



Designing a new rental housing law for Romania

Designing
a new rental
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Abstract

Purpose – This paper aims to describe the outcome of a research program carried out by the Austrian IIBW to support the Romanian Government in redesigning its national housing law in order to cope with specific problems on the Romanian housing market, such as the absence of tenure choice and affordable and tenure-secure rental housing.

Design/methodology/approach – Specific housing problems and requirements of legal changes were identified by policy makers and in previous studies. Solutions are provided by an international team of experts with the target to include European best practice concerning rental and limited-profit rental law.

Findings – This paper concentrates on three major topics within the restructuring of the Romanian housing law that permit integrating European best practice in the field of housing policy. First, Romanian rental housing legislation is reconsidered and a market-based relative price control based on the German experience and on written contracts is proposed. Second, a new public-private-partnership (PPP) housing law, building on the framework of PPP social housing providers in Europe, and especially Austria, is considered. A rigid frame of checks and balances and public compensation of social service obligations are core elements. Third, special attention is paid to the compliance of proposed measures with European Union legislation on competition, which is of major importance for any legal recommendations to be applicable.

Practical implications – The proposed legal changes are designed to foster the development of a functional long-term private and social rental market in order to meet the housing needs of the Romanian population.

Originality/value – The overarching research program this paper builds on was commissioned by the Romanian Government and was intended to address specific and current problems on the Romanian housing market.

Keywords Housing, Romania, International law, Housing legislation

Paper type Research paper

1. Introduction

The housing sector in Romania has undergone profound changes during the transition process, which started in the early 1990s. As in many other former Communist transition countries, the housing sector initially played an important role of “political cushion” for the more radical and politically difficult reforms of other sectors. Consequently, the early reforms focused on politically popular micro-privatization of apartments in multi-family residential buildings to sitting tenants. Less attention was given, after privatization, to an efficient maintenance and management of the existing housing stock and to create affordable housing choices for those who would be (re-)entering the housing sector and could not afford home ownership or renting under profit-driven housing market conditions.

One further challenge on the Romanian housing market is the large quantity of privately owned apartments that are rented out without written contracts. This private



rental segment is not reflected in the official statistics on tenure in Romania. Also, taxes are not collected and Romanian authorities have hardly any possibility to encourage tenant protection.

In response to these problems, the Romanian Government, the Parliament and Local Governments have adopted and discussed various policy measures in the area of legislation, subsidies and direct participation, in order to stimulate alternative housing forms.

As part of this aim, the Romanian Government has been interested in formulating and developing more explicit rental housing policies and implementing the requisite programs as part of the post-privatization realignment of housing policies. Reliance on the private rental sector requires developing transparent and balanced landlord-tenant regulations, including dispute resolution and eviction procedures and securing sufficient competition to prevent usurious rent seeking.

The Romanian Government has also considered the benefits of fostering a limited-profit rental housing sector to address housing affordability problems of middle and lower income households, those who cannot afford (even subsidized) home ownership. This approach would include the implementation of housing financing patterns through public-private-partnerships (PPPs). In sum, the Romanian Government was considering to anchor its rental housing policies on a competitive, private and transparent rental market, supplemented by social rental housing programs building on PPPs.

A fundamental problem in transition countries, such as Romania, is the fact that “the legal framework has failed to keep up with the market” (Tsenkova, 2009, p. 210). Therefore, reconsidering its housing policy and the overarching legal framework, the Romanian Government introduced a tender procedure in order to engage an international research organization with the development of a housing strategy and the drafting of a general housing law. This would define the legal framework of rental housing, limited-profit housing, condominium housing, maintenance and administration of the housing stock and housing subsidies, based on a Housing Policy Strategy from 2006 and a study commissioned by the World Bank by Diamond (2006).

This tender procedure was won by the IIBW, the Austria-based Institute for Real Estate, Construction and Housing in Spring 2007. Consequently, a team of one dozen Austrian and Romanian experts from academic research, law, housing practitioners and policy advisers was put together in order to include a variety of expert knowledge from different fields into the draft of a new Romanian housing law. The final report was completed in January 2008 (IIBW, 2008).

This paper aims to summarize the outcome of this final report and mention the reasoning for specific details of legal recommendations. A far-reaching description of the whole project not being possible, this paper will focus on the private and limited-profit rental market in Romania and the recommended laws designed to cope with present problems.

The structure of the paper reflects this main focus. First, the deficiency of rental housing in Central Eastern European and South East European (CESE) countries and especially Romania will be described. Second, the research project is sketched out and the structure and reasoning behind the proposed new housing law is displayed. We will then focus on two specific laws, the new rental law and the PPP housing law, which were designed by the IIBW within the project, and explain how European best practice

influenced the legal propositions. A consecutive section focuses on the compatibility of the recommended laws with European Union (EU) regulations, which is of major importance for any proposed legal changes since Romania's accession to the EU in 2007. The final section will summarize the lessons to be learned.

2. Background

2.1 Backlog in rental housing in CESE countries

The present economic crisis started in the housing sector and, after spreading world wide, hits the housing sector more than other branches of industry (Scheiblecker, 2008; Euroconstruct, 2008). Economies in transition are more heavily affected than most well-developed Western countries (excepting Spain, Ireland and Iceland) for several specific reasons. Generally, low economic power makes markets (as well as individuals and national economies) vulnerable to risks, and the risks facing CESE countries are considerable and manifold. This is because for many years new construction of multistorey dwellings in all CESE countries was largely orientated towards the upscale condominium market. There was hardly any social housing or indeed rental housing construction (Dübel, 2003; Dübel *et al.*, 2006; Ball, 2007).

Addressing the owner-occupation sector, for years the banking sector was very open to finance any project and borrower in order to establish a client profile and market share in Europe's emerging economies (Buckley and Van Order, 2004; OECD, 2005; Maechler and Ong, 2009). Retail financing developed quickly and covered 100 per cent and even more than purchase prices. Foreign currency loans were increasingly promoted.

Yet, for institutional financing (financing of companies, owners associations, etc. for rental housing or refurbishment) there was, and still is, a shortage. Development of financing instruments is closely related to institutional development in the housing sector, i.e. the establishment of housing developers. Therefore, while the construction of owner-occupied apartments has recovered since the transformation, this is not the case for rental housing. The strong preference for owning property is rooted in economic reasons (Pascariu and Stanculescu, 2003). First, property is regarded as a security against trouble of any kind, above all, future income insecurity. People have experienced that property has kept its value while savings were lost and tenancy rights became more insecure. Second, there is little choice for people regarding investment. In countries with an underdeveloped banking sector, people tend to convert their savings directly into bricks and mortar. Third, property is a way to pool the economic resources of several family members, including relatives who work abroad. Thus, investment in real estate promises a double dividend by providing accommodation with low running costs and an asset that increases in value (Tsenkova, 2005, 2009; Lux, 2006).

Rental housing is not competitive today in most CESE countries (Buckley and Tsenkova, 2001; Scanlon and Whitehead, 2004; Donner, 2006; Amann, 2005, 2006). As long as it is cheaper to finance property privately, renting an apartment is not attractive. The sharp decline in public housing in the 1990s did not recover at all. Municipalities or social housing sectors are only active in housing construction in a few transition countries (e.g. Poland, Czech Republic). Generally, the public sector tries to avoid being involved once more in housing construction, as it disposed of owners' obligations by privatizing big parts of the rental stock.

A rental housing development sector is not established in most CESE countries (Hegedüs, 2010; Tsenkova, 2009). Currently, housing developers are often subsidiaries

of construction companies. Their primary interest is to employ their own construction division and to get returns on investment as soon as possible. Long term investments are neither their core business nor in their interest. Rental housing developers in contrast must have a long-term perspective. There are well-functioning models all over Europe (Figure 1; Donner, 2000; Whitehead and Scanlon, 2007).

2.2 Housing problems in Romania

After Romania's communist regime was overthrown in late 1989, Romania experienced a decade of economic instability and decline, led in part by an obsolete industrial base as well as a lack of structural reform (UNECE, 2001, 2005). Starting from 2000, however, the economy was transformed into one of relative macroeconomic stability, high growth, low unemployment and increasing foreign investment, and is currently among the most developed in South East Europe. Economic growth since 2000 has averaged 4-5 percent, rising to 8.3 percent in 2004, and not less than 7.1 percent in 2008. This has characterized Romania as a boom economy and one of the fastest growing in Europe.

Romania with its 21.6 million inhabitants (2006) is the largest country of South East Europe. Economy and population are strongly concentrated in the capital Bucharest with its 2 million inhabitants. The second largest city Braşov has hardly 300,000 inhabitants. Romania suffers from strong emigration. Since 1997 the population has decreased by 1 million. Further decrease is forecasted. Yet, there are very strong migration flows to the capital city. The population group between 16 and 25 years is some 15.5 percent of the total population, higher than in Hungary, the Czech Republic or Austria.

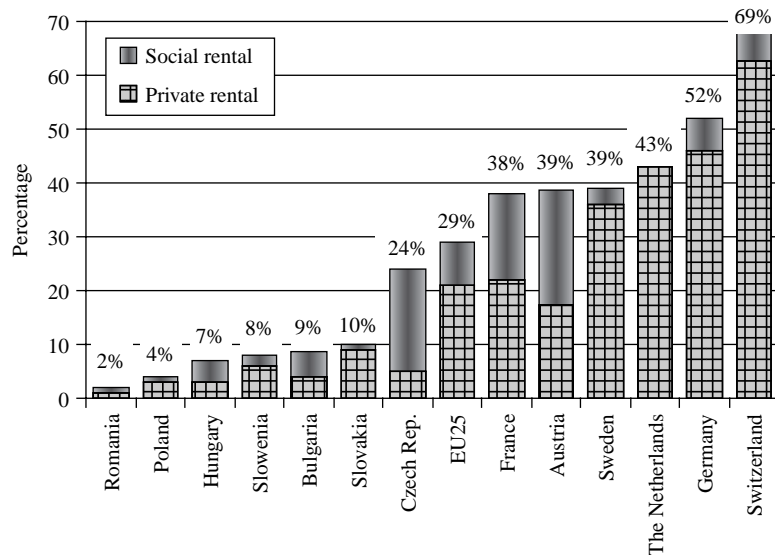


Figure 1. Shares of rental housing in European countries (around 2008)

Note: Official data does not include off-the-record rental units from private owners in some transition countries

Sources: IIBW; Eurostat (EU-SILC); International Union of Property Owners (for Switzerland, 2003); Statistik Austria (for Austria)

Romania has a housing stock of 8.3 million units (2008). There are around 390 dwellings per 1,000 inhabitants. The average household consists of 2.9 persons, which is relatively large, compared to the EU-27 average of 2.4 persons per household.

The evolution of the economy during the transformation period introduced changes which also impacted on housing policy:

- *Privatization* – which contributed to the reinforcement of the ownership rights, but determined a drastic decrease of the public housing stock and led to some major problems related to housing provision and social cohesion.
- *Decentralization* – which encouraged the private sector, but at the same time determined a drastic decrease in public funds invested in housing construction and infrastructure. A big number of municipalities are incapable of dealing independently with the housing problem of socially disadvantaged groups.
- *Restitution* – which is still underway, has provoked many disturbances.

Between 1990 and 2004 as many as 2.2 million dwellings were privatized, which is 27 percent of the total housing stock (PRC Bouwcentrum International, 2005). As a result, the official owner occupation share rose to 98 percent. This official figure does not account for the many individually owned apartments that are rented out without written contracts (see below), which is estimated at around 1 million units. Less than 2 percent of the stock has remained as rental housing. The massive privatization of social housing resulted in an excessively high ownership rate and, on the other hand, in a degeneration of the rental markets. The impacts are severe:

- The “manoeuvring mass” of former social dwellings is missing. This is harmful particularly for young households (which did not benefit from privatization), for migrants to the cities and for low income households.
- It results in extremely unequal market sectors with very low rents in the remaining social housing sectors, while in private markets rents are on an international level.
- Insufficient housing supply already starts to impede economic development, particularly in metropolitan areas.

More than half of the existing housing stock was built between the 1960s and the 1980s. These buildings suffer from poor thermal quality and ongoing deterioration. Housing privatization has made rehabilitation more difficult, as many new owners face serious financial problems concerning the maintenance of their dwellings. Many owners still think the state should provide the much-needed support as it used to. They enjoy the benefits of private ownership but reject the responsibility adherent to such a status. Owing to tenancy and the technical quality of the buildings, housing refurbishment is a paramount challenge (Pascariu and Stanculescu, 2003).

2.2.1 Housing provision. The average useful floor space per capita is approximately 20 m², which is far below the EU-25 average of 36 m². This issue of “overcrowding” can only be solved by new residential construction, but the private sector is unable to compensate the decline of public funds allocated to housing construction.

In Romania, some 30,000 dwellings were completed in 2004, while in 2008 the number grew to some 64,000 (Figure 2). This amounts to 3.0 housing completions per 1,000 inhabitants. The EU-25-average was 5.2. The current financial crisis has negative

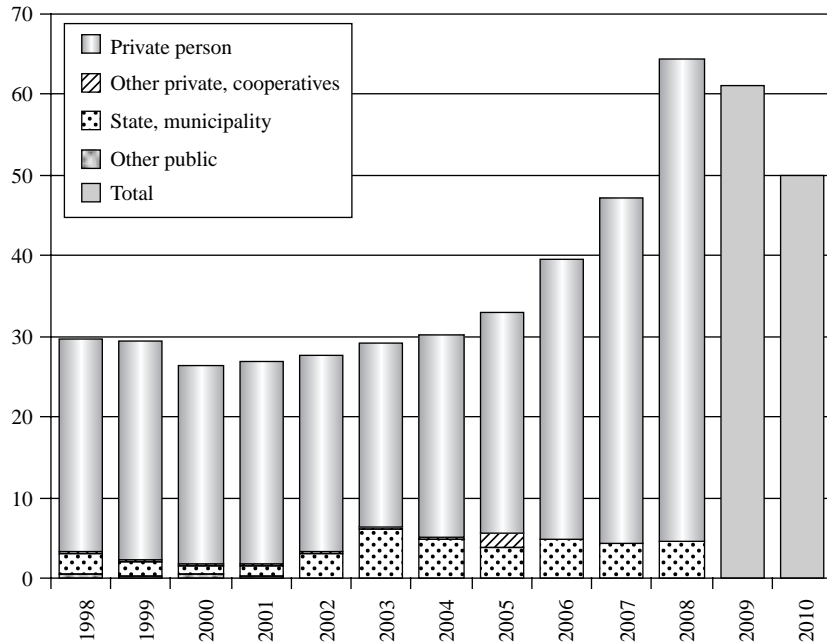


Figure 2.
Housing completions
(in 1,000 units)

Source: National statistical offices, IIBW estimate for 2010

effects on housing production in Romania, with housing completions forecasted to decline slightly.

By far the biggest share of completions is undertaken by private persons. The vast majority of new construction is single family houses and condominiums. New rental construction is almost inexistent. In the past, this was quite different. In 1991, only one-fourth of completions was carried out by private persons. This share grew up to 90 percent by the end of the 1990s and is today at around 80 percent. The public (state and municipalities), on the other hand, used to be responsible for 75 percent of completions. Its share decreased down to only 5 percent in 2001.

The main housing policy programme continues to be the construction of rental housing for young people up to 35 years of age. Beginning in 2001 and developed by the National Housing Agency (ANL), more than 17,000 dwellings have been completed by now all over the country. With support of international financing sources some grand projects with remarkable planning and construction quality were executed. However, after 2004 the number of completed dwellings decreased significantly.

From 2006, the Romanian Government started programmes began to address the existing housing stock for refurbishment against seismic risk and thermal rehabilitation. The legislative framework was improved significantly, but a public campaign for increasing the awareness and coordinating the actions of all the stakeholders involved is still missing.

2.2.2 Housing costs and affordability. Privatization contributed to affordability of housing, at least for the sitting tenants, but the contrary is the case for households that

enter the housing market today. Three household groups suffer particularly from shortages in affordable housing: the young, the mobile and the poor.

It is necessary to distinguish between housing costs that affect all households, and market prices that apply only to new contracts. Of course, housing costs are much lower than market prices.

On average, Romanian households spend some 22 percent of private consumption on housing including energy (2006), which does not seem to be a problem since it is around EU average. Yet, this average is skewed by the extent of low housing costs of many sitting tenants. Additionally, the share of housing expense has increased by 3.5 percent points since 1998. This is alarming, as it seems questionable whether incomes will catch up with the dynamics of housing market prices.

Market prices for condominiums in the capital of Bucharest and in other high-priced cities such as Braşov, Cluj-Napoca, Timişoara and Constanţa have developed very dynamically in the past few years. The largest increases were documented before 2005. The climax was reached at the beginning of 2008 when an average apartment cost around 1,500 €/m² in Bucharest, the highest market segment reaching 3,000 €/m². The price level came close to western European cities, while incomes of the population remained much lower. At that time, a modest apartment at market prices cost approximately 15 times a Romanian person's annual income. This multiple is not greater than 4 or 5 in most EU-countries. Since the peak in 2008, prices have fallen considerably and the local currency has devalued. These factors lead to a decrease in market prices of approximately one-third to a price level of 900-1,100 €/m² in Bucharest.

Considering these developments, the main challenges that can be identified for Romanian housing policy are the lack of affordable rental choices for households entering the housing market, the inefficient management and repair of common parts of high-rise condominium buildings, the inadequate housing output and lacking affordability.

2.3 Structure of a new housing law for Romania

In order to set up a stringent new housing law for Romania, there were particularly three requirements and challenges that had to be met.

First, the legal framework had to be consistent and clearly structured. The Romanian Government sought a thoroughly practicable law with detailing to the level of paragraphs. Many European housing laws are the outcome of consecutive changes, ameliorations and amendments. As a result, stipulations about various domains are often scattered throughout different single laws and paragraphs, as legal changes often reflect the adaptation of regulations to newly surged practical ambiguities that have to be clarified. Therefore, to structure the new Romanian housing law, regulations on different domains are to be found at not more than one place. Definitions ought to be collected in one chapter of the law, so whenever this terminology is referred to in the single laws, cross-reference will suffice. Legal changes may affect the general law without rendering further changes in the single laws necessary. Therefore, a parallel development of legal domains will be prevented.

Second, a major challenge for the compilation of a new legal body was the language dimension. Any legal recommendations and wordings, made mostly by Austrian experts in German, had to be adequately translated into the working language of English from which, in a final phase, it had to be transmitted into clear legal Romanian.

Since legal terms are very specific in each language and convey a large amount of cultural content, communication and mutual understanding was of major importance in the process.

Third, since the integration of Romania into the EU in 2007, any laws, especially the new ones, have to be consistent with EU regulations that, though not directly affecting housing matters, may be in existence in wider policy fields, especially competition. Therefore, while consolidating the existing regulations and supplementing them with European best practice, the outcome had to be checked as for compliance with EU law (see below).

In order to address these requirements in a systematic way, a comprehensive canon of housing regulations was designed within six single laws. Each of the single laws covers a highly specified field of regulation. The specification follows the context of regulation, but also the differing target groups. Laws that address consumers (Rent Law, Condominium Law, etc.) have to use a more understandable language than laws that address professional bodies (PPP housing law, Housing Maintenance Law, Housing Subsidy Law). The general housing law is a framework law that states the legal consistency of all six Laws. Furthermore, it contains regulations that are common to all, e.g. definitions. Summarizing, the proposed legal canon illustrates the following features.

2.3.1 Solidity in structure – flexibility in detailing. The regulations are issued as “Simple Laws” that do not have to be amended frequently. If changes are needed, any of these laws may be amended individually, avoiding that changes in one law contradict regulations in others. In this way an undesirable casuistic future development of housing legislation can be prevented. Details are determined by “Decisions of the Government” and – for particularly flexible aspects – as orders of the Minister in charge. These regulations may be adopted in a most flexible way in everyday legislative practice.

2.3.2 Innovations on basis of European best practice. The Romanian housing law introduces a number of new approaches which might increase the efficiency of the Romanian housing markets and housing provision substantially. Some of them are:

- The introduction of out-of-court arbitration on housing-related matters which should ease the access to legal rights for citizens and quicken legal decisions by ordinary courts. In Austria, for example, out-of-court arbitration on clearly defined housing issues has been shown to be able to unburden ordinary courts and speed up resolution (Hager *et al.*, 2004). In Romania, there is experience in alternative dispute resolution of consumer disputes building on a special legal framework[1].
- With the creation of condominium property in all buildings it should become possible to have one single legal regime for the whole housing stock to ease rent regulation, administration, maintenance, refurbishment, subsidies, etc. This new element was designed in order to prevent the development of parallel accounting and regulation principles within mixed buildings (owner-occupied, rental) that have caused problems of administration in Romania in the past, as well as in other European countries (Pascariu and Stanculescu, 2003).
- Maintenance, administration and refurbishment for all sectors of housing are regulated in one integrated law. This allows for simple procedures for all buildings.

[1] Law 192/2006 on mediation and the organization of the mediator profession.

A particular target of this law is the enforcement of large-scale thermal refurbishments.

- The ANL is a financially autonomous institution of public interest with legal personality, coordinating financing sources in the housing construction sector (Tsenkova, 2009, p. 74). It was established in 1999 to promote housing construction development at a national level and currently operates under the authority of the Ministry of Transport, Construction and Tourism. The ANL will be developed into a key player in improving the financing tools for affordable housing. For this reason, it will acquire loans from national and international sources.
- The rent regulation scheme and the PPP housing law both combine adequate European regulations and will be treated in detail below.
- Additionally, new housing law EU requirements, such as the obligatory energy performance certificate[2], will be implemented.

2.3.3 Integration of existing regulations. The Romanian housing law is designed to maintain operative existing housing regulations, particularly regarding condominium legislation[3]. Nevertheless, the systematic approach of the new laws does not allow for a subordination under the fairly casuistic previous regulations. Many previous regulations with proven effectiveness will be integrated as “executive ordinances”. In this way, it will be easy to maintain tools, procedures and standards that already became common and beneficial.

3. A new rental law

The proposed rent regulation scheme for Romania is, compared to European practice, a most simple and liberal one. By contrast to existing models, it works with one single price mechanism to be applied for the big stock of rented condominiums (built before 1990) and subsidized rental dwellings. The scheme of comparative rents, with the newly developed tool of rent comparison lists, following the German model of “Mietenspiegel” (qualified rent tables), will be the key element. New technologies may be applied in collecting consensual market information. In Germany, the rent level of new contracts may be negotiated freely by the parties involved. Rent changes, however, have to be based on the rents of three similar rental dwellings or on the “Mietenspiegel”, a database with local reference rents[4]. This database keeps track of non-subsidized market rents agreed within all contracts within a locality in a four-year period preceding publication. The main purpose of this system is to enable rent increases to be set in line with market rents and at the same time reduce price inflation by including a time lag. German rent regulation has succeeded in dampening rent increases when rents are rising (Haffner *et al.*, 2008, p. 228; Kofner, 2007).

3.1 Elements of the rental law

The rental law states the rights and duties of tenants and landlords toward each other and toward the public. In general, it tries to interfere with the working of the housing

[2] Starting with: Directive 2002/91/EC on the energy performance of buildings (2003), OJ L1/65-71.

[3] Law 114/1996, 152/1998, 230/2007.

[4] § 558 BBG (German Civil Code).

market as little as possible and at the same time enhance transparency and tenure security.

3.1.1 Reaching the intended housing stock. In order to reach the intended rental housing stock with this law, it is necessary to render official the many individual contracts between private apartment owners and tenants. Therefore, for all rental contracts a written form will be mandatory, including specifications on the dwelling, the partners to the contract, the monthly rent and modifying rules, the obligations of the parties regarding the use and maintenance of the dwelling and further provisions. Rental contracts that do not exist in writing by the date of coming into force of the law shall be effected in writing within a one-year period. Rental contracts not containing the above-mentioned items shall be considered tenancies of unlimited time period. Therefore, the law encompasses a strong incentive for landlords to provide written forms to hitherto unofficial, oral contracts and thereby create tenure security.

3.1.2 Security of tenancy. The municipalities are also encouraged to create arbitration tribunals for out-of-court settlements concerning disputes of tenancies, preferentially with the involvement of representatives of tenants' and landlords' interests. This will lead to a practicable, close-to-life interpretation of the law and may also contribute to the strengthening of the civil society. Recourse to these tribunals is binding before turning to ordinary courts. Their use is free of charge for the parties involved.

The sale of a tenanted dwelling or building does not affect tenancy rights. If such a dwelling with an existing tenancy is sold by a landlord to a third party, the purchaser of the property takes on all rights and duties of the previous landlord for the remaining duration of the tenancy. Therefore, some kind of publicity of rental agreements must be established to avoid problems for *bona fide* purchasers, and selling landlords have the responsibility of informing the purchasers of any existing tenancy agreements concerning the dwelling being sold.

Terms of duration of residential tenancies can be fixed at will by the parties to the contract. The law allows fixed-term contracts, the minimum term being six months, up to unlimited contracts.

In general, assignment of residential leases is not allowed. However, with the consent of the landlord, the tenant may sublet to a third party. Even if the landlord agrees to the subletting, the original tenant remains responsible for damages caused by the third party/sub-tenant. Partial sublease is possible as long as the original tenant also uses (parts of) the dwelling. Written contracts are necessary and the partial sub-tenant remains liable to the original tenant for any damage to the property and for payment of rent.

3.1.3 Rent regulation. Rent regulation applies only to dwellings built with public subsidies, i.e. dwellings built before 1990, as well as those to be built in the future according to the PPP housing Law. Only completely unsubsidized new dwellings will not be rent regulated.

The rent regulation is based on an average rent according to present conditions on the housing market, resembling the German example described above. Dwellings, partly or totally financed by public subsidies, irrespective of private or public ownership, may be rented out at rents not higher than the locally customary rent level. The locally customary rent for a dwelling will be determined in consideration of rents being paid within a municipality for dwellings of similar size, endowment, finishing, quality and

location. For this reason, municipalities have to compile, proclaim and publish rent comparison lists of locally customary rents of the current and past calendar year.

A dampening effect on prices on the entire housing market is to be expected. Yet, the development of the market is taken into consideration and therefore, unlike other European countries, Romania will not experience a “rental freeze” (Lind, 2001; Haffner *et al.*, 2008). On the contrary, landlords will be able to rely on an adequate return on investment, encouraging investment in housing construction by private enterprises.

Changes in the monthly rent are legitimate if the original level of the rent, the date of change and the changing factor are established beforehand. Either the rent increase will be effected every two years in accordance with changes in locally customary rents, as determined by rent comparison lists, or the rent increase will be effected in accordance with yearly changes in the consumer price index. If no indexation or rental increase is specified in the written contract, rents do not change until the end of the rental term.

3.1.4 Encouraging the modernization of dwellings by the landlord and the tenant. The tenant must tolerate measures for the maintenance and/or the adequate modernization of the dwelling for energy and water saving, or for the provision of additional dwelling space. These measures have to be reasonable. On the other hand, the landlord has to agree to measures carried out by the tenant if these measures enhance the usability of the dwelling for handicapped persons or contribute to energy and water saving, and if the future use of the dwelling will not be substantially restricted. Such useful improvements have to be reimbursed by the landlord at the date of termination of the tenancy in consideration of an adequate depreciation rate.

Changes and deteriorations of the dwelling in accordance with the contractual use of the dwelling will not have to be reimbursed by the tenant. Other deteriorations and additional wear and tear of the dwelling have to be reimbursed adequately by the tenant.

4. A PPP housing law

4.1 Potentials of a Third Sector in housing

The potential of a Third Sector, between state and market, in housing can be seen in two different aspects. Firstly, it enables the installation of a functioning rental market and, secondly, it enforces public objectives in housing policy through the operation of non-public housing providers. Under the many advantages of an increased rental housing supply, special attention must be paid to the resulting increase in labour mobility, the improvement in affordability for young and poorer households and the increase in tenure choice.

For the Romanian Government to emphasize rental housing some basic considerations are highly relevant:

- Social housing for low income groups only, with means-tested access, inevitably leads to dual rental markets (Kemeny, 1995; Kemeny *et al.*, 2005). There is a strong tendency towards “poor services for the poor”. Settlements with particularly poor tenants are in serious danger of degrading and becoming ghettos. It is necessary to strive for mixed social structures, granting access to social housing for middle income groups also (Czasny and Stocker, 2007). In the face of limited budgets, it seems favourable to cover a smaller part of demand for lower and middle income groups, instead of social housing for the poorest only.

- Unitary rental markets appear advantageous compared to dual rental markets (Czasny *et al.*, 2008). The major criteria are rental levels that do not crowd out other market segments (private rental, owner-occupation). Therefore, rents in the social housing sector should be calculated to be affordable for middle income groups. Low income groups should be supported by additional means-tested individual allowances.
- Housing is a very long-lasting product with a long period of production. Therefore, it is of major importance to warrant legal security and lasting conditions for financing. The establishment of institutions (e.g. a PPP housing sector) will decrease the probability that short-term housing policy programs are easily abandoned under altered political conditions.

As examples of limited-profit structures in the countries of Austria, France, the Netherlands and Sweden have shown, the implementation of a Third Sector in housing to secure general objectives of housing policy has attained convincing results (Czasny, 2004; Czasny *et al.*, 2008; Amann, 2008). Unlike for-profit providers, limited-profit housing providers will not exclusively focus on rental dwellings for upper incomes, but will provide housing for middle and lower income groups, supported, if necessary, by public subsidies and the legal definition of public service obligations, which specifies the social goals of the housing operators. Unlike private landlords, operators in the Third Sector will not use excess demand for housing to generate economic profits from inadequate housing supply, but will act according to public goals to which they are legally bound. PPP models with adequate state support can therefore combine the strength of the markets with public goals and, at the same time, work as incentives to market-oriented behaviour.

Habitation à loyer modéré providers in France, Limited-Profit Housing Associations (LPHA) in Austria, “woningcorporaties” in the Netherlands and municipal housing companies in Sweden, are typical examples of this approach (Amann and Mundt, n.d.). General characteristics of these housing providers are the obligation to reinvest profits, clearly defined public service obligations in the field of housing, allocation rules, public control and supervision and adequate state subsidies and funding.

But is it true that starting a rental housing scheme is only possible with heavy state expenditure? There is evidence that the necessary support for a social housing sector is inversely proportional to its size (Kemeny *et al.*, 2005; Czischke, 2005; Turner and Birgersson, 2006). In some countries, though, extended social housing sectors with solid and matured non-profit housing companies work with very little state support and hardly invasive legislation (Whitehead and Scanlon, 2007). Matured social housing sectors prove that by making use of market forces and capital market financing at defined stages of the production process, it is possible to realize affordable housing with low public expenditure.

The recommendations for a PPP housing law for Romania are to a large extent based on the Austrian system of LPHA that has proven its efficiency to provide affordable rental housing over the last 100 years. LPHA in Austria comprise altogether some 192 housing cooperatives, private limited and public limited companies with a total housing stock (rental dwellings and owner-occupied apartments) of some 750,000 units, comprising approximately 18 percent of total housing stock (GBV, 2008). The LPHA are responsible for 31 percent of new residential or 50 percent of multistorey housing construction. For this task, they are assigned around one-third of total expenditure on housing subsidies.

The housing associations are cooperatives or companies owned by public authorities, charity organizations, unions, companies, banks or private persons. To avoid moral hazard, construction firms may not be owners of LPHA.

LPHA are legally commissioned to provide tenancy secure rental apartments at cost-based rents for low and middle-income households. They have to focus on housing construction, refurbishment and housing management, and have to reinvest their profits in the construction of new dwellings or the purchase of building land. LPHA assets are bound to social housing goals on a long-term basis.

The strict stipulations of the limited-profit housing law, the supervision through audit associations and the provincial authorities, and the fact that many housing associations are owned by semi-public bodies have as a result that housing associations are regarded as the “lengthened arm of housing policy”. They work on a market-economy basis for goals strongly influenced by the public.

4.2 Elements of a PPP housing law for Romania

The basis of PPP housing are enterprises of private law with (private or/and public) owners who have a long-term perspective and a vital interest in a functioning and flourishing housing sector.

In order to fulfil this task, regulations have to be implemented in accordance with EU law. The state has to guarantee the enforcement of these regulations. The system of PPP housing will not only control the compliance with subsidy conditions and goals, but will also monitor a whole business-sector that commits to long-term reinvestment. PPP housing companies fulfil public service obligations of general economic interest.

4.2.1 Field of operation. Accredited PPP housing companies have to focus their activities on services of general economic interest in the field of housing. They have to apply their assets to these services and agree to open their business activities to regular audits and supervision. A PPP housing company has to be engaged in the construction and management of social dwellings.

PPP housing companies may build social dwellings with a limited useable floor space (e.g. of at most 90m²) and with standard equipment, taking into account the state-of-the-art technology and present time habitation standards, with highest possible efficiency of construction costs, considering operational and maintenance costs.

4.2.2 Structure of checks and balances. There will be several elements to guarantee the transparent functioning of PPP housing companies. The accreditation, denial and revoking of accreditation shall be enacted by the Ministry of Finance as accreditation authority. To be accredited as such, the PPP housing company has to be set up as a limited liability company or as a joint-stock company, with a domestic head office. Cooperatives are included into the PPP scheme as well. It is required to have a supervisory board and it is not allowed to be under the predominant influence of political parties or the construction industry.

The PPP housing company must be affiliated to an auditing association which is in conformity with specific EU stipulations[5] and shall be accredited by the Minister

[5] Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts (2006), OJ L157; Directive 84/253/EEC on the approval of persons responsible for carrying out the statutory audits of accounting documents (1984), OJ L126/20; Directive 78/660/EEC on the annual accounts of certain types of companies (1978), OJ L222/10.

of Finance. An audit must be conducted every year before the approval of the annual accounts.

4.2.3 Allocation of housing. The allocation of dwellings through the PPP housing company has to follow objective criteria, especially regarding housing need, household size, and household income of applicants. In principle, the PPP housing company is not allowed to restrict the allocation of dwellings to defined persons or a defined number of persons. However, PPP housing companies may restrict the allocation of dwellings in some cases (reverse discrimination).

4.2.4 Tie-up of assets. Profits are indispensable to build up equity and to carry risks. A company with too little of its own capital will necessarily be unstable and face economic difficulties, which will influence the willingness of commercial banks to co-finance construction projects. Yet, PPP housing property is to stay restricted to housing policy matters on a long-term basis. Therefore, any profits have to be reinvested. Own equity and capital contributions are granted a legally defined reasonable profit. EU legislation on limited-profit housing providers has recently recommended an adequate relationship between public finance providers and housing operators with public service obligations (Ghékrière, 2008).

If dwellings are sold, the new and any consecutive owners have no right to resell for at least ten years with a gain. Price increases must only cover proved expenses on the premises of the preceding owner. This restriction is to be safeguarded with security entries in the land registry.

In case of liquidation, the PPP housing company has to surrender all assets including inventory to the accreditation authority. Its further use has to be within the purposes of the PPP housing regime.

4.2.5 Rent levels. Rents are cost based but there is room for rent pooling at the level of housing companies. Therefore, cross-subsidization of buildings will be possible. Further determinants of rent calculation may be established through subsidy regulations.

PPP housing companies will combine the following functions: housing development, long-term investment in the housing stock, housing management and maintenance. With the obligation to maintain the buildings and manage the common parts in apartment blocks, the danger of insufficient investment and dilapidation of the buildings can be prevented. They can provide an efficient structure to secure the necessary joint investments of all occupiers/tenants to maintain the common areas. As a consequence, necessary funds for these tasks will be collected continuously as a mark-up on cost rents.

4.2.6 Financing. PPP housing companies must have privileged access to housing subsidies, especially for the provision of affordable rental dwellings. This privileged access is granted as a compensation of their public service obligations.

Central Eastern European countries spend, on average, 2 percent of the state budget on housing [i.e. approximately 1 percent of gross domestic product (GDP)]. The share ranges from 1 percent in Slovenia and Poland up to 4 percent in the Czech Republic. In South Eastern European countries, the expenditure for housing is generally below 1 percent of the state budget. In comparison, the average state expenditure for housing in the EU15 is 3.3 percent of state budgets. The difference is even more striking when the much higher GDP per capita and the quality of the housing stock in EU15 are considered. Additional housing subsidies will therefore be a prerequisite in Romania.

The form of the subsidies remains unspecified in the law. There is no best practice in Europe, since subsidy mechanisms are very diverse in different countries, and nowadays,

after the devolution of housing policy responsibility, even regions (Whitehead and Scanlon, 2007). Whether lump sum grants, construction grants, annuity grants, loans, guarantees or management subsidies are preferred, will be left to the Romanian authorities to decide. But for all this, one point remains clear: the setting-up of a functional social housing sector will require supply-side subsidies and will not be able to depend on demand-side subsidies alone. Additionally, by directly influencing the supply of housing, quality and energy efficiency targets and a counter-cyclical influence on house prices can be pursued.

As in Austria, an additional advantage of PPP models in housing will be the better financing conditions on the capital market, as long as social housing providers are embedded in a framework of checks and balances, with internal and external supervision (Amann and Mundt, 2005; Lugger and Amann, 2006). If PPP housing companies operate under risk-sharing conditions, either by public guarantees or by the implementation of funds, private capital participation will be encouraged due to low-risk and a reliable, stable yield. The potential to raise private capital for the operation of limited-profit housing providers can be further encouraged by instruments such as capital-gains-tax reductions on housing bank bonds, as practised in Austria (Amann *et al.*, 2005; Schmidinger, 2008).

5. Compliance with EU regulations

At the EU level there is no legal basis for a common design of housing policies. Therefore, this policy field is generally the responsibility of the individual Member States. However, for quite some time the EU legislation has influenced the housing policy of the Member States (Mundt, 2006; Elsinga *et al.*, 2008; Boccadoro, 2008; Ghékière, 2008; Gruis and Priemus, 2008; Amann, 2008).

In general, there is fundamental support from EU bodies for social housing policy measures within the Member States:

Social housing is fully in line with the basic objectives of the EC Treaty. It is a legitimate element of public policy and as it is limited to what is necessary it is in the interest of the Community that social housing is supported[6].

Such a support is also noticeable by the opening of the Regional Development Fund for housing[7] and recent financing programmes by the European Investment Bank (Amann *et al.*, 2006).

Additionally, there is explicit support at the EU level for social housing because it is able to support fundamental policy goals as laid down in the European Community Treaty, such as the goal of a high level of employment and social protection, a sustainable and non-inflationary growth, and a high level of protection and improvement of the environment (EC Treaty Article 2; Ghékière, 2008).

In the context of legislation on competition, however, social housing activities have to be in line with EU State Aid policy as governed by Articles 87-89 of the EC Treaty, by the later Decisions of the Commission on the matter (State Aid cases on N209/2001, N497/2001, N239/2002 and especially: Decision 2005/842/EC OJ L312/67-73) and by

[6] Decision N209/2001/EC, p. 5, Housing finance agency borrowings guarantee Ireland (2001) OJ C67/33.

[7] Regulation (EC) No 1080/2006 on the European Regional Development Fund (2006) OJ L210/1-11.

several rulings of the European Court of Justice. Only recently, a coherent EU judicature for social housing was introduced.

The provision of social housing may be considered a public service obligation in the sense of Article 86 (2) of the EC Treaty. This leads to the possibility of compensating these services by the public. As for the question of the legitimate height of public service compensation, the famous judgement in the “Altmark” case[8] has established a general framework. Here, the Court of Justice held that, in the field of public service compensation, in order to escape the State Aid regime of Article 87, four cumulative criteria have to be met:

- (1) The recipient undertaking must actually have public service obligations to discharge, and the obligations must be clearly defined.
- (2) The parameters, on the basis of which compensation is calculated, must be established in advance in an objective and transparent manner.
- (3) The compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit.
- (4) The undertaking which is to discharge public service obligations, in a specific case, should be chosen pursuant to a public procurement procedure that allows for the selection of the tenderer capable of providing those services at the least cost to the community. If that is not possible, the level of compensation must be determined on the basis of an analysis of the costs which a typical undertaking, well-run and adequately provided with appropriate means, would have incurred.

For social housing as a particular field in the common market, the Commission’s Decision of 28 November 2005[9] brought further clarification of the Altmark ruling and established a special treatment of social housing within Competition Law: “Social housing undertakings [...] have specific characteristics that need to be taken into consideration” and “the intensity of distortion of competition in those sectors is not necessarily proportionate to the level of turnover and compensation” (Decision 2005/842/EC, p. 16). The Decision is applicable to compensations of less than €30 million per year provided its beneficiaries have an annual turnover of less than €100 million.

The following definitions and rules were established[10]:

- The target groups of social housing measures are “disadvantaged citizens or socially less advantaged groups, which due to solvability constraints are unable to obtain housing at market conditions.”
- For the compensation of social housing services, a general exemption from notification to the Commission was provided irrespective of the amounts involved. This will enable specific and targeted support for social housing, which is essential, for example, urban regeneration, without the need for a separate notification to the Commission.

[8] ECR I – 7747/2003.

[9] Decision 2005/842/EC on the application of Article 86 (2) of the EC Treaty to State aid (2005) OJ L312/67-73.

[10] Quotations refer to Decision 2005/842/EC on the application of Article 86 (2) of the EC Treaty to State aid (2005) OJ L312/67-73.

- Overcompensation for the fulfilment of a public service obligation may be tolerated as long as it stays within a certain threshold and is carried forward to the next period:

The revenue of undertakings entrusted with the operation of services of general economic interest in the field of social housing may vary dramatically, in particular due to the risk of insolvency of leaseholders. Consequently, where such undertakings only operate services of general economic interest, it should be possible for any overcompensation during one period to be carried forward to the next period, up to 20 percent of the annual compensation.

Any overcompensation amounting to more than 20 percent of the annual aid granted will count as an infringement of EU rules.

- The new package also stipulates that if an undertaking receiving State Aid to deliver services of general interest is also active in other markets, separate accounts must be kept.
- The Decision also lays down clear guidelines for the calculation of an adequate public services compensation and stipulates which costs should be taken into consideration. The Decision allows for a reasonable profit to be included, which:

[...] shall take account of all or some of the productivity gains achieved by the undertakings concerned during an agreed limited period without reducing the level of quality of the services entrusted to the undertaking by the State.

A clarification of the term “reasonable profit” is also provided in order to facilitate the calculation:

It means a rate of return on own capital that takes account of the risk, or absence of risk, incurred by the undertaking by virtue of the intervention by the Member State, particularly if the latter grants exclusive or special rights. This rate shall not normally exceed the average rate for the sector concerned in recent years. In determining what constitutes a reasonable profit, the Member States may introduce incentive criteria relating, in particular, to the quality of service provided and gains in productive efficiency.

6. Conclusions

Rental housing is not competitive today in most CESE countries such as Romania. Additionally, there is no rental alternative based on social or cost rent principles. The main challenges that can be identified for Romanian housing policy are the lack of affordable rental choices for households entering the housing market, the inefficient management and repair of common parts of high-rise condominium buildings, the inadequate housing output and the worsening affordability.

A main prerequisite to provide rental housing alternatives is to render tenant-landlord relationships more secure and transparent. The necessary conditions therefore are written contracts and out-of-court arbitration to provide fast and low-risk settlements of tenant-landlord disputes. In the field of terms of tenancy and rent regulation we propose a liberal handling. The German example of defining a close-to-market upper rent limit stands in between a rigid rental freeze, which would in the medium run discourage the rental supply, and usury rent seeking, practiced up to now in some parts of the unofficial Romanian private rental market. An important element is to make the stipulation of rent increases mandatory within written rental contracts.

How does the proposed PPP law meet the EU requirements? EU institutions have time and again acknowledged their support for social rental housing in the Member States and provide special financial support via their funds and development banks. This universal support was given a more definite framework by the *Altmark* ruling and by decisions concerning social housing. The recommended PPP housing law for Romania is trying to make use of European support for social housing, and at the same time apply the requirements of competition law. Therefore, it clearly defines public service obligations in the field of social housing, and establishes a framework within which PPP housing companies are commissioned with these obligations by official accreditations, and control by the accreditation authority. The parameters of compensation are determined transparently by the Subsidy law. The requirement of a tie-up of assets and strict control over the accounts will encourage a long-term binding of social housing assets. A tight framework of regular audits and control will render social housing investment attractive and less risky for capital market finance providers and at the same time facilitate the acquisition of European funds for housing policy goals. The limitation of profits to what is necessary, and the enforcement of capital reinvestment, make public support of the Third Sector both reasonable and legally viable.

The setting-up of a transparent and tenure secure rental market to increase tenure choice and labour mobility and at the same time increase affordability for low-income and young households will require continuous public commitment and sufficient time. By the implementation of the proposed new Romanian housing law, we hope that the necessary framework for such a development will be provided. Unfortunately, since the termination of the research project in late 2008, the financial crisis has hit Romania hard and several changes of government and housing policy responsibility have protracted policy reforms. It remains to be seen whether the Romanian Government will be able and willing to implement housing policy changes in the future, despite, or even in response to, the crisis.

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