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ABSTRACT/RESUME

Bridging the housing gap in Poland

Despite a high level of homeownership, the housing market in Poland is suffering from an important shortage. The difference between the number households and available dwellings, the number of dwellings per thousand inhabitants, and the availability of basic amenities (especially in rural areas) all indicate that significant improvements are needed to catch up to the most affluent OECD and EU countries. The formal rental segment of the market is also underdeveloped, contributing to low labour mobility and persistent disparities in regional unemployment. Given the social, economic and political dimensions of the problem, various housing policies implemented since the beginning of the transition process have aimed to fill the housing gap, though they have been either narrow in scope or have led to unclear results. However, the housing market has been buoyant in recent years, spurred by rising levels of GDP per capita, lower interest rates and the emergence of a competitive mortgage market. Yet a brisk price appreciation has also occurred at the same time, while households' exposure to interest- and exchange-rate risks has significantly increased and banks' funding capabilities have shrunk. Although the market has not been directly affected by the recent global financial turmoil, recent information shows that a turn-around is underway, with prices declining in several major cities as sentiment has plunged. This raises concerns about the capacity of the market to achieve a smooth adjustment in the face of a possible downturn.

JEL codes: R21; R31; E22; E51; P33
Keywords: OECD; Poland; housing supply; housing policies; house prices; housing market; mortgage lending; property taxes; rental market; rent regulation; social housing

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Combler le déficit de logements en Pologne

Malgré la place importante qu'occupe la propriété, le marché immobilier polonais pâtit d'une importante pénurie de logements. La différence entre le nombre de ménages et le nombre de logements disponibles, la densité de logements par millier d'habitants et l'équipement en éléments de confort de base (en particulier dans les zones rurales) sont autant de facteurs qui témoignent des progrès que la Pologne doit encore accomplir pour se hisser au niveau des pays les plus riches de l'OCDE et de l'Union européenne. Le segment locatif formel est également sous-développé, ce qui contribue à une faible mobilité de la main-d'œuvre et à la persistance de disparités régionales du chômage. La question du logement ayant une dimension sociale, économique et politique, la plupart des politiques du logement mises en œuvre depuis le début du processus de transition visaient à combler le déficit de logements, mais avaient une portée insuffisante ou ont eu des résultats mitigés. Il n'en reste pas moins que le marché immobilier a été dynamique ces dernières années, notamment en raison de la hausse du PIB par habitant, de la baisse des taux d'intérêt et de l'apparition d'un marché hypothécaire concurrentiel. Toutefois, dans le même temps, les prix se sont fortement appréciés, tandis que l'exposition des ménages aux risques de taux de change et de taux d'intérêt s'est fortement accrue, ce qui a réduit les capacités de financement des banques. Par ailleurs, bien que le marché polonais n'ait pas été directement touché par les turbulences financières qui ont secoué l'économie mondiale ces derniers temps, de récentes données montrent que le retournement du marché est en cours, les prix ayant baissé dans plusieurs grandes villes à mesure que le climat des affaires se dégradait. Cette situation amène à s'interroger sur la capacité des marchés à réussir un ajustement en douceur en cas de retournement.

Classification JEL : R21 ; R31 ; E22 ; E51 ; P33
Mots-clés : OCDE ; Pologne ; offre de logements ; politique du logement ; prix immobiliers ; marché immobilier ; crédit hypothécaire ; impôt foncier ; marché locatif ; réglementation du secteur locatif ; logement social

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Bridging the housing gap in Poland

By
Rafał Kierzenkowski[1]

Introduction

The challenge linked to the housing market is to increase the supply of available accommodation and improve living conditions for Polish residents. Market reforms got underway in 1990 from a position of significant excess demand in the housing market, both due to an insufficient supply under the centrally planned economy (resulting in protracted queuing) and a low quality of the existing stock. However, the problem of the housing deficit was not solved during the transition process of the 1990s. In fact, the increase in the number of permanently inhabited dwellings was lower between 1989 and 2002 (8.5%) than in the period from 1979 to 1988 (14.9%), even though the quality of delivered units was higher in the former period due to improved standards and availability of building materials. Several policy responses have aimed at addressing these issues, based on preferential measures for homeownership, rental housing, urban development and social policies. Although the national budget has not been called upon to raise government spending, the general feature of the various housing measures is that they have tended to be unfocused due to poor targeting of beneficiaries. Indeed, they might have led to some unintended adverse effects in some cases.

Nonetheless, the housing market has experienced robust growth in recent years, supported by strong income gains linked to booming wages, remittances of Poles working abroad, increased banks' appetite for mortgage loans and historically low interest rates. Yet along with buoyant housing demand a strong real estate price appreciation has also occurred, partly reflecting obstacles preventing a larger response from the supply side. The regime change in the mortgage market in the 2000s implies the need to focus on the financial aspects of the housing market too. It calls for a close monitoring of the quality and soundness of banks' and households' balance sheets, given not only the jump in households' indebtedness but also its underlying type of currency and interest-rate structure. It also puts banks' and developers' funding practices in the spotlight. These aspects are all the more relevant as there are indications that a possible turning point might have been reached in the market around end-2007.

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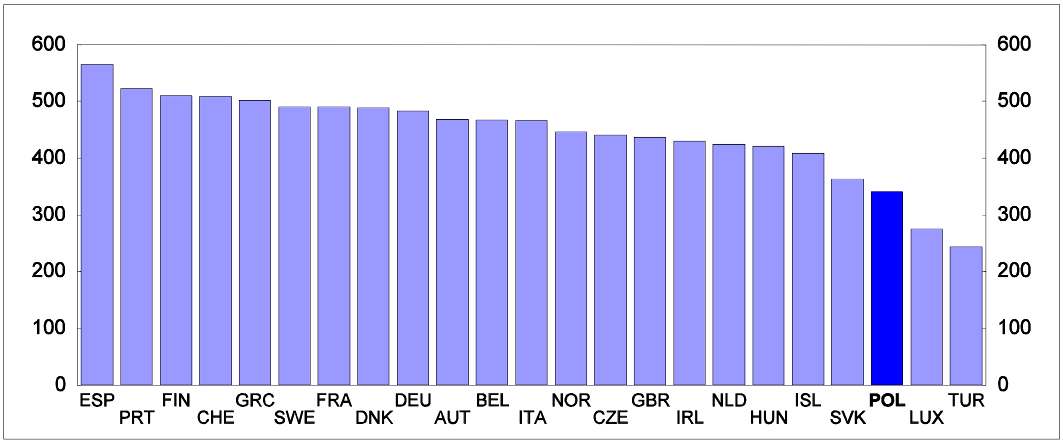
1. This paper was originally produced for the *OECD Economic Survey of Poland* (www.oecd.org/eco/surveys/poland) published in June 2008 under the authority of the Economic and Development Review Committee. The author is indebted to Andrew Dean, Alain De Serres, Balázs Égert, Peter Jarrett and Val Koromzay for their valuable comments. Special thanks go to Sylvie Foucher-Hantala for technical assistance and to Mee-Lan Frank for editorial support.

Assessing the magnitude of the housing gap

According to the latest available census data (2002), there were 12.4 million dwellings with two-thirds of them located in cities. At the end of 2006, the overall stock is estimated to have risen to nearly 12.9 million. In 2002, the housing shortage, defined as the difference between the number of households and the number of available dwellings (both occupied and non occupied), amounted to nearly a million units. In fact, a comparison with the previous 1988 census data reveals that the housing deficit increased by over 300 thousand dwellings. This is partly linked to the rising number of households (a consequence of the baby boom in the second half of the 1970s), the migration of population from rural areas to large urban centres and higher divorce rates. Other indicators confirm the insufficient availability of the housing stock. By end-2006, the number of dwellings per 1000 inhabitants amounted to only 337, one of the lowest in the OECD (Figure 1). A simple calculation shows that in order to reach the average ratio of 470 units observed in the EU15, Poland would need approximately five million extra houses to add to the existing 12.8 millions. The under-provision of housing, at least by international standards, is corroborated by data showing that the average available living area in square metres per person, which amounted to 22.8 m^2 in cities (23.5 m^2 on average), is well below the floor space available in major urban centres in other developed economies (Figure 2). Although a more detailed analysis reveals that these indicators are positively related to income levels to some extent, a gap remains nevertheless with the number of dwellings per thousand inhabitants that one could expect given the GDP per capita reached in Poland. By international standards, the very low level of residential investment as a percentage of GDP has not contributed to reduce this shortage so far (see below Figure 6).

Figure 1. **Density of the dwelling stock**

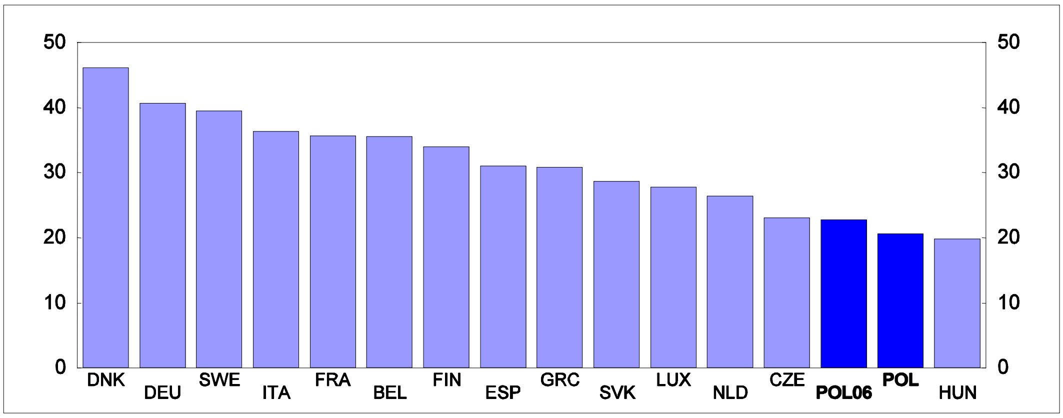
2006 or latest year available, units per 1 000 population



Source: European Mortgage Federation (2007), Hypostat 2006.

Figure 2. **Average living area**[1]

m² per person in 2001

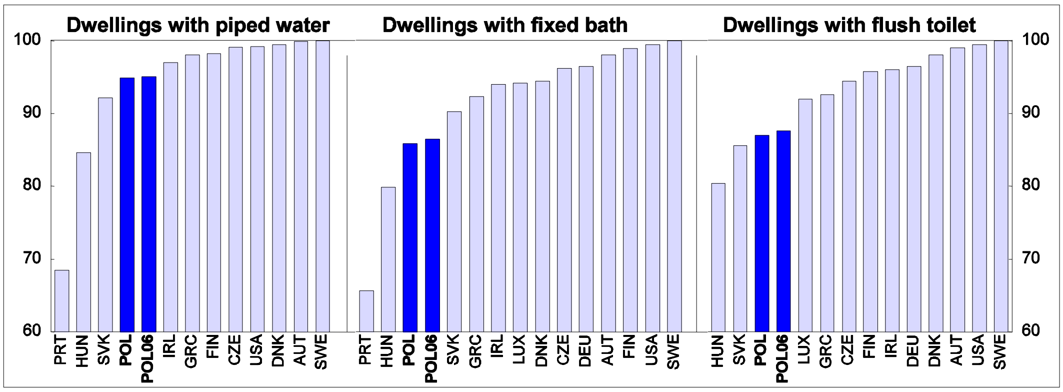


1. Average area in large cities.

Source: Eurostat, New chronos database, and GUS.

Figure 3. **Indicators of housing quality**

2002[1]



1. 1997 for Hungary, 1993 for Denmark and Germany when available.

Source: Égert, B. and D. Mihaljek (2007), 'Determinants of house prices in central and eastern Europe', BIS Working Paper 236, and GUS data for Poland.

In terms of basic amenities, the quality of the housing stock also lags by international comparison (Figure 3). In 2006, nearly 95% of dwellings were equipped with piped water and between 86-87% with lavatories and a fixed bath. Even if these ratios appear to be high at first sight, a gap remained with the best equipped OECD countries. These ratios are mostly driven by a poor equipment level of the housing stock in rural areas. However, the worst technical and sanitary installations are in the rental segment of the market: in 2002, almost only 80% of renting households located in cities had access to these three basic amenities, while this ratio was as low as 69% in rural areas. More generally, the 2002 census data revealed that for the country as a whole only one-third of inhabitants were living in "very good" and "good" conditions (dwellings with no more than one person per room and equipped with piped water, flush toilet, bathroom and/or central heating and a connection to the gas-distribution system), while 23.3% were exposed to "bad" home standards (between 2 and 3 inhabitants per room and/or with an installed piped water system only) and near 12% to "very bad" conditions (three or more persons per room and/or without piped water).

The average age of the housing stock is not particularly old compared to other European countries (OECD, 2005). According to 2002 data, 50.1% of total occupied dwellings were built before 1970. However, 63.9% of houses were built in the former communist area, most of it under widespread standardisation with limited resources and having benefitted from little maintenance expenditure. Therefore, with quantity favoured over quality, repair problems are widespread in the pre-transition stock. All in all, regardless of the gap in terms of effective availability of housing, basic amenities and the scale of usable floor area, there is not only an excess demand for safe accommodation, but also a pent-up latent demand for enhanced units combining less standardisation and higher-quality building materials.

Improving policies for closing the housing gap

Various policies have been implemented in order to improve the situation in the housing market and thus contribute to closing the housing gap, not only in the 1990s and at the beginning of the current decade (OECD, 2004 and 2005), but also more recently. Yet some of them have been narrowed in scope, and, due to tight budget constraints, they have involved rather little expenditure as a share of GDP: annual averages of 1.4% in 1991-95, 0.6% in 1996-2000 and 0.2% in 2001-07. A consistent strategy for dealing with the problem (rental, promotion of first-time homeownership, etc.) has yet to be developed.

Housing policies to promote homeownership and upgrade the housing stock

The transformation of the structure of housing tenures has proceeded rapidly throughout the transition process, as mass privatisation has been an important hallmark of housing policies for homeownership. At the end of the 1980s, around 44% of the existing stock of dwellings was fully owned by private individuals. Since then, a growing share of co-operative, municipal- and employer-provided houses have been privatised and sold to tenants, often with a discount of 80% or more from the estimated market price. Privately owned dwellings (including co-operative privately owned stock) amounted to some 78% of all accommodations in 2006 (Table 1). This share has probably increased even further, as in 2007 the former government offered preferential terms for tenants in co-operatives to become owners.

Table 1. **Dwellings by type of ownership, 2006**

	Total	Privately-owned outright by natural persons	Housing co-operatives		Municipal	Companies (inc. State Treasury)	TBS[1]	Other entities
			Privately-owned	Tenant				
Number (thousands)	12 877	7 582	2 450	988	1 252	373	68	164
Share (%)	100	58.9	19.0	7.7	9.7	2.9	0.5	1.3

1. TBS – Towarzystwa budownictwa spolecznego (Social Building Associations).

Source: GUS, Central Statistical Office (2007).

Another mechanism designed to facilitate homeownership was the introduction in 2002 of income tax deductibility of mortgage interest payments. However, this measure no longer applies for loans contracted since 2007 but will prevail for the old loan portfolio until 2027. Yet, following the former government's 2005 electoral promise to build 3 million dwellings in the coming years, it introduced a new programme of interest-rate-buy-down in October 2006. The programme is targeted at low-income households, though it is not limited to first-time home-owners and applies to both new and existing housing. It also applies to commercial zloty-denominated loans at variable interest rates indexed to the three-month money-market rate and, as such, promotes the use of national – instead of foreign-currency – loans. During the first eight years of the loan the government pays half of the interest cost. The subsidies are conditioned by limits on size and maximum price per square metre of the dwelling (the ceiling is the average local construction cost calculated for each voivodeship and the main urban centres). However, the programme's performance has been poor, mainly because real estate prices have largely outpaced such costs, in particular in large urban areas, squeezing out many potential beneficiaries. A subsequent decision in August 2007 to add a 30% mark-up over building costs alleviated this problem. Nevertheless, market prices have continued to exceed the new price limits (especially in major cities), and, as a consequence, the stock of extended loans barely reached 4 000 by end-2007. Although it is difficult to identify to what extent the programme has or has not led to higher house prices, it is obvious that in a market characterised by excess demand, such policies may fuel further price increases, with developers siphoning off the benefits of the measure. Therefore, even though the programme might yield positive results in some areas, it would be preferable to consider phasing it out: it is geographically inequitable in its scope (easy to implement mainly in distant suburbs or rural areas but not necessarily in urban centres) and could possibly lead to higher prices in the lower-standard segment of the market or block their downward adjustment in the declining stage of the real-estate cycle. Moreover, should it expand substantially further, the programme could also lead to significant increases in public expenditure. Instead, to facilitate home-ownership without harming labour mobility, the authorities could consider eliminating stamp duties on house purchases.

Taxation aspects, in particular those governing VAT, are also viewed as an important hallmark of policies promoting homeownership. Poland's membership in the European Union has modified the treatment of VAT with regard to housing, including as it relates to the purchase of new dwellings. A reduced 7% rate on the value of new apartments and houses was to prevail until the end of 2007, and consideration was given to removing the existing special dispensation, as compared with the EU legislation, by introducing the standard 22% rate as of January 2008. However, given strong political reluctance, the Polish authorities decided to use the possibility offered by EU legislation. In particular, EU authorities do not have responsibility for social housing policies, a prerogative belonging exclusively to each member state. Therefore, it was planned that all dwellings, up to a predetermined number of square meters, would be considered as having a social purpose, thereby making them subject to the 7% rate. There were nevertheless lengthy discussions as to the exact definition, with a clear tendency to extend the maximum surface subject to the preferential tax treatment. The lower rate was ultimately set for 150 sq. m. apartments and 300 sq. m. houses. But, in December 2007, the Polish authorities were ultimately allowed by the ECOFIN Council to keep the preferential rate for three additional years, independent of any criterion about the usable floor area. In any case, should such limits be viable and fulfil genuine social housing objectives, then it would appear warranted to establish some income-related criteria for benefitting from the measure. This would also have the advantage of reducing the negative impact on VAT revenues collected.

Along with the policy to maintain the reduced rate on new dwellings, it has also been decided that a lower 7% VAT rate will be applied to construction services, repairs and conservation works relating to housing, though a 22% rate will be kept for servicing land plots with basic amenities and infrastructure. Although renovation costs have not been tax deductible since 2002 (and were grandfathered only until 2004), in September 2007, the Polish authorities granted individuals an unlimited tax refund on building materials, equal to the difference between the 7% VAT rate that prevailed before Poland joined the European Union in 2004 and the 22% rate introduced thereafter.[2] More generally, the creation in 1999 of a Thermal Modernisation Fund has helped to prevent further dilapidation of the housing stock, particularly of units built in the communist era. According to this programme, the government pays a subsidy amounting to 25% of any bank loan used to improve insulation, provided that the resulting energy savings allow the reimbursement of the remaining 75%.

2. The tax refund introduced in 2005 was initially scheduled to be in force only until December 2007.

Rental and social housing policies

The protection of tenants is an important dimension of housing policies in Poland, since the rental market involves around 20% of all households. Tenant protection was reinforced at the beginning of the current decade, at a time when overall economic prospects were depressed. However, growth conditions have improved spectacularly since then, and, with the benefit of hindsight, many Polish experts admit that tenant protection is excessive and may yield adverse effects on economic activity (see, for instance, KNB (2007a)). One of the system's features is the Tenant Protection Act, adopted in 2001. Even though several amendments adding more flexibility have been made since then, some concerns remain. The current law continues to impose controls on rent increases that relate to both public and private rental sectors. Although the initial value of the rent can be set without any restriction for newly signed contracts, yearly increases are subject to control if the level of the rent exceeds 3% per year of the dwelling's replacement value (established by local authorities on the basis of construction and land-acquisition costs). In fact, rent increases beyond that threshold are authorised but cannot exceed 1.5% of the capital spent on the dwelling's building costs or its purchase or 10% of renovation costs spent for its upgrading, though it can also include a "fair profit" component.[3] Regardless of the economic logic behind such thresholds, one obvious difficulty is that the notion of "fair profit" has not been defined. This can lead to conflicts between the tenant and the landlord about the scale of rent increases, which can end up in court.[4] Indeed, in the case of disagreement about the level of rent hikes, the tenant is authorised to appeal, in which case the burden of proof rests with the landlord.

The courts are also opposed to enforcing eviction on non-paying tenants mainly due to an insufficient stock of social housing. Indeed, even if eviction is court approved, the bailiff needs to provide the debtor either with provisional shelter or a social premise designated by the relevant municipal authorities. Yet there is a genuine shortage of such facilities in virtually all cities in Poland, and thus many non-paying tenants are allowed to delay pending evictions from landlords' dwellings. In principle, if an alternative accommodation cannot be found, then the landlord can receive an offset payment from the local authorities, but this is conditioned by yet another judicial proceeding, and, in any case, municipalities are rather reluctant to pay (Kroner, 2008). In this respect, the promulgation of the December 2006 law on the creation of social premises, shelter dwellings, dormitories and houses for the homeless can be viewed as a first step in solving this deadlock. The objective of the programme is to deliver 100 000 social shelter dwellings and 20 000 dormitories and houses for the homeless over the years 2007-11, with the central government co-financing between 20 and 40% of the investment costs. However, the implementation of the programme has been slow so far and, according to the Ministry of Labour and Social Policy, this might be due to insufficient information provision to local authorities. Out of the 68 million zlotys earmarked in the central government budget, barely 42% were used by end-2007.

Overall, a rigid framework of tenant protection and controls on rent increases that is fertile ground for conflicts may contribute to the underdevelopment of the supply side of the rental market. Private landlords' new investments might be discouraged due to a high level of risk, thus impinging negatively on expected returns from housing investments made for rental purposes. As a result, the availability of potential supply as well as renovation and modernisation efforts for the existing housing stock may both be restricted. Imposing any barriers to the exit of tenants (as in the case of weak evictions and protracted judicial procedures) creates barriers to investor entry. The absence of a deep, efficient and transparent rental market also has the disadvantage of curbing labour mobility across regions and thus may contribute to the persistence of sizeable discrepancies in regional unemployment. It may also encourage informal letting,

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3. The law also allows rent increases to be offset for yearly changes in the CPI in the previous calendar year.

4. In June 2007, a regional court decided that a "fair profit" could amount to 5% – the average yield on Treasury bonds (Krupa-Dąbrowska, 2007).

which in fact is widespread.[5] In such circumstances, in order to improve the functioning of the labour market and increase the availability of the housing stock, the authorities should work towards further easing of controls on rent increases, a move which could be offset by the provision of means-tested allowances to households. Also, once the available housing stock for rental purposes is more developed, court-ordered evictions should be effectively implemented.

Inspired by the French *Habitation à Loyer Modéré* (HLM) model, another device to increase the supply of social housing for rental purposes, established in 1996, is based on non-profit building associations (TBS, *Towarzystwo Budownictwa Spolecznego*) created by municipalities, some rental co-operatives and, occasionally, private developers. The system is subsidised through below-market interest rates, with loans granted to TBS companies from the public National Housing Fund. Thus, the number of houses constructed depends on the scale of allocated public resources. By the end of 2006, 68 000 dwellings had been built, which accounts for 0.5% of the existing housing stock (Table 1). However, some criticisms have been raised as to the targeting performance of the programme. According to the World Bank (2006) and Dübel *et al*. (2006), it is geared toward middle-income households, rather than the poorest, and a more recent official appraisal by policy officials confirms this concern (Ministry of Construction, 2007). This does not come as a surprise, given that controls on rent increases are subject to a threshold of 4% of the replacement value in this programme against 3% authorised elsewhere. The average effective rent hovers around 3.6% of that value (depending on the location of the dwelling), and 60% of rent payments go to capital repayment of the construction cost. Another element confirming that the programme is not well targeted on the poorest is that significant upfront payments are required on behalf of future tenants and these may cover up to 30% of building costs (11% on average in 2004-05), even though renters cannot benefit from ownership rights. Finally, payment arrears are rather lower than in the municipal or co-operative sectors, which confirms that the financial positions of tenants in TBS dwellings are relatively better than in other types of social housing. In such circumstances, the orientation of the programme should be appropriately redefined. On the one hand, it would be legitimate if existing tenants were granted a buy-back option of ownership rights, given the scale of their involvement in funding building costs. On the other hand, should the programme stay close to its social vocation, this would need to be reflected in the level of collected rents and therefore imply a higher contribution of municipalities in funding construction costs. Finally, there have been proposals to extend the programme through public-private partnership arrangements, with some financial involvement of the private sector and the municipalities in terms of providing serviced plots. Although this initiative is still at a preliminary stage, the overall concept appears appealing and thus deserves further investigation, as it could deliver results efficiently, provided that the relevant incentives are clearly defined.

Urban development policies

Another important obstacle preventing housing supply from emerging is linked to shortages of building land and a related lack of zoning plans. In 2003, the Parliament abrogated Poland's local development plans released before January 1995 (and not further modified after that date), but the design of new layouts for urban land use has been a lengthy process as it was not made compulsory. Insufficient financial means of local municipalities underlies the problem, but poor incentives are also an important weakness (at present around 20% of Poland's area is covered by such spatial plans). When development plans are absent, exemptions for specific projects are nevertheless possible through an administrative procedure, but steps for obtaining building permits are time consuming and often unclearly defined, causing delays. The procedure itself includes some degree of arbitrariness, thereby opening up possibilities for corrupt behaviour. Additional difficulties arise in rural areas for changing the zoning of land from agricultural use to building purposes.

5. Informal letting is estimated at 1 million dwellings, especially rented by students.

In view of these problems, the government in power until late 2007 intended to amend both the Law on Spatial Planning and the Construction Law. The idea was to increase the availability of land and encourage the design of good urban plans by streamlining existing regulations and reducing the arbitrariness of decision-making by creating a complete list of all needed approvals. While these proposals appear to be steps in the right direction, the issue of co-ordination with transport-infrastructure investments has not been fully dealt with in the draft legislation, and the consistency between the two acts has been brought into question (GKUA, 2007a and 2007b). Moreover, other plans of the authorities have proved to be even more controversial, notably the possibility of developing buildings of up to 5 000 m^2 in area and 25 m in height without any formal zoning plans. However, such proposals have not been under consideration of the current government. All in all, in order to relax constraints weighing heavily on the provision of land for building purposes, it appears urgent to make the establishment of municipal zoning plans compulsory. This would also have the benefit of putting an end to the possibility of local corruption. Meanwhile, the new government's approach consists in promoting the development of general local urban standards applicable to the whole territory of each commune (*e.g.* built surface and green areas per person) as well as local urban regulation for visual nuisances (*e.g.* restrictions on the establishment of billboards).

As to the needed resources for the development of related urban infrastructure, the authorities could consider the introduction of an explicit *ad valorem* property tax. In this respect, it should be underlined that municipalities are already allowed to collect a "planning tax", which is indexed on changes in the value of the land resulting from the introduction or modification of a local spatial development plan, but it cannot exceed 30% of the price appreciation.[6] For instance, such an increase is likely to occur when the land is turned from agriculture to residential purposes. However, the obvious difficulty is that taxpayers are not liable to the "planning tax" immediately as it is paid only if the property is transferred (understood as a paid transfer – *i.e.* excluding donation, life-annuity, exchange and heritage) during the five years following the introduction of the zoning plan. Thus, waiting longer than the five-year threshold allows the tax to be avoided. The result is that very little revenue is actually collected.

An additional issue that needs to be tackled is that property rights may still be unclear, uncertain or unenforced, mainly as a legacy of the state's expropriation policy of the 1940s (RICS, 2007). As a result, claims for compensation or restitution are still being made, but the legal process is slow, which restrains repairs and investment in the contested dwellings. Also, with property prices rising sharply (see below), restitution claims may become even more numerous. While dealing with these issues is time-consuming and often delicate, sorting them out should also help to improve the conditions for boosting housing supply. Finally, the process of legally registering housing and mortgage transactions is sometimes particularly protracted, lasting for many months. The introduction of an electronic system is expected to accelerate matters, but it is planned to be fully operational only in 2009.

The pick-up in the housing market

The expansion of housing demand…

A significant housing-market pick-up started in 2002, confirmed by business tendency and capacity utilisation indicators for the construction industry. A variety of factors explain the buoyancy of housing demand in recent years. Several indicators of the housing gap have a key role in the explanation (see above). Other structural factors are linked to enhanced price stability and growing levels of GDP per capita, along with a favourable trend in households' earnings stemming from rising wages as well as a rapid fall in unemployment. Surveys of senior loan officers by the National Bank of Poland confirm that

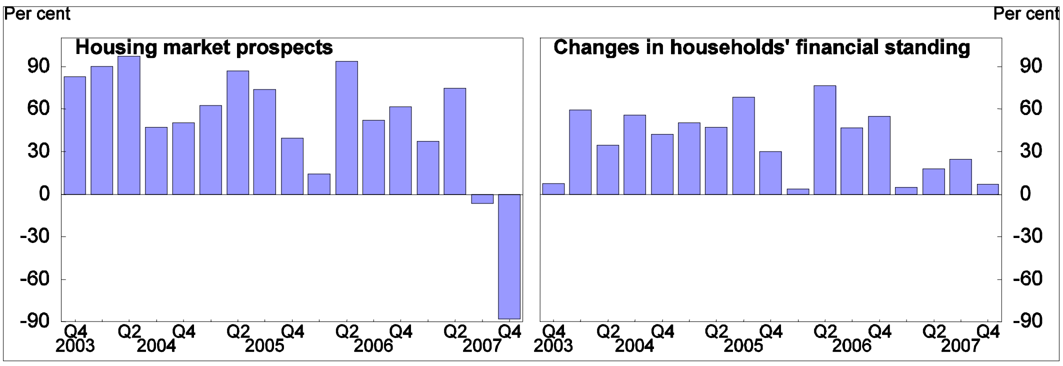
6. Local authorities can also levy a tax for servicing plots. The tax can reach up to 50% of the increase in the value of the land resulting from the installation of basic amenities.

changes in households' finances explain the briskness of demand (Figure 4). Yet, they also reveal that a sudden sharp reversal in market sentiment occurred in the last quarter of 2007.

The robust effective demand on the property market also reflects cyclical and transitional influences. Medium-term elements are linked to Poland's 2004 accession to the European Union and, as a consequence, growing remittances of emigrant Poles as well as increased interest among foreign investors, notably for higher-standard flats in the most prestigious locations. At the same time, the expansion in the housing market would not have been possible if banks had not significantly relaxed their credit standards (particularly in 2004 and 2005, see Figure 9 below), going hand in hand with a wider use of foreign-currency loans and falling domestic interest rates (see below).

Short-term factors that lie behind buoyant demand in the market include taxation aspects as well as probably self-fulfilling expectations of further price increases. Indeed, Figure 4 shows that modifications in housing-market prospects were positively influencing the demand side of the loan market until late last year. Thus, some households might have brought forward their purchases because of an expected upward trend in property prices, while other buyers might have undertaken transactions only for speculative purposes. Finally, foreseen changes in the tax and regulatory systems have also had a short-term magnifying impact on the demand side of the market. The introduction of a 19% capital gains tax[7] on property sales as of January 2007, the simultaneous elimination of income tax deductions for mortgage interest and the uncertainty over the introduction of a 22% VAT rate on new dwellings as of January 2008 all sped up housing purchases. However, with rapid real estate inflation outpacing the growth of households' incomes, housing demand may have started to run out of steam around end-2007.

Figure 4. **Factors influencing changes in housing loan demand**



1. The difference between the percentage of responses "Contributed considerably to higher demand" plus "Contributed somewhat to higher demand" and the percentage of responses "Contributed considerably to lower demand" plus "Contributed somewhat to lower demand". A positive index means that a given factor contributed to an increase in demand, and a negative one – to a decrease in demand.

Source: National Bank of Poland (2008), Senior Loan Officer Opinion Survey.

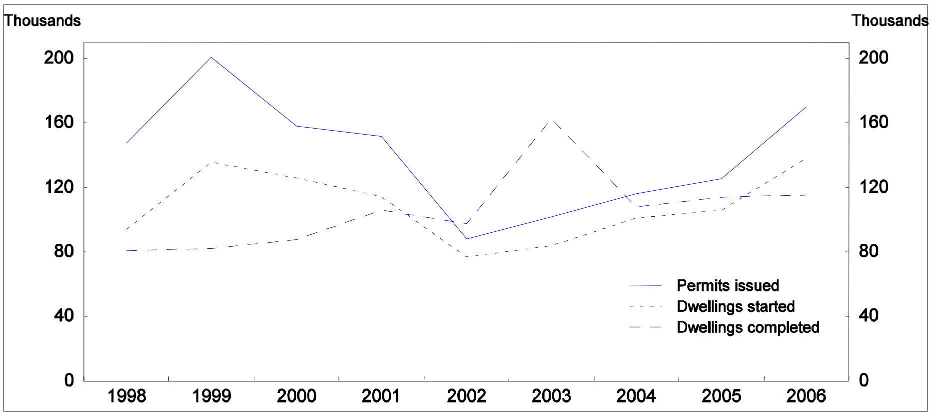
… coupled with a lengthy adjustment of housing supply…

In view of the until recently vigorous demand, the reaction of housing supply has been quite inelastic, though it has been slowly improving since 2002, as confirmed by the number of construction permits issued and housing starts (Figure 5). Nevertheless, even if the ratio of residential investment to GDP

7. Up to the end of 2006 private individuals were exempted from any taxes if they had held the property for over five years or if they had re-invested in another property within two years after sale. Otherwise, they were liable for a tax of 10% of the selling price (not just the capital gain).

improved significantly in 2006, it remained at a low level compared to international standards and other countries of the region (Figure 6).

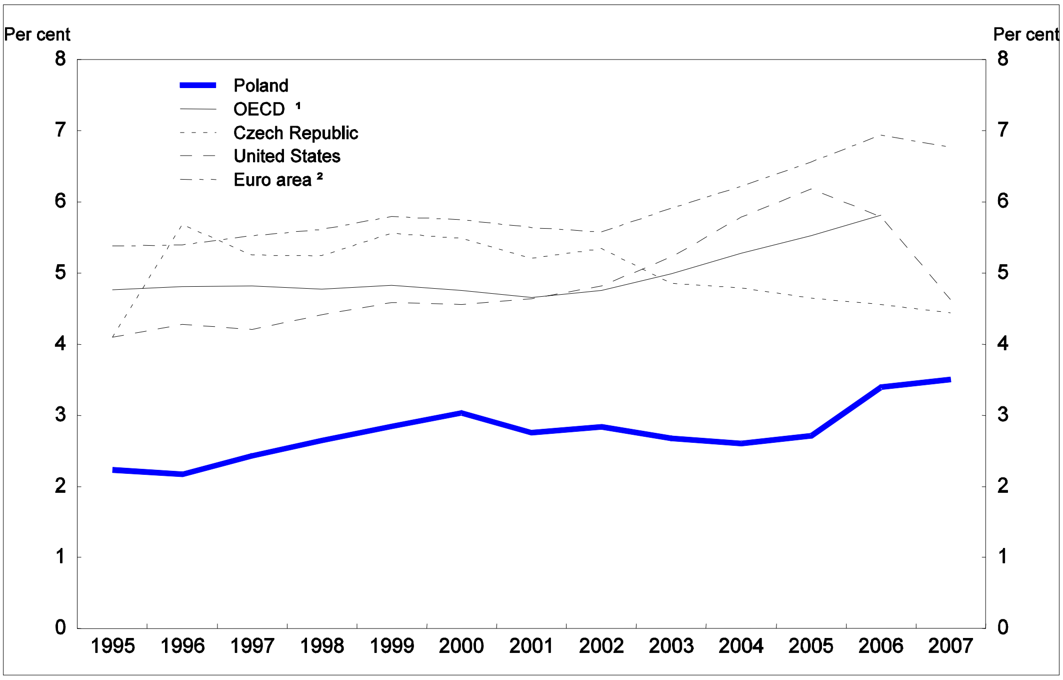
Figure 5. **Permits issued, started and completed dwellings**



Source: GUS, Statistical Office, Construction – Results of Activity in 2006.

Figure 6. **Residential investment**

As percentage of GDP, current prices, public and private



1. Excluding Luxembourg, Hungary, Portugal and Slovak Republic.
2. Excluding Luxembourg and Portugal.

Source: OECD Economic Outlook 83 database.

Besides various structural factors linked to the unsettled land-use planning framework, uncertain property rights and controls on rent increases (see above), other factors also help to explain the lack of an abundant housing supply and its slow adjustment to expanding demand. Since 2006, and especially in the second half of 2007, construction costs have been subject to upward pressure due to growing shortages of building materials and qualified labour. In some cases the scale of shortages of relevant inputs has been so great that property developers have had to withdraw from certain tenders of land. According to the business tendency survey in the construction sector, in mid-2007 between 50 and 60% of firms considered the costs of materials and labour as important barriers to their activity and pointed to significant labour shortages, while the industry itself operated at record-high capacity levels with almost no obstacles from insufficient demand (Figure 7). In parallel, the implementation of important transport infrastructure projects and a low labour mobility across regions in deficit and surplus have certainly rendered underlying shortages and price pressures all the more acute. In such circumstances, it is important that the authorities reduce bottlenecks in the construction sector by enhancing vocational training as deficiencies have been noted in this area in recent years (CLR, 2007). Other levers would include easing access to the labour market for foreign workers by tailoring work permits to meet specific needs and maintaining a strong vigilance about possible collusive behaviour between the main suppliers of building materials.

… have led to excess demand and upward price pressure

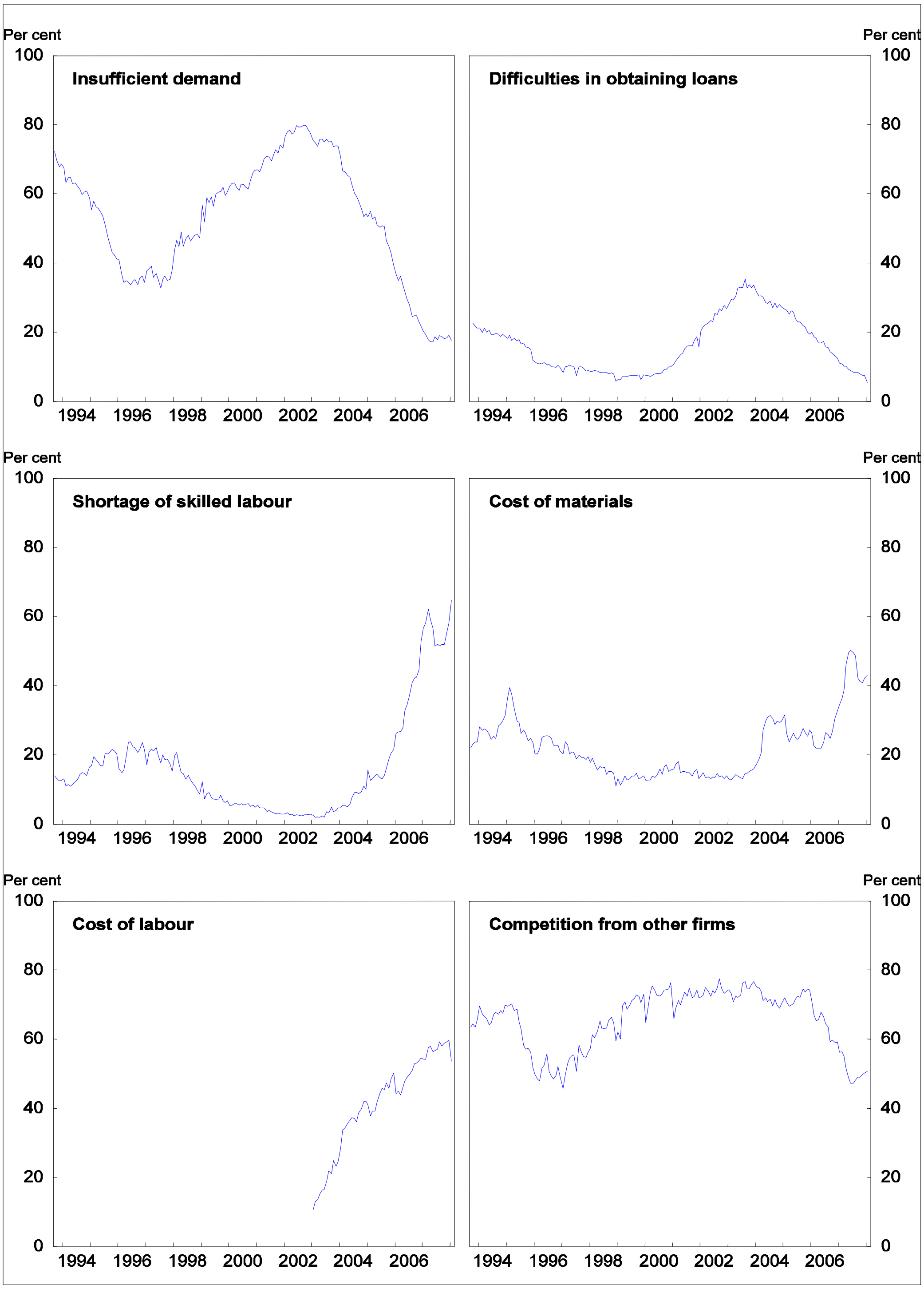
Several statistics indicate that demand has been significantly outstripping supply in recent years. Sales of new apartments and houses have been occurring even before the start of effective construction works. Moreover, instead of introducing the whole offer immediately on the market, property developers have been selling units only gradually, thus testing the strength of demand. As mentioned, since 2003 a steadily and rapidly declining share of construction enterprises pointed to insufficient demand as being an obstacle to their activity (Figure 7). As a result, the average time of waiting for an apartment in the primary market in major cities has been lengthening considerably, while the available stock has decreased sharply since 2004 and collapsed to almost zero in January 2007 (NBP, 2007).

Although residential property prices fell in 2001-02, they have been rising steadily since then at a yearly pace of 10-20%. In 2006, the annual growth rate picked up to 55-75% on both the primary and secondary market (Figure 8), and Poland probably led the property boom in Europe that year (NBP, 2007; RICS, 2007). Warsaw accounts for a third of the national market, and prices there are among the highest in Central and Eastern European countries and close to levels reached in some western European countries. In the first half of 2007, real estate inflation spiked at unprecedented levels (in year-on-year terms) in some cities (Figure 8) and decoupled with price developments in other regions of Poland. A catch-up process with 30% to 40% annual price increases began nevertheless in smaller towns during 2007 (NBP, 2007). Yet, even though Poland recorded the highest house-price inflation in Europe for the whole year (RICS, 2008), a correction in prices occurred in several major urban centres by year-end, bringing down year–on–year growth rates towards more sustainable developments (Figure 8) and close to 20% annual increases for the country as a whole.

It is difficult to say to what extent the market has been subject to a bubble insofar as this issue relates to the question of the scale of deviation of actual house prices from their fundamental values. Recent empirical evidence suggests that fundamental factors have been important drivers of house prices not only in Poland, but also in other countries of the region (Box 1). However, according to the National Bank of Poland the observed disconnection between the high level of house prices and their rental values would signal a significant speculative short-term component in housing demand (NBP, 2007), though controls on rent increases have also accounted for the growing gap.

Figure 7. **Barriers to construction firms' activity**

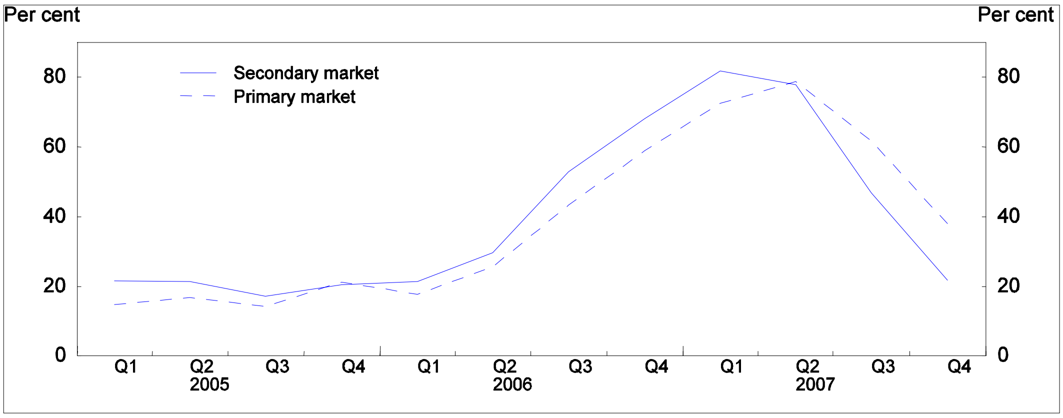
Business tendency survey



Source: OECD calculations based on GUS series.

Figure 8. **Residential property price inflation in the largest cities**[1]

In nominal terms, year-on-year changes



1. Average of prices in Warsaw, Poznan, Lodz, Cracow, Gdynia, Gdansk and Wroclaw.

Source: National Bank of Poland (2007), Financial Stability Report, and National Bank of Poland (2008), Inflation Report.

Box 1. **What drives house prices in central and eastern Europe?**

The run-up in house prices in Poland has been part of a wider phenomenon, which affected not only many OECD countries (Girouard *et al.*, 2006), but also transition economies in central and eastern Europe (CEE), with double-digit real annual increases not uncommon. For instance, property prices in Croatia, the Czech Republic, Hungary and Slovenia rose by 9 to 13% annually on average between 2002 and 2006 and reached 20-35% per annum in Estonia, Lithuania and Bulgaria over the same period (Egert and Mihaljek, 2007).

Egert and Mihaljek (2007) find that the evolution of property prices in CEE countries can be explained quite well by various indicators such as per capita GDP levels, real interest rates, credit growth, demographic factors and labour-market developments. However, some differences with the most developed OECD countries remain. The sensitivity of house prices to real interest rates is twice as high in CEE as in other OECD countries, but only half as great as far as the credit growth determinant is concerned. But there are also specific factors that may account for price changes in transition economies. These are structural finance and institutional development aspects of housing markets* that can be captured by European Bank of Reconstruction and Development indicators of progress in banking reform and interest rate liberalisation on the one hand, and improvements in securities markets and non-bank financial institutions on the other. Other structural parameters with clear intuitional backing may also play an important role, but the econometric evidence is weak due to a lack of relevant data. These include a robust demand for better-quality housing due to important gaps in standards (average size of dwellings, floor space per occupant, access to basic amenities) relative to other western countries, a possible correction from initial undervaluation of house prices due to large distortions in relative prices at the beginning of the transition process, and a structural withdrawal of the public sector from housing construction and provision during the 1990s. Increased external demand of late (by residents in EU15 countries for second homes, CEE residents temporarily working abroad and global real estate companies for investment purposes) leading to higher land prices and spillover effects to property prices for local residents, a limited supply of new homes due to a lack of zoning plans, an easier access to foreign-currency loans with lower interest rates and possible wealth effects stemming from surging equity prices have all contributed as well.

* For a detailed characterisation of housing market institutions and finance in CEE countries, see OECD (2005).

The precise identification of the scale and evolution of the house price appreciation is difficult nevertheless, as accurate data do not exist for Poland. Available price statistics are made by private market participants (research institutions, real estate services providers), but they are fragmentary and refer mostly to some larger cities. The lack of relevant information about house prices blurs the assessment of the value of collateral in mortgage transactions and, more generally, hinders financial stability diagnoses regarding the quality of banks' and households' balance sheets. Therefore, even if it is a difficult challenge, it is crucial that composite house price indexes for the country as a whole as well as different market segments be computed by the statistical authorities. The Central Statistical Office (GUS) has undertaken methodological work in the field of compiling house price indices, in co-operation with institutions such as the Polish Bank Association, the National Bank of Poland, the Institute of Urban Development and the Polish Federation of Values' Associations. These institutions have agreed to deliver data concerning the real estates' price levels as well as tools for analyses and construction of indices. This is in addition to the information that GUS collects via its own survey of real estates' purchase/sale transactions. These progress notwithstanding, there is still no clear timetable for the publication of nationwide index as well as regional indices of housing prices and, therefore, efforts should be renewed to accelerate the development of such valuable statistics.

With booming real estate prices the profitability of construction companies has increased as manifested in high mark-ups by existing firms and the entry of new domestic and foreign firms. Average mark-ups over costs have reached 20–30%, and profitability has been very high in some cases, for instance reaching a 68% return on equity for one of the largest developers in Poland in 2006. At the same time, the stock-market index of construction companies has outperformed the overall index. However, this evidence should not mask the fact that the vast majority of private developers (who are the second most important provider of new housing supply after individuals) are rather under-capitalised (World Bank, 2006). Moreover, following a series of losses at the turn of the decade, developer finance is restricted by rather conservative bank lending policies, though the situation has improved over the last few years (see Figure 7). As a result, it has become common practice for buyers to make substantial upfront payments, which help with project working capital but exposes them to a significant risk of the developer's bankruptcy. Although the creation of a developers' self-insurance fund for construction risks is viewed as too difficult to implement in a transition country like Poland, a plan was developed to protect buyers' advances through the opening of escrow accounts. Banks were supposed to play a key role in the monitoring process, leading to early detection of solvency problems.[8] However, following lively discussions about a possible adverse upward impact on house prices and the scale of transaction costs that such regulation would entail as well as the strong opposition of the building industry, the adoption of the draft is still pending. Its introduction by the authorities is of primary importance, nevertheless, given record high real-estate prices, signs that demand is progressively running out of steam and the likelihood of growing problems of funding construction loans. The peak in business activity of the construction sector has probably already been reached, triggering the beginning of consolidation of the industry.

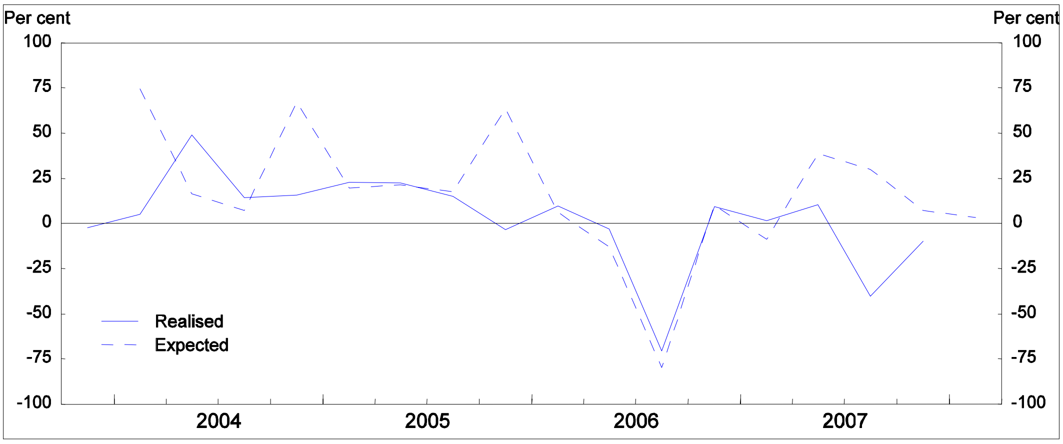
Financial aspects of the housing market

Mortgage loans had been virtually non-existent in Poland in the 1990s, but the market took off in 2000 and has been expanding very rapidly in recent years. Rising GDP per capita, along with declining interest rates have boosted affordability and spurred loan demand, while banks have lowered their credit standards and margins due to intense competition. Even in CPI-deflated terms, housing loans extended to the household sector have been growing at an exponential pace, rising 13.0-fold between mid-2000 and mid-2007 and 2.9-fold between mid-2004 and mid-2007. At the same time, the share of housing loans in overall banking assets has also increased considerably, from 1.8% at mid-2000 to 13.3% at mid-2007. Housing loans represented 25.8% of all bank loans by mid-2007 as compared to only 4.1% at mid-2000.

Surveys conducted by the NBP indicate that banks have significantly relaxed their lending policies, particularly in 2004 and 2005 (Figure 9). Various indicators of terms on housing loans corroborate this view (Figure 10). The spreads between such loans and riskless assets were reduced, non-interest rate loan

8. Two types of escrow accounts can be defined. In the first, the developer would receive the payment at the end of the construction process (closed account); alternatively, payment could be made once a predefined stage has been reached (open account).

Figure 9. **Banks' lending policies pertaining to housing loans**[1]



1. The difference between the percentage of responses "Ease considerably" plus "Ease somewhat" and the percentage of responses "Tighten considerably" plus "Tighten somewhat". A positive index indicates a tendency towards easing of lending policies.

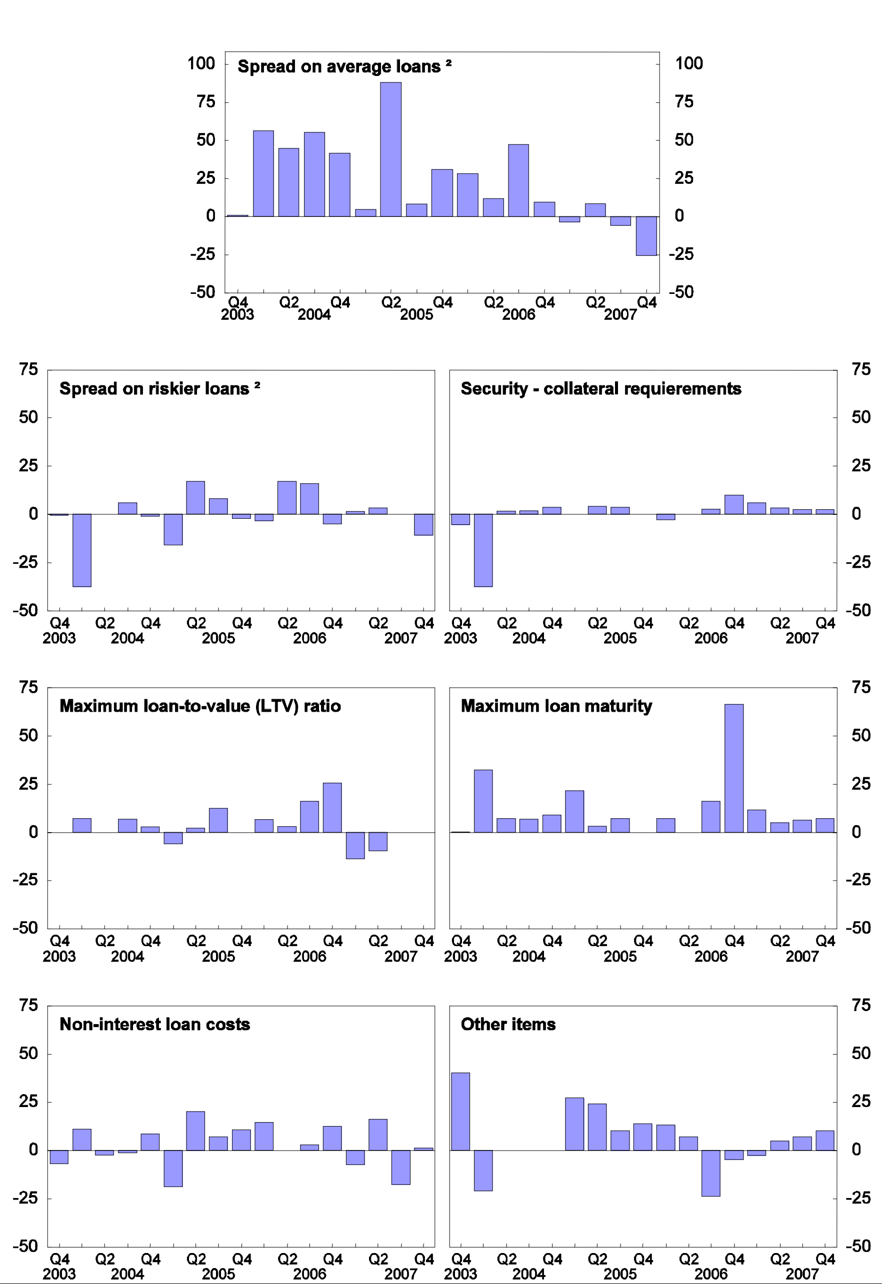
Source: National Bank of Poland (2008), Senior Loan Officer Opinion Survey.

costs cut and maximum loan-to-value (LTV) ratios and loan maturity extended. Market information confirms that LTV ratios for zloty loans have been pushed to 100% or above in some cases (against 80% for foreign-currency loans) and their maturity extended to around 22.5 years for new loans (against almost 27 years for new foreign-currency loans) at the end of 2007, while the average maturity of the stock increased to 15 years (17.5 years for foreign loans). Banks' lending policies were driven mainly by vigorous loan demand, strong housing market prospects and robust market competition on the housing segment of the loan market. More recently, according to the latest version of the survey, banks' capital positions started to impact negatively on credit conditions (notably in the last quarter of 2007), which relates back to the wider question of the banking sector's accessibility to and the availability of needed financial resources.

Although there is no evidence of any direct impact on the banking sector of the credit crisis in the United States, Polish banks have nevertheless started to encounter rising funding and refinancing constraints, not only because of growing liquidity shortages in international markets. *First*, banks' capital adequacy ratios have diminished, even though they continue to exceed the 8% BIS threshold. As increases in commercial banks' capital were insufficient to match the expansion of lending activities, the solvency ratio (the relation of bank's capital to its risk-weighted assets) of the banking sector declined from 15.5% in 2004 to 13.2% in 2006 and reached only 12.4% in 2007. *Second*, Poland's universal banks have traditionally funded their lending with deposits, but the mortgage boom has considerably narrowed the gap between loans and deposits on their balance sheets. Indeed, this gap has vanished by end-2007 for households' assets and liabilities and has turned negative for the domestic non-financial sector as a whole (Figure 11). With surging equity prices and lower interest rates, households' portfolio holdings in mutual funds have increased to the detriment of bank deposits, and banks have had to face stronger competition for households' savings. *Third*, the credit expansion has reduced the scale of excess liquidity in the banking sector (with banks selling their liquid assets)[9] and increased the mismatch between long-term assets and short-term liabilities, given that deposits with maturity over one year barely exceed 1-2% of

9. The excess liquidity of the banking sector is mainly the outcome of past sterilisation policies of the central bank conducted in the 1990s.

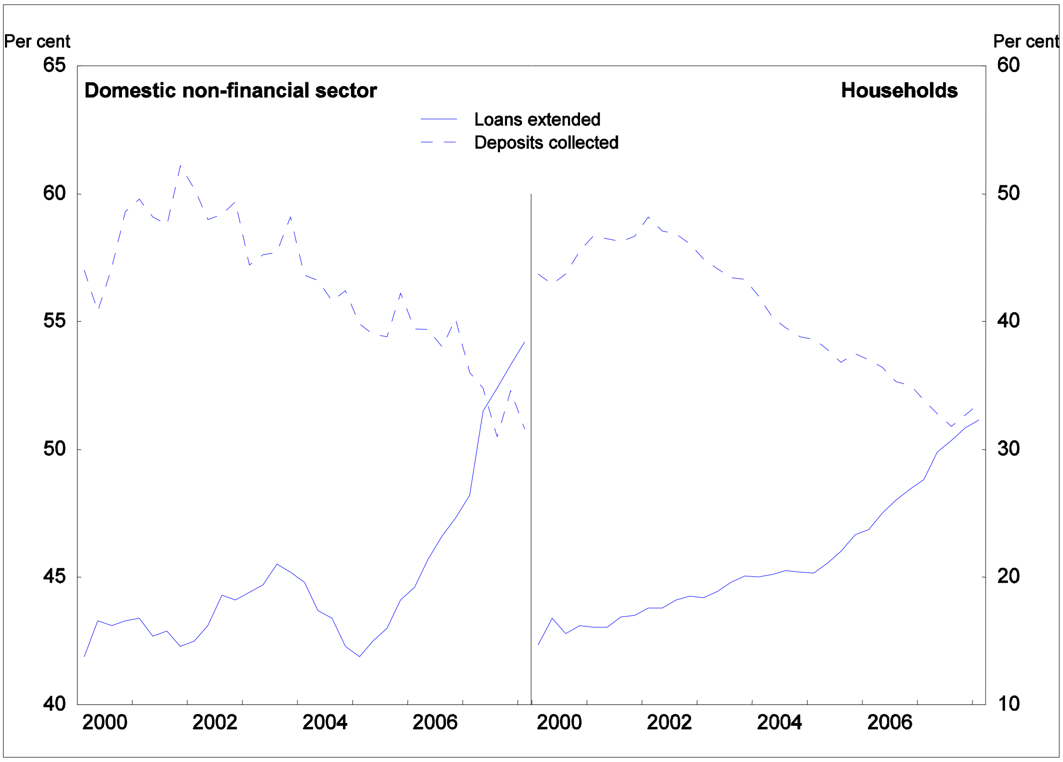
Figure 10. **Terms on housing loans[1]**



1. The difference between the percentage of responses "Eased considerably" plus "Eased somewhat" and the percentage of responses "Tightened considerably" plus "Tightened somewhat". A positive index indicates a tendency towards easing of credit terms.
2. Spread is defined as the difference between the interest rate on the loan and the market interest rate.

Source: National Bank of Poland (2008), Senior Loan Officer Opinion Survey.

Figure 11. **Loans and deposits as a share of banking assets**



Source: Polish Financial Supervisory Authority, Banking Sector, key data.

banks' assets. Although banks' main activity does consist in maturity transformation and the Polish banking sector should not encounter immediate liquidity threats (due to observed higher liquidity transfers from foreign parent companies and still sizeable holdings of liquid assets), nevertheless from the stability point of view a deterioration of banks' financing structure has occurred.[10] This raises the issue of the availability for banks of long-term instruments to fund their mortgage-loan portfolios.

In this area, several constraints remain in the current legal framework. Even if the lack of rating agencies is an issue, a recent survey undertaken by the banking supervision authority reveals that securitisation is underdeveloped due to several regulatory and fiscal obstacles that prevent banks from a widespread use of this mechanism (KNB, 2007b).[11] For the time being, securitisation is mainly used to get

10. Some heterogeneities remain within the banking sector: for instance, some banks have a substantial deposit base, with others tapping the interbank market or using foreign-currency borrowing, notably through foreign exchange swaps.

11. Banks have pointed to several factors that are limiting their securitisation possibilities (KNB, 2007b):

- Tax regulations on sub-participation where a one-off inflow of funds received by the initiator at the beginning of the transaction is entirely recognised as taxed income, while the costs for tax purposes are acknowledged only gradually over time.
- The need to obtain a separate agreement of the debtor for a payment order when securitisation is carried out *via* the securitisation fund and relates to regular loans.
- The lack of statutory regulations enabling the protection of special purpose vehicles' (SPVs) assets against the consequences of an enforcement proceeding.
- An issuing entity that would purchase mortgage-secured credit exposures does not have priority in claiming its receivables when this coincides with a tacit mortgage lien held by the State Treasury.

rid of sub-standard loans as tax deductibility is allowed for such actions. Another problem is that universal banks are prohibited from issuing covered mortgage bonds, as this option is reserved only for specialised mortgage banks, but their market share in the mortgage market is rather marginal (around 5%).[12] Should the authorities decide not to lift existing long-term funding barriers rapidly, it might be the case that in the short term banks' lending policies could be contained indirectly from the supply side. However, these constraints could also lead to a lower involvement of the banking sector in closing the housing gap in Poland over the longer term. Indeed, in the most affluent OECD countries, housing market growth is directly linked to housing finance (OECD, 2005). It could be argued nevertheless that securitisation is a complex mechanism that has played a prominent role in the world-wide sub-prime crisis whose introduction might thus not be advisable. However, it is probably preferable to let banks determine their own funding choices and, in return, to strengthen the regulatory supervision of securitisation, rather than to hinder its development.

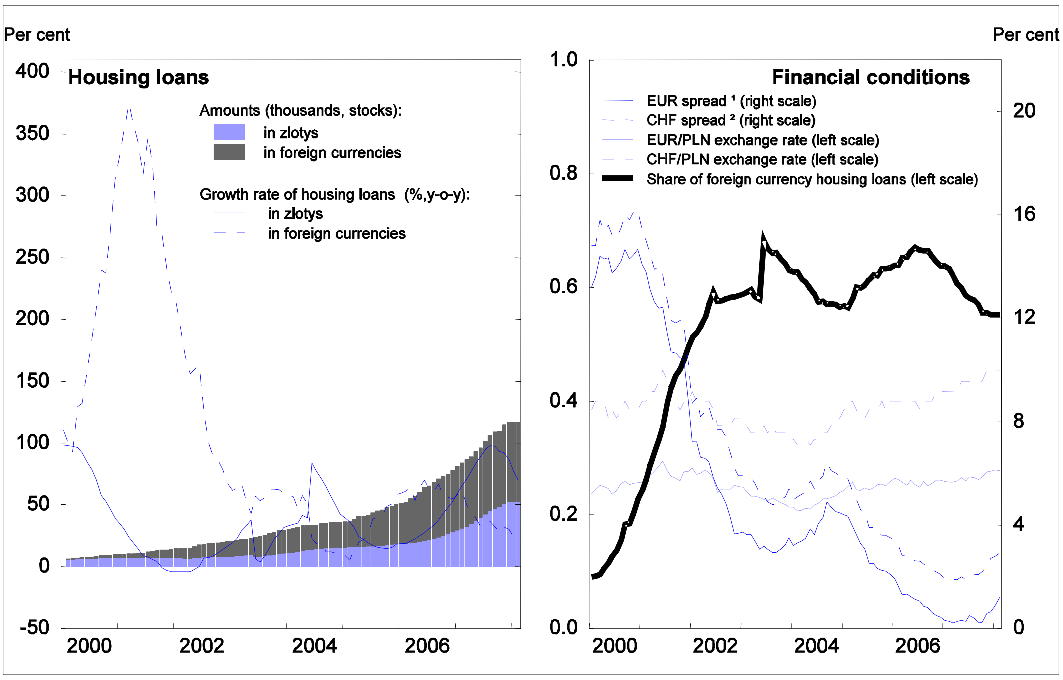
Another challenge for keeping a robust and healthy mortgage market is related to the fact that a substantial amount of housing loans is contracted in foreign currencies. While the share of foreign-currency loans in real estate financing had been lower than 10% at the end of the 1990s, it sky-rocketed at the beginning of 2000s and has stabilised at nearly 60% since mid-2002 (Figure 12). Given the scale of the spread between Polish and foreign – and more specifically Swiss – interest rates, the share of loans denominated in Swiss francs among foreign-currency loans exceeded 90% at the end of 2006. Therefore, the household sector is directly exposed and the banking sector indirectly to both the exchange-rate risk (a potential depreciation of the Polish currency) and the interest-rate risk on the Swiss franc (as loans extended by banks are chiefly at variable rates). Although both risks have not materialised yet, the supervisory officials have decided to intervene in order to limit the expansion of foreign-currency loans. Notably, this was all the more necessary given that banks had been increasingly eager to grant this type of loan to less wealthy households. Furthermore, close currency substitution in banks' assets has also been constraining the effectiveness of the transmission mechanism, rendering trickier the conduct of monetary policy. Indeed, in such circumstances a tightening of the domestic policy rate increases the relative attractiveness of foreign-currency loans compared to zloty loans (Brzoza-Brzezina *et al.*, 2007).

- The lack of an explicit interpretation relating to the treatment of securitisation transactions as financial intermediation services.
- Too narrow a scope of agreements excluded from the clause on banking secrecy relating to securitisation transactions.
- The sale of credit exposures at a discount in regular cases is unprofitable from the tax side – the discount is not considered as a cost for tax purposes.
- The lack of clarity with respect to the tax treatment of capitalised interest on loans.

12. The main difference between covered mortgage bonds and genuine securitisation – of both asset-backed securities (ABS) and mortgage-backed securities (MBS) – is that the former type of assets remains on banks' balance sheets, while the latter is removed.

Figure 12. **Evolution of housing and financial conditions**

In nominal terms

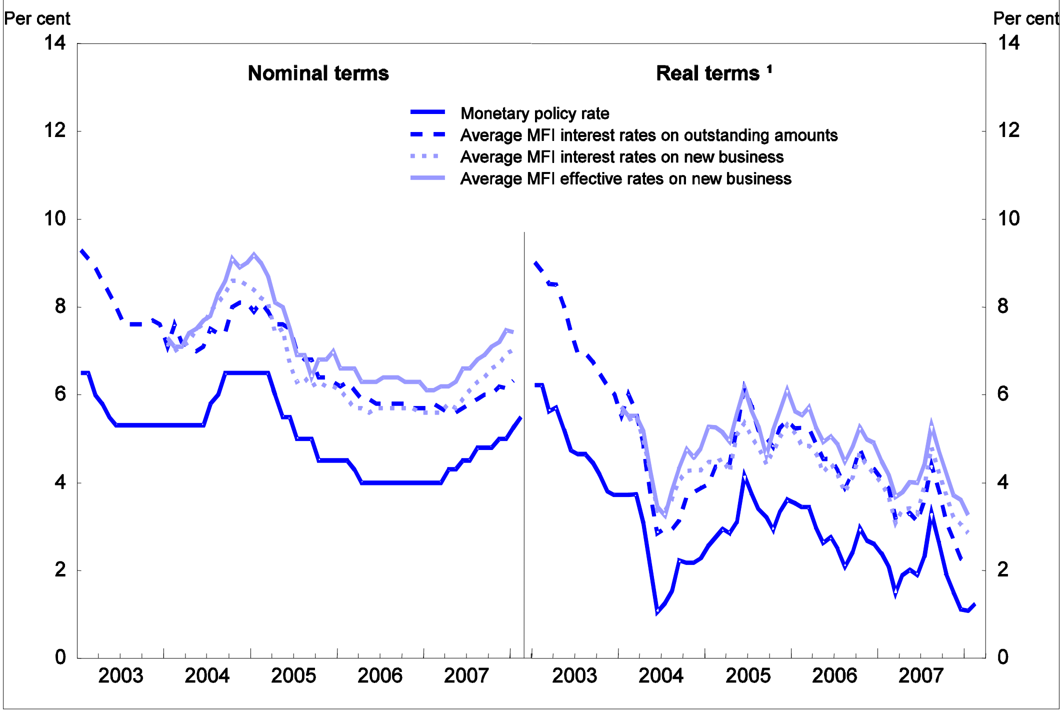


1. Spread between 3-month (PLN – EUR) interbank interest rates.
2. Spread between 3-month (PLN – CHF) interbank interest rates.

Source: National Bank of Poland and OECD calculations.

In July 2006, "Recommendation S" was introduced, aiming at strengthening credit risk management at banks with regard to housing loans and providing adequate information for customers about related risks (KNB, 2006). More specifically, among other recommendations, it requires that, when considering foreign-currency loans, banks evaluate households' creditworthiness by assuming a 20% depreciation of the zloty and an interest rate at least equal to those on loans in domestic currency. Banks have effectively tightened their lending standards with regard to foreign-currency loans since then: foreign-currency loans decelerated from year-on-year growth rates of around 60% in July 2006 to close to 31.5% in February 2008. A lower attractiveness of Swiss franc loans may also have resulted from a tighter interest rate stance of the Swiss National Bank. This may have demonstrated to potential borrowers the risks from taking on interest-rate exposure. Yet it appears that banks have simultaneously relaxed even further their lending policies in zlotys, especially given the low relative (Figure 12) and absolute (Figure 13) level of domestic interest rates. Growth in zloty-denominated loans growth sped up from 30% in July 2006 to almost 100% a year later, as average loan amounts were rising largely due to runaway property prices. However, latest data show a deceleration to near 70%. Should the housing boom continue, it would be advisable that the supervisory authorities maintain a reasonable frequency of on-site inspections, especially by targeting the most active banks in the mortgage market.

Figure 13. **Policy rate and banks' interest rates on PLN mortgage loans**



1. Deflated by the consumer price index.

Source: National Bank of Poland and OECD (2007), Main Economic Indicators database.

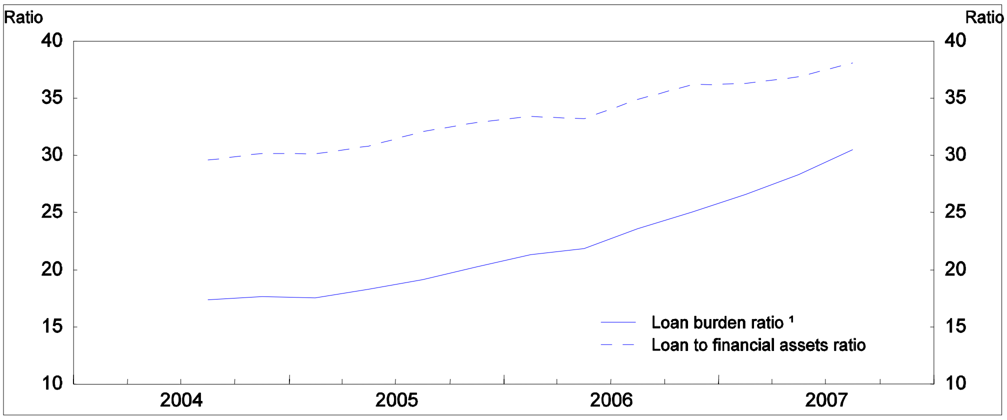
Expansion in the real-estate market mainly financed through bank loans engenders a potential risk of over-borrowing by the household sector, leading to growing concerns about its long-term creditworthiness. Notwithstanding lower interest rates, as house price inflation has outstripped increases in earnings, banks have extended loan maturities significantly in order to support households' demands and make monthly instalment payments affordable (see Figure 10). However, in spite of this, a faster growth of loan amounts as compared to disposable income has pushed up households' debt burden (including all types of loans), which by mid-2007 reached 30% of gross disposable income (Figure 14). As a consequence, with mortgage loans contracted primarily at variable interest rates and a high share of foreign-currency loans in borrowers' liabilities, their exposure to both a monetary tightening and the exchange-rate risk is all the more obvious. With longer loan maturities, debtors' solvency has also been subject to a more protracted risk of economic slowdown and thus of unemployment. The NBP undertakes valuable stress tests that help to assess the scale of households' sensitivity to different types of possible financial shocks (NBP, 2006 and 2007). One of its simulations indicates that a 3.4 percentage point increase in the policy rate of the NBP in the next two years would push the ratio of monthly debt-service costs (principal and interest instalments) to net income of a typical household having contracted a mortgage from 25.2% in the second quarter of 2007 to 33.5% 24 months later. Also, a 35% depreciation of the zloty coupled with a 3.1 percentage point rise in Swiss interest rates would boost the foreign-currency debt-service ratio from 25.9% to 36% two years later. An activity shock might even have stronger consequences. Zajaczkowski and Zochowski (2007) show that an increase in the unemployment rate of 4.7 percentage points would move 43-47% of households with mortgage loans into a negative margin position.[13] It follows from these results that a combination of real and financial shocks could have dramatic effects and push a

13. The margin is defined as the difference between disposable income and debt repayment costs as well as basic living expenses.

substantial number of debtors into serious financial distress. A detrimental impact on house prices and a subsequent negative feedback on activity could follow as a consequence.

Figure 14. **Households' loan burden[1]**

Ratios calculated on the basis of data for the whole household sector



1. Ratio between loans granted to households (residents) and their yearly gross disposable income. Data on loans come from the NBP monetary statistics; data on gross disposable income come from the national accounts.

Source: National Bank of Poland (2007), Financial Stability Report.

Indeed, as a result of expansionary lending policies, the exposure of banks' assets and financial results to potential risks has increased rapidly and considerably. Mortgage repayment could be hampered through the standard exchange-rate channel and/or the interest-rate channel of deteriorating inflationary prospects and rising interest rates. However, empirical research suggests that credit risk in the household sector might be negatively related to currency depreciation if the ensuing greater competitiveness and related household income growth overcompensates the increased instalments on foreign-currency loans (IMF, 2007). Another mechanism is linked to financial accelerator effects that might occur in the case of a sharp reversal in property prices. This would undermine the value of collateral and thus increase loan losses from potential defaults. These adverse effects could be even stronger in Poland than in other countries. *First*, although purchased houses or dwellings can be legally pledged as collateral, the registration of mortgage liens is not compulsory and is a lengthy process anyway: only 62% of housing loans had dwellings mortgaged to the bank by mid-2007 (KNB, 2007a). This raises banks' exposure to a downturn and/or possible fraudulent debtor behaviour. *Second*, the strength of foreclosure regulations has not yet been tested on a wide scale to a reversal in the credit cycle. For the time being, the share of non-performing loans is quite low, in part because most mortgages outstanding were extended in a period of strong income growth, but also due to a statistical base effect as three-quarters of them have been granted just over the last three years. Yet there are indications that foreclosure regulations might not be strong enough, as it can take several years for debtors to recover collateral. Eviction procedures are difficult to implement, a situation that is linked to an insufficient quantity of dwellings for social housing purposes (see above). However, even if the collateral is seized, tax claims of the Treasury have seniority, unless bank loan claims are secured by a mortgage lien (NBP, 2004). Issues are even trickier once the bankruptcy of the debtor is pronounced: pending applications for mortgage registration are declared invalid if they have not been made within six months prior to the failure, which is all the more problematic as the registration process of mortgage liens is time-consuming and queuing is necessary; even if loans are secured by a mortgage, the creditor cannot rent or lease the property but can only recover its debt through a sale. Overall, the acceleration of the registration process of mortgage liens, the suppression of legal barriers in collateral recovery through a strengthening of foreclosure laws and eviction procedures and the freedom to dispose of the property in the case of debtor's bankruptcy would all be helpful steps. Dealing rapidly with these rigidities and obstacles would allow a faster adjustment in the loan market to a possible downturn and avoid related real adverse effects of deteriorating bank solvency, with negative spillovers coming from tight lending policies.

At first sight, the macroeconomic consequences of any future defaults in the household sector do not appear likely to be too important: by end-2006, the ratio of residential mortgage debt to GDP in Poland was as low as 8.3%, one-fifth of the euro area average (41.2%) (European Mortgage Federation, 2007). Against this background, even if the level of the ratio is still low by international standards, it is nevertheless growing rapidly, having increased by 3.6 percentage points in 2005 and 2006 alone. And it goes without saying that an unexpected shock to households' creditworthiness (as described above) would put their consumption under pressure and thus impact on GDP growth. Falling property prices could also undermine the value of the collateral and induce adverse spillover effects on overall lending standards and thus reduce growth prospects. However, the macroeconomic consequences of changes in asset prices and, more generally, possible interactions between real and financial spheres (for instance, through wealth effects of housing and equity markets on consumption) are currently less certain and, in any case, not modelled by the central bank. In this perspective, in order to provide a relevant assessment of the scale of potential problems and underlying risks from the view of monetary policy conduct and financial stability diagnoses, it would be worthwhile to develop a fully fledged financial-sector module in the NBP's macroeconomic ECMOD model. While the length of relevant time series may be an important obstacle, some analysis could be undertaken nevertheless, in particular on the basis of stress tests already performed by the Bank.

The government in power until the late-2007 decided to transfer banking supervision from the central bank to the Financial Supervision Authority (KNF). Since January 2008, KNF is the sole supervisor, responsible for the surveillance and control of the banking sector, insurance institutions and securities markets. The context of this change is the growing integration of the banking, insurance and securities markets worldwide, as well as their respective instruments and products. However, arguments have been developed in the literature for and against an integrated supervisory model (Wymeersch, 2007). Pros and cons of keeping banking supervision within the central bank also exist (Ioannidou, 2005), but, empirically, there does not seem to be a clearly predominant model (Masciandaro, 2007). However, given the current global context of financial turmoil and the looming challenges lying ahead for the Polish banking sector with the future possible downturn in the domestic credit cycle and in particular its mortgage-loan component, it was probably not the best time to organise this institutional transfer. Also, banks and supervisory officials have to take up the challenge of the new capital requirements linked to the Basel II regulations. Overall, it is important that strong co-operation and efficient and transparent flows of information are organised between the central bank and the KNF through appropriate arrangements. They need to prevail in both directions, not only in crisis times but also on a regular basis. In this respect, having opted for a similar model of supervision to the United Kingdom, the Polish authorities should draw all the lessons from the recent Northern Rock episode.

Conclusion

Housing policies in Poland need to be overhauled. The supply of housing is hampered both by the absence of urban zoning plans and by regulatory barriers to the development of a rental market. This limits access to affordable housing, especially in major cities. The solution is to further ease controls on rent increases and enforce eviction of non-paying tenants. More efficient means to facilitate access to home ownership than subsidising borrowing costs should also be considered. Detailed recommendations to improve housing–market policies can be found in Box 2.

Box 2. **Main recommendations on housing-market policies**

Structural aspects of housing policies

- Ease capacity constraints in the construction sector by strengthening vocational training and by facilitating labour-market access for foreign workers through the issuance of work permits tailored to meet specific project needs.
- Make compulsory the establishment of municipal zoning plans and introduce an *ad valorem* tax system for providing local authorities with additional financial resources.
- Work towards further easing of controls on rent increases, and consider the introduction of offsetting measures through means-tested allowances to households. Evictions of non-paying tenants need to be better enforced.
- Reform the TBS programme of social housing: grant a buy-back option to tenants, improve income-targeting rules and the correspondence with the level of collected rents; proposals to extend the programme through PPP arrangements linking private funding and the provision of serviced plots by municipalities are promising and deserve further investigation.
- Consider terminating the central-government programme of interest-rate buy-down. To facilitate home-ownership without harming labour mobility, the elimination of stamp duties on house purchases should be envisaged.

Financial aspects of the housing market

- Introduce escrow accounts to protect buyers' advances against the risk of developers' bankruptcy.
- Publish official composite house price indexes for the country as a whole as well as different market segments. The Central Statistical Office (GUS) needs to redouble its efforts in this area.
- Speed up the registration process of mortgage liens and remove legal barriers in effective mortgage collateral recovery.
- Lift long-term funding and refinancing barriers of banks' mortgage loan portfolios: allow universal banks to issue covered mortgage bonds, and remove existing regulatory and taxation obstacles that prevent securitisation from taking off.
- Ensure adequate co-ordination and exchange of information between the central bank and the banking regulator recently moved to the Financial Supervision Authority.

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