

# Housing Affordability: Theoretical Approaches and Practical Implementation

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## **Introduction**

Housing affordability has become an extremely effective political instrument for most of the East and Central European (ECE) countries, even though they are often in quite different stages of the housing transition (Economic Commission for Europe, 1993a). As a consequence of these changes, housing expenditures in most of the ECE countries continue to burden homeowners more and more severely. As these societies have rapidly changed to nations of homeowners, where more than 90 percent of the housing stock is owner-occupied, they are plagued by several serious housing problems many of which have grown worse in recent years. While housing privatisation was targeted to encourage owners to invest in their housing, several traditional housing problems, such as the physical substandard condition of dwellings and neighbourhood decay, not only persist but also seem highly resistant to positive change.

Though the rising ratios of housing expenditures in family income is troubling, there are no reliable principles to analyse the dynamics of housing expenditures, and the reasons for these changes (Dogan and Pelassy, 1990; Economic Commission for Europe, 1993b). At the same time any process to be managed has to be carefully checked and analysed, and this should be the case with housing expenditures as well. Since there is still quite a poor understanding about the background and inter-relationships of these expenditures it is surprising that housing affordability is one of the major indicators used to assess national housing policy. Housing affordability has become a major focus of policy debates wherein all possible parties are involved regardless of the conflicting interests that exist between them, including the individual households, as well as the different institutions in housing sector.

This paper has two objectives. First, it explores theoretical perspectives on housing affordability to decipher what are the important questions related to the issue. Second, it gives a brief overview of the experience gained by the author in recent and relevant project work. Accordingly, no official or unofficial housing

affordability related 'numbers' are presented. Neither is any national housing policy analysed in-depth. The paper will instead try to represent the conventional wisdom of academic research when trying to analyse the behaviour of different bodies/actors in the housing scene.

### **The Issue of Housing Affordability**

One of the primary goals of national housing policies in the European countries is to make housing affordable for the majority of the population (Joseph Rowntree Foundation, 1990a and 1990b). Housing policy of the welfare states typically has the aim to provide good and affordable housing to all, rather than being responsible only for people with special needs. This remains a political target even though there are high costs associated with developing new quality housing as well as maintaining the existing housing stock. In addition to this, the national housing standards continue to change and become more stringent, specifying more severe requirements for housing quality, protection of the environment, personal security and consumer satisfaction. At the same time, meeting these higher requirements translates into much higher expenditures for the owners of the properties as well as the individual households or tenants.

There is a need to be more precise when defining the political priorities and objectives related to housing affordability. The main role of the national governments is to understand the basic factors influencing housing affordability, and to create the necessary legal and financial instruments necessary to assist individuals in keeping their properties up to the national housing standards. Achieving reasonable levels of housing affordability, however, cannot be a goal in itself. To achieve housing affordability means first ensuring housing is habitable, and then ensuring the habitable conditions are affordable for the households accommodated there.

Housing affordability, and the principles of calculating or assessing it, may become a powerful instrument that can influence housing markets. If the national housing market can provide an affordable housing environment for the majority of homeowners, this will give households more choice when looking for decent housing. This environment may also create incentives for the owners to improve their housing situation relatively independently. Within this context, improvements in housing conditions may become possible only in the case when the relevant investments into housing are feasible - not only in the very direct economic sense (when giving certain return), but also in terms of meeting the needs of the households and providing habitable neighbourhoods for them.

Accordingly, owner-occupier households are only likely to make additional investments into their properties when relevant financial instruments support the housing market. Relatively good examples of this can be found in programs attempting to improve the energy-efficiency of the housing stock.

Energy-efficient programmes have been the first post-privatisation campaigns in most of the ECE countries in transition that mobilise investment in housing. All these energy improvement schemes, based primarily on national grants and loans, have been directly related to elementary 'profit'-making calculations. Every 'penny' invested had to improve the energy-efficiency of the buildings and give a return through reducing the costs for heating, or for other types of energy used in the house. Introducing these schemes, however, meant either that households, or the communities in the apartment buildings, were 'voluntarily' burdened with the additional expenditures required for invest as well as commitments to pay back the loans.

During the 1990s a number of ECE transition countries initiated and carried out some type of energy saving scheme albeit with different levels of success (European Parliament, 1997). A relatively quick return, based on savings in heating costs, and considerable increase in the level of affordability were the major incentives for households to invest. These energy-saving schemes can be viewed as the first phase of investment, after massive privatisation, aimed at improving the long-term affordability for households. The results of this first phase were realized relatively quickly due to the considerable and rapid increase in energy prices.

Today it is more difficult to find any other examples of proper and economically effective working incentives to trigger off the next phase of investment, and further improve housing quality and housing affordability. For example, calculations done show that after the thermal systems of the blocks of flats are reinstalled and some insulation works are done, the changing of existing old windows (frames and glazing) for the flats becomes quite unfeasible for households. This is because the payback period for such a project may extend up to about 15-20 years (Liias, 1998). Also, it is often assumed that all the households in a block of flats will participate in the reconstruction project, and this precondition is a most unrealistic one.

Currently, there is no other strategic vision, other than those related to energy saving schemes, regarding neighbourhood development. In the neighbourhoods with multi-flat housing the blocks that have been built about 30 to 40 years ago either currently require structural reconstruction, or will in the forthcoming decade. But neither the individual owners, nor the local authorities, are ready to take the financial risks necessary for such large-scale improvements. Indeed there is a lack of funds in transition countries for these projects, but at the same time a clear vision regarding the role of community development in this process. Since the housing stock is decaying rapidly, and will be requiring even more future investments, the decay of the physical quality of housing translates into reduced affordability, especially for the individual households. To improve the level of housing affordability, quite sophisticated national schemes are now being introduced to reduce the costs for preventive and conditional maintenance.

Different national reports and studies suggest about a half of the owner-occupied households accommodated in the multifamily apartment housing in the ECE countries have severe problems where payments is concerned (Economic Commission for Europe, 1993a and 1993b; European Parliament, 1997). In a situation like this it is very difficult to find any financial schemes that will encourage all the households within a block to work together in joint action, especially since they have very different motives and levels of income. In fact every new investment aimed at improving housing quality will burden the household with additional financial obligations, and, correspondingly, the affordability level for the households will decrease quite considerably. In these circumstances the term 'housing affordability' requires clear identification if not for international use then for the national and local level use.

### **Definitions of Affordability**

In most of the countries the term 'housing affordability' is quite poorly defined, both in the research papers as well as in the different public documents. Often it is even used in quite a meaningless context (Joseph Rowntree Foundation, 1990a and 1990b). It has become a political buzzword: everybody is talking about it but nobody is responsible for it. In the most comprehensive understanding the term 'affordability' is assessed as the ratio of housing expenditures to the income of the household in some given period of time (e.g. monthly or annually). Though this basic and quite primitive concept for assessing affordability is widely accepted and used, there are, at the same time, quite different possibilities for its interpretation.

The pure term 'affordability' or 'housing affordability' is entirely meaningless if the subject is not clearly defined. In the majority of the political discussions the question 'affordable to whom?' has not always been clearly answered (Joseph Rowntree Foundation, 1990b). The most common answer to this question is 'affordable for the households'. Looking at the origins of the transition changes, however, privatisation of the former public housing stock was undertaken because it was no longer affordable for the former owner to manage this stock. Accordingly, affordability is not only an issue for households but for any other owner as well, including bodies such as the local authority or public institutions. But affordability is not only the problem of the owners. Thus, when starting any discussions about affordability it is always important to identify the bodies responsible and the bodies influenced.

Most of the ECE transition countries have now become nations of homeowners, and as a result, the most usual definition of the subject in the context of affordability is the 'individual household'. There are also classifications of households based on level of income (deciles) that statistically define social groups in studies of affordability issues at national, regional or

local levels of analysis. Based on these statistical aggregates, major judgements about housing affordability are done. Every individual household may differ considerably from these national average levels, some being more affluent and others being poorer. The problem is not as much a question about the reliability of the statistical data, as it is about the basic concept that is extremely poorly defined, and does not always represent the true picture on the housing scene.

As suggested above, the most common way to interpret the terms 'affordable housing' and 'affordability' is to find (calculating, assessing, forecasting, etc.) the ratio between the sources required and the sum of resources available for the household in question. Let the basic model be like this:

**housing EXPENDITURES of the occupier**  
**INCOME of the occupier**

All the forthcoming arguments and discussions about affordability will be based on these keywords - EXPENDITURES and INCOME. Though this basic model is compiled for the household/occupier scenario, it may also be restructured for any institution running housing and being responsible for the expenditures, including the public institution, the NGO, or the private body running the housing stock.

Owner-occupation is perhaps the simplest case to understand the complexity of housing affordability. The owner-occupier households have to meet the full list of obligations and responsibilities that are legally related to property ownership. All of these obligations and responsibilities require either certain actions to be carried out or certain costs to be covered, and different properties have different ranges of obligations related to particular properties. If the expenditures an owner is obligated to pay are too high (as a portion of the total resources available), there is the only alternative for this owner: to dispose of the property and to move to one where the obligations will be affordable. This 'opportunity' has been quite widely advocated in several housing related documents after privatisation - it is a choice that allows an owner the opportunity to guarantee the best affordability solution for the household.

This choice will not always work efficiently. Only if a normally functioning housing market exists, it will generally provide the opportunity for people to undertake transactions that will allow them to find a more affordable place to live. Correspondingly, the owner-occupier households will remain very firmly tied to their property, and to their affordability problems, having no alternatives.

This theoretical scheme for flexibility does not 'work' in the transition countries, and the owner-occupiers massively experience affordability problems. There is lack of housing vacancy and often housing units are not tradable, meaning that while they do not have a market value, there are still costs associated with their maintenance (Economic Commission for Europe, 1999,

2000, 2002a, 2002b). It is, and will remain, a long-term issue for the local authorities as well. This means that households having affordability problems may be evicted from the property when in debt. In this case, the municipality will become responsible for their alternative accommodation.

Following this scheme, one may even argue that it is more favourable for the local authorities if owner-occupier households are having serious problems with their monthly payments as the budget is not loaded with additional costs for subsidies. These problems may be solved through a system of limits to service prices, and/or reducing the housing quality requirements, rather than dealing with all the problems related to accommodating these households in the social housing sector. In this case, the responsibility for housing is shifted to different companies, but the actual problems remain untouched.

The second scheme refers to tenants accommodated in private-rental housing. In this case, the issue of affordability can become more complex and confusing. First, the owner of the rental unit has to meet all the requirements, obligations and responsibilities as any other landlord. As the owner-tenant relations are based on the market supply-demand relationships, the status for the tenants may become quite unstable, even if the landlord is doing very 'fair' business as to managing the housing. While landlords have to follow all the public requirements (norms, standards) with regards to housing quality, they are also motivated to get make a profit as well. As the prices for housing-related services increase anyhow, there is always the risk that in a certain moment the costs created by the landlord may become unaffordable for the tenant. In this instance, the tenants, like any other consumers on the market, require a system to protect their rights to enjoy habitable living space. Rent limits and service charge limits are introduced to keep down the housing expenditures.

In this situation housing affordability related issues are to be understood professionally. In most societies, both on the national and on the local levels, housing standards are defined so as to guarantee habitable housing conditions. All these standards have a very clear and calculated market price - there are either the national tariffs for thermal energy, for water, for electricity, for gas, etc. There are also the minimum levels for salaries (plus taxes) one has to pay for the work done to maintain the required standard in every housing unit. Every housing standard has its actual price consisting of initial investments as well as the life-cycle costs. Correspondingly, any rise or change in these prices, tariffs and/or standards, will cause an increase in housing expenditures for the landlord.

Legally, all the local authorities are responsible for organising housing in the region they are governing. This means that they are responsible for the housing standards in a very direct way! When the relevant and professionally audited (if required) expenditures done by the landlords are higher than the nationally accepted housing affordability level, the local authorities have to cover the surplus difference for the tenant or for the landlord. Here one can conclude again with the statement that quality housing and contemporary

housing standards have also become a heavy burden on the budgets of the local authorities. Too often one can still hear the statement ‘owner-occupied housing is not affordable for the national economies’.

In addition to the interpretation of housing affordability, it is also useful to identify the major interested bodies. In fact there is a triangle with regards to the affordability issue with three major parties involved.

- Local authorities
- Property owners (landlords) for the housing facilities
- Tenants/occupiers requiring these facilities.

To manage all these relationships in this imaginable triangle, different data is used when presenting the results and calculating the affordability level over the basic model (relation of expenditures to income). In fact, there are no pure market forces governing in this triangle. Different legal acts manage the relationships amongst the parties in the triangle but quite often these relationships are unbalanced.

### **Influencing Housing Affordability**

In several housing policy related documents (reports, plans of action, etc.) of the countries in transition there is the belief that economic growth and growing incomes are the key solutions to solving the majority of long-term housing problems. Additionally, there is also the view that it may be possible to guarantee an increase in the affordability level for the majority of the households by not involving any other instruments.

Based on the oversimplified model of affordability given above - the ratio of EXPENDITURES to INCOMES, there are some possible scenarios that emerge. These descriptions for strategic behaviour are important to understand the chain of actions and how different actors will start acting in the problematic housing environments.

Normally the housing-related expenditures of a household should be lower than the incomes. Though, theoretically, these expenditures may even be equal to the incomes, there is the list of other inevitable costs individuals required for their everyday existence, including things as food, social needs, etc. There are several factors influencing the reasonable level of housing affordability, but the discussion below tries to study the affordability model by analysing the incentives and motives the different actors may have. Anyhow, we may assume that the ‘normal’ affordability ratio should be somewhere between 0.2 - 0.3, but in the current paper there are no numbers presented or calculations done to assess the reliability of this ratio.

First of all there are the basic methodological questions on the 'top' (EXPENDITURES) and on the 'bottom' (INCOMES) levels of the model. How are the housing expenditures defined? How are the incomes defined?

Along with the general technological and social development of the society the items defined as the housing expenditures have changed considerably. In fact the list of items that is included is in constant change. Even in Europe there may be considerable differences between countries when defining housing expenditures - both the quality of services and the list of services may differ by country as well as differ from those in transition countries. Regardless, the level of affordability is extremely dependent on the quality of service. Different technical solutions used in housing may require very different quality standards for maintenance services resulting in more funds being required to pay for these services. Finally, the service prices and tariffs used may differ considerably depending on the location of the housing stock. There is a list of factors influencing the price of a property, but also the price one has to pay for the housing services. These include locality, availability of infrastructure, local climatic conditions, as well as legislation. This is also the reason why the 'pure' numbers, when dividing the expenditures to incomes, cannot give any reliable answer to the problems studied (Lias, 2000).

Quite similarly there are also the problems on the 'bottom' end. How is the income defined? Should it be the gross or the net income? Which are the incomes to be included? But the fundamental question is defining the household. Who are the individuals whose incomes should be considered there?

If no clear principles are introduced to assess the level of housing affordability, all the parties involved are only interested in showing the results in a way that meets their individual and institutional interests. Affordability assessments have, to a great extent, become an inevitable part of political arguments. More often, they also become the field for international comparative studies. Correspondingly, in most of the ECE countries extremely different calculations, assumptions, and reports on the national level can be found that represent various institutional interests in connection to affordability. At the same time there are no clear signs how these results are developed.

Assuming that there is a mutually acceptable model available for calculating affordability, then there are the following three modes of actions various parties can embrace to 'improve' the affordability level. These are either to: i) reduce the housing expenditures, ii) increase the incomes, or iii) keep the changes in both figures in balance. Here we should make the assumption that when the share of housing expenditures increases as part of the total of the incomes the situation is becoming less affordable for the household and vice versa. Depending on the role a party has on the housing scene, they are likely to use any one, or combination of, the instruments that is likely to produce the best results for them.



Below, the activities to reduce the housing expenditures are studied in more detail. The activities of the second and the third modes of actions can be discussed in more detail when studying the macroeconomic issues related to income and consumption trends (the bottom half of the affordability equation). While reducing housing expenditures it is an extremely effective and widely used tool, quite often the method for implementing it is a rather speculative one. In the long run, all the prices and tariffs for housing-related services (maintenance charges, communal services, property related fees, etc.) have the tendency to increase. So using the most common approach for reducing the top of the affordability equation (expenditures) through administrative methods targeted at price controls do not improve the level of housing affordability in reality, but make the expenditure pattern more predictable.

### **Speculations with the Level of Housing Affordability**

Though officially not defined, housing affordability has still become an effective regulatory instrument used by the majority of authorities responsible for housing. In fact, the housing-related expenditures increase relatively quicker than the relevant incomes, therefore there are just the following administrative measures widely used to 'reduce' these expenditures.

- Developing more refined interpretations for housing expenditures and since the list of different housing-related services is increasing, the so-called 'official shortlist' of eligible housing expenditures includes only the very basic and traditional ones; or
- Stating the upper marginal limits to some of the components included as the housing expenditures (e.g. for maintenance or for using the utilities).

Housing expenditures have become the arena for debates, and while expenditures differ by locality, the definitions used to define expenditures are also not clear enough for the parties involved. (Lias, 2000). When looking at the issue from the viewpoint of the local authorities, their actions and motivation are clearly understandable. As the local authorities are legally responsible for providing housing allowances for the households in need, they should have the full information about these costs since they are responsible for channelling public money to individuals. This role is clear. The authorities, however, are also interested in cutting these funds but they have no instruments to reduce or even influence the housing expenditures on the market as independent entrepreneurs provide them.

Traditionally, the services listed on the monthly bills provided to the households by the housing management companies were considered as the 'housing expenditures'. All the other housing related expenditures by the

households have not always been qualified as eligible ones for the allowances. The so-called 'official' expenditures that are presented by the housing manager are also used for statistical purposes. The other group, though inevitable ones for the households in blocks, have been quite often identified as 'the luxury goods' and 'private business'. These expenditures are mainly excluded from the affordability calculations, though they cover very specific housing-related costs.

This scheme of two expenditure groups worked 'perfectly' in the ECE countries during the period when municipal companies carried out housing management and maintenance. In this case, initiatives by individual owners of the flats, were under control: the municipal manager either did the works required or not. The solution to this option now greatly depends on the availability of funds by the local authority to cover the surplus.

At the moment privatisation of the maintenance companies in several of these countries is either on its way or has already been completed. Also, different homeowners associations (HOA) organise management and maintenance using their own skills and staff. The completed surveys suggest that to reduce the household expenditures several HOA's use direct payments for repair and maintenance works done (following the traditions of the black market). With all these cases the households are motivated to increase their housing affordability by reducing their expenditures, often though non-payment of taxes. This is evident in the official statistical data, which suggest HOA's run housing more efficiently as the housing expenditures are lower.

The most serious consequence related to these direct payments is the full absence of reliable data about the actual expenditures. When these data are missing, housing management and maintenance problems cannot be dealt with professionally.

At the same time, the local authorities face new problems when households in need apply for allowances. The list of eligible housing services and their quality with the corresponding expenditures has to be identified in more detail. As a result of this, all the major parties involved in the housing management procedure - authorities, households as the property owners, and service providing private companies - have to start defining housing services, and study their quality aspects as well as their costs.

## **Findings and Conclusions**

Societal and economic transition in the ECE countries has had dramatic consequences for the housing sector in these countries. Privatisation campaigns carried out under the transition policy have encouraged and even assisted everybody. Households either with reliable market incomes, but also with no reliable incomes, have entered the owner-occupied housing market. In fact, the owner-occupied housing market in the blocks of flats has been created

overnight. It has been widely assumed that after transferring the title for the ownership to the former tenants they will change into fully responsible property owners.

In blocks with HOA's all the owners have the obligation to participate in decision-making, and supervising how these decisions are followed. This is the environment wherein professional activities are expected to be carried out not only by the professionals but also by the non-professionals, and by, in fact, every single household. The issue that arises from this is that if the quality of housing stock falls due to non-professional management and maintenance, legally, nobody will share the responsibility as the majority of the owners have voted for the decisions and they have been satisfied with the activities planned and carried out. Ordering the full list of necessary housing services is too costly for the majority of households in the blocks. Consequently, the most 'profitable' housing management schemes are based on cancelling all the maintenance contracts except for the emergency works. This scheme, however, gives only short-term 'return' over improving their current affordability level; over the long-term the results of non-professional management can become devastating both for the owners and for the society. Still, in the ECE countries, there are too many cases working like that.

Today even relatively high national authorities allow serious methodological mistakes when comparing different forms of housing management schemes. In their very different forms, HOA's are advertised as more efficient since the households have to pay less compared to a block run by a management company. At the same time, the only fault that is advertised about housing management companies is that they are not 'fair' and correspondingly these housing managers collect too much money. Very sadly, though, most of these statements are based on assumptions rather than on facts.

When it is the individual owners facing the affordability problems, and there is the real danger that the housing stock will be under-maintained, the emerging housing policy agenda has to address the issues related to the affordability of the homeowners. Professional and fair calculations of affordability levels should become the norm for national housing policies. Based on the reliable ratio of housing expenditures to income, one may be able to judge the affordability level of the households.

In any case, assessing the affordability level is only a tool; a 'number' to be used when analysing the situation. But to see results, the following problems need to be studied and dealt with to make the housing affordability level 'work':

- Housing standards need to be defined clearly for the national and local markets for different types of properties. Based on these guidelines the basic concepts for housing management and maintenance activities are to be defined;

- ‘Housing expenditures’ need to be identified, and the national housing sectors made responsible for professionally defining the suitable system of housing expenditures, including the definitions and the principles of their calculation;
- To manage housing in an ‘affordable manner’ professionally skilled managers have to provide advice and consultancy to the owners when faced with choices with respect to renewal and ongoing expenditure to cover routine maintenance.

If the three fields of activities listed above are dealt with, the major parties (owners, experts, officials, managers, politicians, etc.) may get more reliable information about the housing situation. Most importantly, however, it is essential that all primary housing expenditures be registered clearly on the level of a single house and/or a block of flats. Only then can owners have the reliable data necessary to make decisions about the future of their homes.

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