandering of funding, eventually requiring significant investments in renovation of the housing.

In order to harmonize the legislation with the principles of national housing policy and to optimise institutional framework, and to meet international commitments, the Building Department of the Ministry of Environment and Regional Development developed *Concept document on the improvement of legislation and institutional structure relating to housing and tenure*, approved by the Cabinet of Ministers on 4 September 2001. It is necessary to revise relevant legislation to determine

the sharing of responsibilities between the government, municipality, individuals and incorporations on housing, to activate housing market and to ensure quality maintenance of housing.

The need for this Concept Document was determined also by the involvement of Latvia in the activities of the United Nations Centre for Human Settlements and participation in the United Nations World Conference on Human Settlements Habitat II City Summit, which took place in 1996 in Istanbul.

Legislation

The key laws regulating housing-related issues are:

- Law On Restitution of Lawful rights to the Real Estate, adopted by the Supreme Council on October 30, 1991;
- Law On Denationalization of Real Estate in the Republic of Latvia, adopted by the Supreme Council on October 30, 1991;
- Law On the Rent of Housing, adopted by the Supreme Council on February 16, 1993;
- Law On Privatization of State and Municipality-Owned Housing, adopted by the Saeima on 21 June 1995;
- Law On the Ownership of Housing, adopted by the Saeima on 28 September 1995;
- Law On Social Apartments and Social Homes, adopted by the Saeima on 12 June 1997;
- Law on Cooperative Societies, adopted by the Saeima on 5 February 1998;
- Law On Municipal Housing Assistance, adopted by the Saeima on 6 December, 2001;
- Law On Construction, adopted by the Saeima on 10 August 1995;
- Law On Land Register, adopted by the Cabinet of Ministers on 22 December 1937 (in force since 05 April 1993);
- Law On Cooperative Dwellings, adopted by Supreme Council on 4 December 1991;
- Law On Registration of Real Estate in Land Register, adopted by Saeima on 30 January 1997;
- Cabinet of ministers Regulation No. 561 “The Auction Procedure on Renting State-Owned Housing”, issued by the Cabinet on 27 December, 2001, pursuant to the amendment to the Law On the Rent of Housing;
- Cabinet Regulation No. 45 “Methodology for Calculation of Management Costs, Included in the Rental Charge for Dwelling Premises”, issued by the Cabinet of Ministers on 29 January, 2002, pursuant to the amendment to the Law On the Rental of Dwelling Premises;
- Cabinet Regulation No. 133 “Procedure of the settlement for services and utilities between the Tenant, the Landlord and service provider”, issued by the Cabinet of Ministers on 26 March, 2002, pursuant to the amendment to the Law On the Rent of Housing;

- Cabinet Regulation No. 112 “Regulations On General Construction”, issued by the Cabinet of Ministers on 1 April 1997.

In accordance with the provisions of the Accession Partnership, the Government of Latvia has prepared, with the European Commission, Directorate-General for Employment and Social Affairs, and signed a Joint Inclusion Memorandum with the purpose of preparing the country for full participation in the open method of coordination on social inclusion upon accession. The Memorandum outlines the principal challenges in relation to tackling poverty and social exclusion, presents the major policy measures taken by Latvia in the light of the agreement to start translating the EU's common objectives into national policies and identifies the key policy issues for future monitoring and policy review. Progress in implementing such policies will be assessed in the context of the EU social inclusion process, whose goal is to make a significant impact on the eradication of poverty in Europe by 2010. A significant precondition for reducing the risk of social exclusion is the availability of suitable housing. Low-income levels and comparatively high rental and utility charges are the cause of the majority of housing related problems.

Housing taxes

Tax on imputed rent	Mortgage related interest relief	Indirect taxes on new homes in %
The tax on imputed rent will adjust until 2007. This tax is calculated only for the land under dwelling, not dwelling as property	The tax is already included in acquisition of building materials, costs of construction etc	18

4.2. National Policies and Programmes affecting Urban Development in Latvia

Latvian national urban policy is developing. However, a number of national economic, social and environmental policies and programs shape the framework within which urban local governments address specific local issues. Central government institutions play a leading part in defining important sectoral priorities (economic, social, for example) and in designing programs levelling off territorial inequalities. The urban agenda is not a political priority and policy reforms have pushed regional development approaches ahead. The overarching policies for Latvia's development are articulated in The National Spatial Plan, The National Development Plan and more than 20 national and sectoral development programmes. Line ministries and newly-established Regional Councils ensure the coordination of regional development planning and support measures in accordance with basic principles identified in regional development planning documents at the national and regional level.

Economic policies

The most important national economic policies are set out in *The National Employment Plan (NEP)*. NEP for 2003 contains a list of 56 activities, mainly concentrating on the improvement of employable skills and support for business activity. The employment promotion measures are closely linked with the implementation of the *Joint Assessment of Employment Priorities in Latvia* signed by Latvia and the European Commission and the Development Plan for 2004-2006. The funding of activities is linked with the European Social Fund, which is the main EU financial instrument for the development of human resources and improvement of the labour markets. *The Long-term Economic Strategy of Latvia* defines the basic positions of the economic policy. The aim of the long-term development strategy of Latvia is to ensure the transition from a labour-intensive economy to a knowledge economy and in this way to reach the average per capita GDP levels of the EU member states in the next 20-30 years (Ministry of Economic Affairs, 2003).¹¹

Social policies

Latvia has started several important reforms to address social issues. A state-funded second-level pension scheme was launched on July 1 2001; the scheme is one of the most progressive in the countries of transition. The pension age will be gradually increased to 62 years both for men and women by the middle of 2008. Better mechanisms of providing and channelling social assistance are being introduced within the scope of the reform of the welfare system to ensure the efficient integration of people in social and economic life and to provide better social protection. The *Joint Inclusion Memorandum* has been signed with the European Commission. The memorandum stipulates priority areas and activities to reduce poverty and social exclusion, with a special concentration on groups at risk of social exclusion such as disabled and unemployed people.

Environmental and planning policies

The Law on Regional Development (2002) and The Law on Spatial Planning (2002) provide a framework for territorial planning and include provisions concerning local government responsibilities in environmental protection and the use of natural resources. Cabinet of Ministers Regulations on the *National Spatial Plan* and on *Local Government Territorial Plan* regulate all aspects of the spatial planning process. The Ministry of Regional Development and Local Government (formerly Ministry of Environment & Regional Development) prioritizes investments in water, wastewater, and waste management projects. These projects have been financed by EU Phare funding, grants, and soft loans from donor countries, international finance institutions, money from the national budget and the Natural Resources Tax through the National Environmental Protection Fund, and the Environmental Investment Fund. The largest environmental investments have gone to the national level cities and larger towns. Funding from the EU LIFE programme has also been used to fund projects in the nature and environment sectors. National transportation priorities are established in the *Transportation Strategy*. Road and bridge projects linked to national and trans-national roadways (VIA Baltica) are priority items. EU pre-structural ISPA funds are used for transport and environmental sector projects in urban areas, including Riga.¹²

Supra-national policies and programmes

In April 2003, Latvia signed the Treaty of Accession to the EU; a referendum in favour of joining the EU followed in September 2003. One of the preconditions for Latvia's successful integration in the EU was the ability to harmonize Latvian legislation with EU requirements. The process was initiated at the conclusion of the Treaty of Europe and has continued in parallel with the process of the accession negotiations. In its *2003 Supervision and Monitoring Report* the European Commission has stated that Latvia has met all requirements.¹³

Correspondingly, the Government has coordinated its 2003 *Single Programming Document* (SPD) with the European Commission and it will be used as the basis for allocation of the EU Structural funds in 2004-2006. In addition, the Framework Document for the use of the Cohesion Fund in 2004-2006 has been drawn up. While none of the priorities of SPD have an explicit urban focus, activities and projects are expected to benefit Latvian cities in at least three strategic areas: (1) the promotion of sustainable development; (2) the fostering of business activity and innovations; (3) the encouragement of the development of human resources and employment. Funding to Latvia from the structural funds in 2004-2006 will total 845 million euro (626 million euro from EU structural funds and 220 million euro from the Government budget).

On the other hand, EU accession requirements impose great demands on local governments. It is estimated that local authorities will need to invest approximately 180-200 million Lats to meet the

EU's landfill directive by 2015.¹⁴ To meet EU directives on drinking water and urban wastewater, local authorities will need to invest approximately 571 million Lats, a sum which exceeds the fiscal capacity of both central and local governments (Ministry of Foreign Affairs, 2001). Critics also argue that small local authorities have insufficient capital budgets to meet the minimum investment size criteria demanded by the EU. The minimum size of EU-financed ISPA projects, for example, is 5 million euro (2.8 million Lats) with a minimum 25 percent municipal contribution. Most local government authorities with populations below two thousand will find it impossible to qualify (World Bank, 2003).

NOTES

- 1 Data source_ CSB, 2004
- 2 Ministry of Finance of the Republic of Latvia
- 3 Dematerialised security granted by the State, which can be used once as a method of payment for privatised State or Municipal property .
- 4 Ministry of Economics of Republic of Latvia
- 5 Ministry of Economics of Republic of Latvia
- 6 Ministry of Economics of Republic of Latvia
- 7 Monitoring Housing Policy and Housing Market Performance, Sasha Tsenkova
- 8 Data source: CSB, 2004
- 9 Ministry of Economics of the Republic of Latvia
- 10 Ministry of Economics of the Republic of Latvia
- 11 To ensure the development of knowledge-based sectors and the growth of products with a high added value, the Government emphasizes the need to promote cooperation between industry and research. In April 2003 the Cabinet Ministers adopted *The National Innovation Programme for 2003-2006*.
- 12 ISPA, the Instrument for Structural Policies for Pre-accession, is one of the European Union's three financial assistance programs to assist the candidate countries in Central and Eastern Europe in the accession process.
- 13 The full text of the report is available on the European Commission homepage http://europa.eu.int/comm/enlargement/report_2003/index.htm.
- 14 Ministry of Foreign Affairs, *Addendum to the Position Paper of the Republic of Latvia Chapter 22: "Environment"* CONF-LV-60/00, 2001, p. 29.

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