

COOPERATIVE MUTUAL HOME OWNERSHIP IN SERBIA

LEGAL, FINANCIAL AND FISCAL IMPLICATIONS

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CHAPTER 1

SUMMARY

MUTUAL HOME OWNERSHIP (MHO) – A NEW SOLUTION FOR HOUSING NEEDS IN SERBIA?

The aim of this feasibility study is to assess the current status of the housing sector in Serbia and test the possibilities for introducing a cooperative housing model, based on mutual home ownership (MHO).

Considering the high and still rising prices of real estate, especially in Belgrade, compared to the limited purchasing power and credit ability of the population, there is a strong need for models to resolve the housing needs of the moderate- and lower-income part of the population. The large discrepancy between construction costs and the market price of the apartments suggests there is considerable space for lowering housing prices by introducing this kind of alternative model that would avoid speculation with real estate price increases.

The Law on Cooperatives recognizes housing cooperatives, although they are under-regulated. This regulation provides only general terms, without further (detailed) regulation for housing cooperatives based on lease occupancy agreements. As a legal form, housing cooperatives provide:

- A framework for their members to pool resources, thus lowering the cost of acquiring an apartment. They also enable long-term affordability of housing costs by lowering initial and ongoing (yearly) expenses.
- They allow prevention of speculation, i.e. selling the acquired apartments at market prices. This way the housing prices can stay affordable in the long-term.

In practice, Serbia has experience only with housing cooperatives operating as property developers. They gather members who pool their resources to build apartments that would become their individual property and thus also commodities available on the housing market. Only a very few of these housing cooperatives are active to date. This study does not consider such a practice. It focuses instead on the MHO model where the cooperative retains the asset in the long term, at the price of costs, for its members.

In other European contexts, this kind of MHO model has already achieved affordability by being non-profit, while speculation is prevented by decoupling the value of the homes from local real estate market prices (the cooperative retains ownership of the homes).

LEGISLATIVE FRAMEWORK

MHO is a novelty in the Serbian housing landscape. Some of its aspects fall under the existing legislation on cooperatives and housing, although as a model in itself it is not regulated.

Existing legislation on housing cooperatives may provide a framework for democratic decision making and control by the residents, and thus the direct involvement of residents in maintaining affordable housing. Cooperative Rules can regulate that member contributions will be proportional to their income, thus providing affordability for the members (although a minimum income for entering a cooperative must be set, to provide economic viability of the model).

Cooperatives provide better protection against speculation compared to a limited liability company (LLC). A share in an LLC can always be sold, while cooperative members don't have a share that is subject to transfer. Contributions to the capital of the cooperative will be returned only upon termination of member status, and at the same value as entered into the cooperative (or a valorised value, if stipulated in the Cooperative Rules).

A cross-holding rental MHO model (like the Mietshäuser Syndikat from Germany) can be replicated in Serbia, further strengthening the prevention of speculation with its elaborate cross-holding system.

The Law on Cooperatives (Article 12) stipulates special protection for cooperatives and their activities, encouragement by means of economic and housing policies, special incentives, benefits, and public funds for cooperative development. However, this is stated only in principle, while actual specific measures should be provided through specific regulations. There are currently no such measures related to housing cooperatives, neither to non-profit coops.

TAXATION OF HOUSING COOPERATIVES AND MHO

A housing cooperative, as all other cooperatives, has the same tax treatment as other companies in Serbia. Therefore, in the current tax context, this is not a specific reason to use the cooperative form instead of a limited liability company. Furthermore, tax regulation is the key obstacle for the introduction of MHO in Serbia.

The identified issue is that from a tax and financial point of view building for sale is more favourable than building for rent. Therefore the functioning of cooperatives based on the transfer of ownership is currently more economic compared to cooperatives where members' occupancy rights are based on a lease agreement, while the cooperative retains ownership of the apartments. On the other hand, when ownership is transferred to a member (regardless of the form of ownership – sole, co-ownership, or similar), there is no way to prevent this member from selling, as it is his/her constitutional right to dispose of his/her private property. What is allowed is to contract the pre-emptive right of purchase (buy-back) for the cooperative, at the sales price of the apartment (this implies the cooperative has funds reserved for this purpose). However, this can be limited to a five year period only, according to Article 531 of the Law on Contracts and Torts.

Amendments of tax legislation are necessary, along with the provision of tax incentives to enhance the sustainable development of affordable housing through MHO based cooperatives, but also to the entire housing sector (e.g. corporate tax exemption for non-profit rent of housing cooperatives, government subsidies, low-interest loans, and similar). Furthermore, changes to legislation related to personal income tax may provide an opportunity to recognize rent as tax-exempt, thus allowing the more effective implementation of housing policies. This could be done by introducing taxation of synthetic income, meaning that the total income from all sources would be taxed as a whole, instead of specific taxation of income deriving from different sources.

RECOMMENDATIONS FOR IMPROVING THE LEGAL FRAMEWORK AND WIDER INTRODUCTION OF MHO

The MHO model could be the solution for the housing needs of people with insufficient credit ability for a housing loan (currently, over 70% of the population in Serbia). Among other benefits, it is a way to expand the housing market by unlocking it for medium income households. In order to achieve these goals, it is necessary to provide state support, thus turning it into a national housing policy instrument.

The following steps are required to encourage the wider implementation of housing cooperatives and MHO in Serbia:

- Giving cooperatives the status of housing support provider, in accordance with the Law on Housing and Building Maintenance (for apartment occupancy by coop members);
- Adjusting tax regulations to grant tax incentives for housing cooperatives, especially under non-commercial, non-speculative terms and conditions, in order to equalise tax burden on cooperative residents and homeowners.

CHAPTER 2

INTRODUCTION

2.1. BACKGROUND

Cooperative mutual home ownership housing (MHO) is a non-profit and non-speculative model of cooperative housing where apartments and land remain the ownership of the cooperative, while the cooperative in turn is owned and managed by its members, which gives them control over their housing. Members as residents have a lease agreement with the cooperative, while their payment (contribution) is set to cover a loan for the construction of the building and operating costs (maintenance, utilities, etc.).

MHO is developed to address the needs of people with moderate and lower incomes (although not the lowest income groups) who cannot afford housing on the market. Due to its specificities, MHO could be valuable in the Serbian housing reality to solve the housing needs of the part of the population that currently cannot buy apartments:

- It allows those not eligible for individual mortgage to participate in a collective mortgage;
- It is a non-for-profit alternative to the for-profit market of buying and rental of apartments;

- It is a non-speculative model that prevents speculation on the increase in the price of apartments;
- It allows for levels of built-in security that expose tenants to less risks of default and eviction.

MHO differs from the transfer-of-ownership-based housing cooperatives that existed in Serbia so far. This study aims to identify whether various MHO aspects are legally and financially feasible in the Serbian context, how they can be altered to be legally feasible while preserving the purpose of the model, and to give recommendations for a wider introduction of the MHO model in Serbia.

2.2. STUDY CONTEXT, APPROACH AND METHODOLOGY

The immediate reason for the study “Cooperative Mutual Home Ownership in Serbia: Legal, Financial and Fiscal Implications” is to support the efforts of developing cooperative housing in the Serbian context that is financially affordable and environmentally sustainable. The association Ko Gradi Grad (“Who Builds the City”) is dealing with this challenge and has carried out a large amount of development work over the last seven years. This has resulted in the Pametnija Zgrada (“Smarter Building”) concept introducing a novel housing approach. Following years of pioneering work, the Housing cooperative Pametnija Zgrada has been incorporated (January 2019) with the primary aim to develop a pilot project for a multi-apartment building in Belgrade. It is the first housing cooperative established within the territory of the city of Belgrade in almost 20 years, and marks a crucial first step in the reintroduction of housing cooperatives in Serbia.

However, the legal situation has changed significantly during the last 20 years, with the introduction of the 2015 Law on Cooperatives and the 2016 Law on Housing and Building Maintenance. The Pametnija Zgrada MHO approach adds another layer of innovation to the historical model of housing cooperatives in Serbia by focusing on long-term collective ownership of a building and prevention of speculation – this is in contrast to previous cooperatives, which delivered private property for sale to individual households instead. This new legal environment and innovative approach means that there is currently no expertise or experience on this specific model available in Serbia.

The overall approach of the study is based on testing the options offered by MHO as a new way of solving housing needs in Serbia, in order to achieve long-term housing stability and affordability. This includes an analysis of

various comparative models of cooperative housing (suggested by Ko Gradi Grad) and testing if they could function in Serbian conditions.

In particular, **Chapter 3** analyses the housing situation in Serbia and the market conditions in regards to setting-up MHOs as a possible model for solving housing needs for part of the population. Statistical data are provided related to the availability of apartments, occupancy structure and affordability with respect to household income. Special attention is given to the real estate market (residential properties) and the gap between construction costs and the market price of housing apartments. The low purchasing power and low credit ability of the population on the one hand, and MHO's potential to reduce housing costs on the other reveal a strong motivation for the successful introduction of novel housing cooperatives and MHO in Serbia.

Chapter 4 assesses the legal feasibility of the cooperative MHO model under the Serbian legal framework. It tests its feasibility, including major risks and protection mechanisms for individual cooperative members and insurance against speculation on house price increases. International experiences with various MHO-related models in Europe show useful lessons about the key features of the concept, and provide an analytical framework for its implementation in Serbia.

Chapter 5 elaborates financial and tax implications related to developing MHO in Serbia, thus analysing the best financial design for MHO in the Serbian context. Tax treatment of construction and leasing for housing purposes (for cooperative members) is identified as a major issue that prevents wider introduction of housing cooperatives and MHO in Serbia.

Chapter 6 summarizes findings from previous chapters. We can conclude that whole field of housing cooperatives is under-regulated. For successful development of MHO in Serbia, it is crucial to provide institutional support for this approach. Recommendations are provided for desirable legislative changes, primarily aimed at recognizing housing cooperatives and MHO as a form of housing support, and at introducing favourable tax policies.

The end of the document features a number of **Annexes** that provide:

Annex 1: Legal regulation of cooperatives in Serbia in the Coop Law – a detailed review.

Annex 2: Roadmap template for possible implementation of the MHO model in Serbia.

Annex 3: Legal support models for housing cooperatives in other countries.

The study was carried-out following a methodology combining desk and field research:

- Internet research;
- Review of various documents and evaluation reports on housing cooperatives, construction industry, real estate market;
- Discussions with experts from the scientific and operational fields;
- Field study in Serbia comprising e.g. interviews with local stakeholders, commercial banks, real estate agencies;
- Outline of comparative tax incentives and policies in the frame of cooperative housing;
- Technical workshops with representatives of the Ko Gradi Grad association, active in the field of housing initiatives in Serbia.

The feasibility of the proposed solutions is then assessed on three levels:

- Legal feasibility – whether the proposed solutions conflict with legal requirements, e.g. they must comply with the Serbian national regulations, as well as be in line with EU legislation in terms of state aid;
- Operational feasibility – a measure of how well a proposed solution solves the problems identified;
- Economic feasibility – more commonly known as cost-benefit analysis; determines the benefits and savings expected from a proposed housing model.

CHAPTER 3

BRIEF OVERVIEW OF THE HOUSING SITUATION IN SERBIA

This chapter serves to provide insight into the reasons and needs for the diversification of the housing supply in Serbia, particularly in Belgrade, where pressure and demand are highest. It introduces the housing context, brings together statistical data on the availability and occupancy of apartments, housing costs and the affordability of housing in terms of loans and rental. The last part of the chapter gives insight into the real estate market and profits made in this market branch.

This combined data point to the fact that alternatives are needed to the current exclusively market oriented approach, with a particularly large space for intervention that would include introduction of non-profit alternatives like mutual home ownership based on a cooperative model.

3.1. HOUSING CONTEXT, THE BACKGROUND

The specific nature of today's housing situation in Serbia cannot be understood well without having in mind the abrupt end of housing policies following the disintegration of socialist Yugoslavia. In those policies housing was perceived as a fundamental right, rooted in concepts of social ownership and self-management, while the production of housing was financed from the Solidarity Housing Fund, with all employed persons contributing a small percentage of their income. In the early 1990s, almost the entire socially owned housing stock was first nationalised and made into state property, then in 1992, with the Law on Housing, the flats were offered to the tenants living in them for purchase at bargain prices. According to the 2011 Census, dwellings built during the socialist period (1946-1990) still constitute most of the housing stock – over 63%.¹

The privatisation of social apartments from the early 1990s brought 98.3%² of the inhabited housing stock to be under private ownership, and resulted in the phenomenon of “poor owners”, unable to cover the expenses of owning property, especially investing in maintenance and improvement of their apartment buildings. With privatisation, the housing policy also disappeared, leaving those that did not get their housing situation resolved, and the generations that followed, to manage on their own – on the market.

Even during socialism those excluded from the provision of socially owned housing sought their own solutions either in the unregulated private rental sector, living with extended families in usually overcrowded apartments, or building “wild” suburban settlements. In circumstances following the 1990s, accelerated by a high influx of refugees from other regions of war-torn Yugoslavia, these previously minor housing “solutions” multiplied. What consolidated turning apartments into commodities within a real-estate market was the introduction of commercial (foreign) banks and their mortgage lines during the first half of the 2000s. This significantly changed the entire housing landscape and resulted in a boom of investor companies, offering properties on a highly speculative, for-profit market.

1 2011 Census of Population, Households and Dwellings in the Republic of Serbia: Dwellings by the Type of Building, Statistical Office of the Republic of Serbia (SORS), 2013

2 2011 Census of Population, Households and Dwellings in the Republic of Serbia: Dwellings According to the Ownership and Tenure Status of Households, SORS, 2013

3.2. APARTMENT AVAILABILITY, OCCUPANCY AND HOUSING RELATED COSTS

To assess the housing situation in Serbia we will start from the following three questions:

- (1) Are there enough apartments for the population?
- (2) Are they large enough for the households that occupy them?
- (3) Can households afford the costs related to the apartments in which they live?

3.2.1. AVAILABILITY OF APARTMENTS

While the number of apartments in Serbia is growing, the distribution of housing is rather unbalanced. This can be seen in the following table³ that compares data from two censuses, in 2011 and 2002. It shows a positive trend related to the total amount of apartments (an increase of 9.3%), but also points to the significant increase (76%) in the number of uninhabited apartments for permanent living. This is the result of two main processes: the ongoing depopulation of villages and smaller towns, and uninhabited new apartments built in cities.

	2011	2002	Difference	
Apartments - total	3,231,931	2,956,516	275,415	9.3%
Inhabited apartments for permanent residence	2,423,208	2,409,002	14,206	0.6%
Uninhabited apartments	589,715	334,994	254,721	76%
Apartments in temporary use	201,519	201,045	474	0.2%
Apartments for business purposes	17,489	11,475	6,014	52%
Other housing units	13,900	18,729	-4,829	-25.8%

Table 3.1. *Housing units in Serbia between the last two censuses, source: Statistical Office of the Republic of Serbia*

³ Introduced in the Analysis accompanying the Draft Law on Housing and Building Maintenance, 2016.

Furthermore, comparing the number of households in Serbia (2,487,886) with the available (occupied) apartments shows that the number of households without an apartment is about 65,000 – while 18.3% of all apartments for permanent living are uninhabited. However, data on the number of unoccupied apartments should be taken with reservations, since evasion concerning rental income tax is widespread, meaning that while a large number of apartments is recorded as unoccupied, in reality this percentage is certainly lower.⁴

3.2.2. OCCUPANCY OF APARTMENTS

What do the data show regarding occupancy of inhabited apartments in Serbia? According to the 2011 Census there is a constant decrease in the average household size – 2.88 persons (from 2.97 in 2002 and 3.24 in 1991). This goes hand in hand with an increase in the number of smaller households, most of them 2-person (25.65%) and 1-person (22.3%) households, while 3-person households are at the stable 19%, and 4 and more-persons households show a constant decline.⁵

Nevertheless, are these apartments large enough for the number of people who occupy them? The appropriate surface area to be applied per person in new apartments for social housing purposes⁶ in Serbia is shown in Table 3.2, while Table 3.3 shows the surface area per person in the 2011 housing stock.

Household size	Surface area per household	Surface area per person
1-person	22-30 m ²	22-30 m ²
2-person	30-42 m ²	15-21 m ²
3-person	40-55 m ²	13.3-18.3 m ²
4-person	50-65 m ²	12.5-16.2 m ²
5-person	62-75m ²	12.4-15 m ²
6-person	75-85 m ²	12.5-14.2 m ²

Table 3.2. Social standards – surface area per household/person

⁴ According to the interviews conducted with tax inspectors in charge of controlling apartment lease, there is no reliable data on the scope of tax evasion. Their estimation is that only about 10% of the lessors report lease of their apartments and pay taxes, while other apartments are registered as unoccupied. The Tax Administration has initiated campaigns (primarily through public media) to motivate citizens to report lessors who lease apartments in this way. More on rental income tax and how it affects rental housing can be found in Chapter 5. Here, it is important to add that the consequences of this situation are an almost entirely unregulated rental market due to tax evasion and lack of private rental housing projects due to higher taxes than for selling apartments.

⁵ 2011 Census of Population, Households and Dwellings in the Republic of Serbia: Housing Units According to the Number of Occupants and Households, SORS, 2013

⁶ Regulated in Article 18 of the Regulation on the Standards and Norms for Planning, Designing, Construction and Requirements for Use of Social Housing Apartments, Official Gazette of the Republic of Serbia No. 26, 2013

Surface area per person	Republic of Serbia	Belgrade region	Vojvodina	Šumadija and Western Serbia	South and East Serbia
Total number of occupied apartments	2 423 428	586 337	677 559	648 371	510 941
up to 10 m ²	94 341	24 113	16 150	30 191	23 887
10 – 14.9 m ²	305 254	80 583	60 664	93 837	70 170
15 – 19.9 m ²	366 412	98 450	87 020	102 428	78 514
20 – 29.9 m ²	621 692	154 091	173 523	165 075	128 603
30 – 39.9 m ²	371 840	89 475	113 452	94 879	74 034
40 – 59.9 m ²	378 587	86 921	121 515	93 804	76 347
60 m ² and more	285 082	52 304	105 235	68 157	59 386

Table 3.3. Surface area per person in the 2011 housing stock⁷, source: Statistical Office of the Republic of Serbia

Based on the above criteria, we may conclude the following:

- 94,341 (3.9%) apartments in Serbia have less than 10 m² per person, below any social standard. In Belgrade this number is 24,113 (4.1%).
- 305,254 (12.6%) apartments are between 10-14.9 m²/person, below the acceptable level. In Belgrade this number is 80,583 (13.7%).
- Apartments up to 20 m² per person amount to another 15% (in Belgrade 16.8%).

Based on the available data, it appears that 32.8% of the apartments in Serbia (and 34.6% in Belgrade), are overcrowded or on the verge of it. The above indicated data show that about 105,000 apartments in Belgrade are overcrowded, and almost 100,000 are on the verge of it.

According to Eurostat data Serbia scores the worst regarding the overcrowding rate – over 55% (in comparison to the EU average of 16.6%).⁸ Furthermore, it should be mentioned that 69% of young people (18-34) still live with their parents (Eurostat, 2018).

⁷ 2011 Census of Population, Households and Dwellings in the Republic of Serbia: Housing Units According to the Number of Occupants and Households, SORS, 2013

⁸ Overcrowding rate 2016, Eurostat, 2018.

3.2.3. AFFORDABILITY OF APARTMENTS

To have a complete view of the Serbian housing situation, we should also look into affordability. According to data provided by the Statistical Office of the Republic of Serbia for 2018, the average costs of housing with all utilities and services⁹ amount to RSD 11,224 (17% of average household consumption) in Serbia and RSD 12,739 (17.5%) in the Belgrade region. These costs vary significantly between those households which are servicing mortgages or paying rent and those living in an apartment they own. However, this break-down is not provided in the official data.

On the other hand, Eurostat provides data with imputed rent,¹⁰ showing that there were 66% households in Serbia in 2018 with heavy financial burden due to housing costs¹¹ (the housing cost overburden rate is the percentage of the population living in households where the total housing costs represent more than 40% of disposable income).¹² According to the same statistics, only 1.9% households are under no financial burden due to housing costs. According to this data, Serbia is the country with the least affordable housing among EU and EFTA members and candidate countries for EU membership.¹³

Eurostat data related to living conditions in Serbia for 2017 shows an even grimmer picture. Over 25% of the population¹⁴ are at the risk of poverty¹⁵ Furthermore, 20.6% of people aged 18-59 are living in households with very low work intensity, an indicator of unemployed households.¹⁶ The distribution of income is also highly unequal, with 20% of the population with the highest income generating almost ten times the size of the income of the 20% of the population with the lowest income. As a result, the average income is almost EUR 500, but the national median equalised disposable income after social transfers in Serbia in 2017 was just over EUR 200, meaning that half of the realized income (per person) was below this number. For any household below the median income, with one person generating that income, housing costs are unbearable. Given all this, the risk of disruption of household income from exposure to housing costs can be estimated as high.

9 Costs of utilities include: heating costs, electricity consumption, water consumption; costs of services include: garbage collection, sewage, building maintenance fee, etc. Of all utility costs, heating costs account for the major cost. According to data from Public company Infostan district heating comprised 11.36% of the total household expenses in Belgrade in 2015.

10 Imputed rent is the assumed rent that households that own apartment would be paying for their apartments.

11 Financial burden of the total housing cost - EU-SILC survey, Eurostat

12 Glossary: Housing cost overburden rate, Eurostat

13 Housing cost overburden rate by income quintile - EU-SILC survey, Eurostat

14 Enlargement countries - statistics on living conditions, Eurostat

15 Glossary: At-risk-of-poverty rate, Eurostat

16 Proportion of persons living in households with very low work intensity, 2012 and 2017, Eurostat

SUMMARY OF 3.2.

APARTMENT AVAILABILITY, OCCUPANCY AND HOUSING RELATED COSTS

The available data show that about 30% of the apartments in Serbia are over-occupied or on the verge of it. In Belgrade this would amount to over 200,000 apartments. On the other hand, newly constructed residential buildings mostly increase the stock of unoccupied apartments, having little effect on the actual availability of housing.

Housing costs (including utilities) are around 17% of income according to official data. However, these costs do not include imputed rent. More relevant data are provided by Eurostat – when imputed rent is included, it appears that 66% of households are under a heavy financial burden, while only 1.9% are not burdened by housing costs at all. This makes Serbia the country with the least affordable housing in all of Europe with a widespread risk of disruption of disposable household income from exposure to housing costs.

Therefore, there is a strong social need for the introduction of new models into Serbian housing practices, able to provide solutions for those categories of the population not eligible to take out loans (“the unbankable”) and not falling under the category of social housing.

3.3. SOLVING HOUSING NEEDS THROUGH EXISTING OPTIONS

3.3.1. HOUSING LOANS

For those in need of an apartment, the road for getting there is quite difficult. The following quote, from the Analysis accompanying the 2016 Draft Law on Housing and Building Maintenance recognises the main issue related to the unaffordability of housing purchased on the market. “One of the biggest problems of the housing sector in Serbia is the outstanding marked unavailability of housing and housing services on the market. The extent of the problem for households trying to independently solve their housing needs on the market can be seen from the ratio between the average annual income and the price of the average apartment on the market, which in 2013 amounted to 1:13 if the apartment was purchased in cash, or 1:19 if purchased through a loan. The mathematical indicator pointing to the need for public housing intervention is between 1:4 and 1:5.”

According to the Republic Geodetic Authority, the average price of an apartment in Serbia in 2018 was 920 EUR/m² (in Belgrade 1.587 EUR/m²¹⁷ – 1,150 EUR/m² for apartments in old buildings, and 2,097 EUR/m² for those newly built).¹⁸ Given that for a three-person household apartment the appropriate size is around 55 m², this amounts to an average price of about EUR 50,000 (in Belgrade EUR 63,000 on average for an apartment in an old building, and EUR 115,000 for new buildings). According to the National Bank of Serbia, for a person with regular monthly income the interest rate for a 20-year loan varies from 2.68% up to 6.73%.¹⁹ A monthly instalment for the purchase of such an apartment with a repayment period of 30 years (at the rate of 3%) amounts to EUR 210 (in Belgrade EUR 265 and EUR 485 respectively, depending on whether apartments are in old or new buildings). It is important to note that these figures are given without considering that a minimum 20% of the apartment value must be paid up front. This makes housing loans even more inaccessible, as a household should save for this upfront contribution while paying regular rent.

17 Statistika tržišta nekretnina u Srbiji, nekretnine.rs, 29.3.2019.

18 Izveštaj sa tržišta nepokretnosti za 2018. godinu, Republic Geodetic Authority (RGA), 01.03.2019; Prosečne cene stanova u stambenim zgradama za kolektivno stanovanje za period 01.01-31.03.2019, RGA, 07.2019; Cene stanova novogradnje u 2018. godini, SORS, 15.03.2019.

19 Stambeni krediti – pregled efektivnih kamatnih stopa, National Bank of Serbia, 01.12.2018.

According to conventional banking practices (and as suggested in the Social Housing Strategy of the Republic of Serbia),²⁰ a monthly instalment of a housing loan should not exceed 33% of income. Compared with data on household income by decile, we can see how accessible housing loans are.

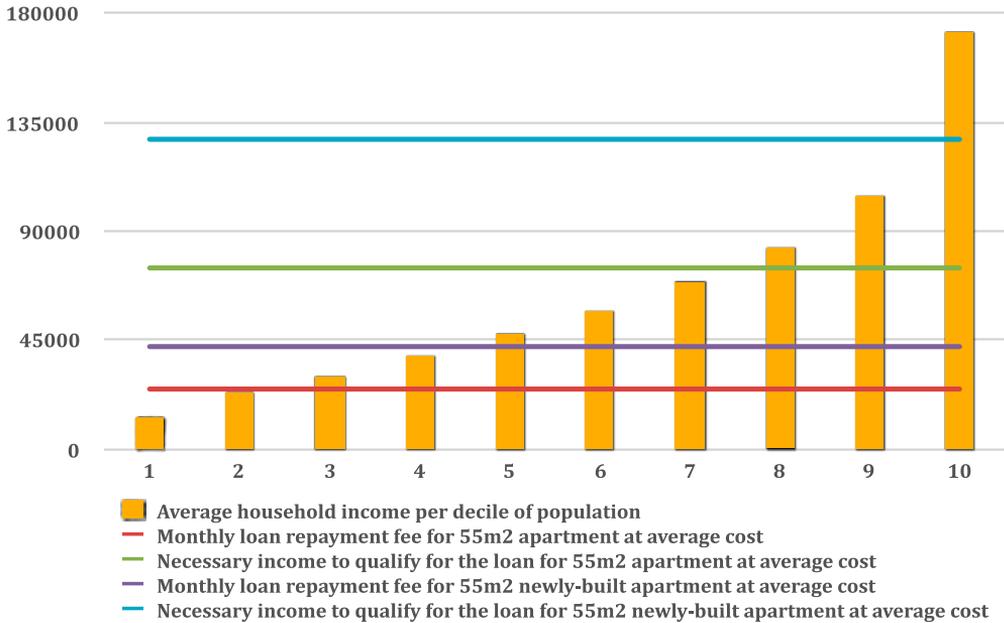


Image 3.1. Housing loan capability in Serbia, based on the average household income in cash and in-kind per decile of population.

²⁰ Nacionalna strategija socijalnog stanovanja, Official Gazette RS, No. 13/2012.

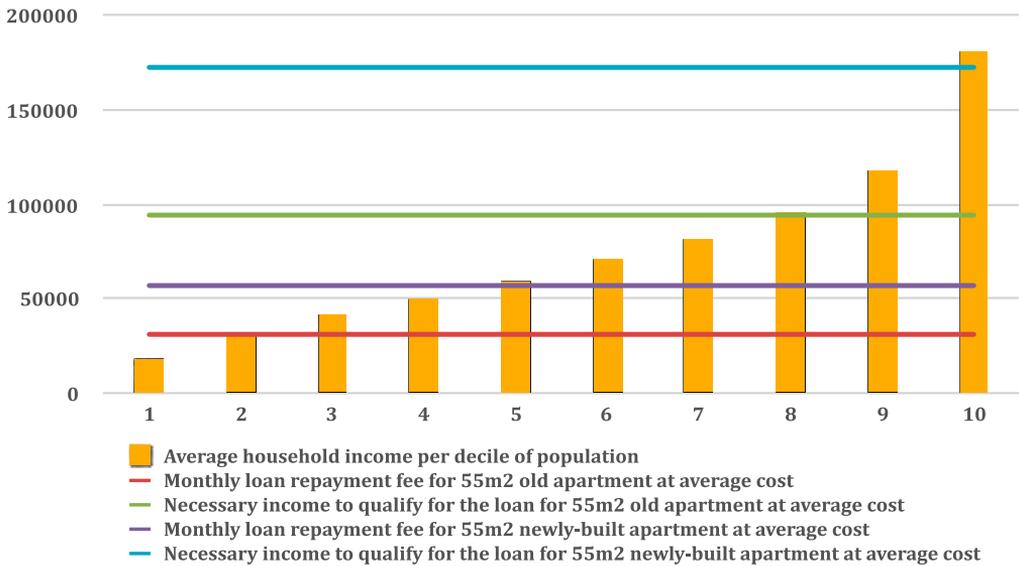


Image 3.2. Housing credit ability in Belgrade, based on the average household income in cash and in-kind per decile of population.

A monthly instalment of a loan with a very low interest rate for the average apartment price in Serbia can be covered by only 30% of households (in the 8th, 9th and 10th decile) as per the generated monthly income (which includes in-kind and other types of income conventionally not measured towards their credit ability). In the Belgrade region, housing loans are even less accessible. This excludes more than 70% of households from access to housing loans required for purchase an apartment on the market. In case of newly built apartments even fewer households, not even 10% of the whole population, can take out the necessary loan. However, as there are no data on the additional financial liabilities of citizens classified in the above decile groups, we can estimate that the actual number of creditworthy citizens/ households is lower.

3.3.2. RENTING APARTMENTS

According to statistical data, 6.8% of the apartments are under rent and an additional 5.7% are used by relatives or are under another status. The rental housing market operates in the private sector, with few and insignificant exceptions in cities where City Housing Agencies and a new publicly owned housing stock have been formed. It is estimated that in large cities,

rental housing covers more than 10% of the population.²¹ The vast majority of apartments that are rented are in individual private ownership. Due to official policy giving full advantage to privately owned housing through favourable taxation of construction intended for sale, it is uncommon for companies to be in the rental business.

Precise data on rented apartments does not exist, because lease agreements are rarely made official. This is due to the widespread evasion of personal income tax (that applies to rent income at a rate of 15%), and fear of lessors that if they conclude lease agreement, the tenants cannot be evicted. The legal consequence of this is that tenants do not have legal protection by the competent authorities. On the other hand, tenants are discouraged from reporting the lack of lease agreements as that would imply a rent increase for them, because the lessor would transfer the cost of the personal income tax on rent onto the tenant. Under present conditions, renting, as a significant segment of the housing market, functions almost entirely in a grey zone.

In addition to tax reasons, it must be noted that anyone planning a long-term or permanent solution to their housing issue treats apartment lease as an immediate and temporary solution until the conditions for obtaining a housing loan can be met. There are several reasons for this but economic ones are the most obvious. First, the rent for the cheapest of flats is roughly equal to half the average wage or more (there are minor differences depending on location). According to an available market overview (which should be taken with some reservations), the average price for renting a 55 m² apartment in Serbia in 2017 has been EUR 230, or EUR 300 in Belgrade. Second, the amount of monthly rent (still without the 15% tax) for a particular apartment should be approximately 30% lower than the amount of a possible monthly annuity that would be paid for the repayment of a housing loan for that same apartment.²² However, this is rapidly changing, and with an increase in apartments offered through AirBnB and similar platforms renting is becoming increasingly more expensive than a loan.²³ Therefore it is understandable why people opt for buying an apartment and building up equity over uncertain rental deals that cost a similar amount and don't preserve value.

21 Lokalna stambena politika, Program za urbani razvoj, 2009.

22 Da li su rata kredita i kirija za isti stan jednake, kamatica.com, 28.01.2017.

23 "300 evra i više": zašto je sve teže iznajmiti pristojan stan i šta je drastično podiglo cene, blic.rs, 10.04.2019.

3.3.3. PUBLIC HOUSING PROGRAMS

Nowadays, Serbia has an extremely small number of publicly owned apartments – only 0.87% of all apartments, with the number in Belgrade being 1.07% or about 6,300 apartments.²⁴ This is far from enough to be able to have a meaningful public housing policy. As a comparison, two-thirds of the population in Vienna live in municipal or publicly subsidised housing (220,000 publicly owned and an additional 200,000 developed through a city-regulated process).²⁵ Furthermore, there is no precise data on the categories of households or persons using these apartments in Serbia. Some of them are used for social housing programs for different highly vulnerable social groups, but their scope is much smaller than the demand.

The 2016 Law on Housing and Building Maintenance introduced the term “housing support” intended to replace and expand social housing with a variety of interventions in the housing sector. However, none of these new programs have been developed thus far due to a lack of funding and strategic decisions of the state. Most new public housing stock used for social housing programs is not financed from the budget of the Republic of Serbia, but by foreign donors.

The Government did initiate non-profit housing development for sale (most notably in Belgrade, like the Stepa Stepanović neighbourhood), but the prices of these apartment did not differ much from the market price. The primary state intervention related to housing since 2005 was aimed at increasing the accessibility of loans. However, these measures did not contribute to affordability, because as interest rates were going down – the prices of apartments were going up.

24 Stanovi prema svojini i osnovu po kojem domaćinstvo koristi stan, SORS, 2017.

25 Vienna's Unique Social Housing Program

SUMMARY OF 3.3.

SOLVING HOUSING NEEDS THROUGH EXISTING OPTIONS

Even under the best of circumstances, less than 30% of households in Serbia are eligible for a housing loan. For the remaining 70% of the population, who are also more likely to have a housing problem, loans are not an option.

Renting an apartment is also not a favourable solution, although an estimated 10% of households live under a lease. Rent is cheaper than the monthly annuity of a mortgage, but not enough to justify the fact that it is not building equity like a mortgage. It does not resolve the housing need in the long-term, while in the short-term it is not stable due to the volatility of rent and the wide-spread practice of leasing without any legally binding contract.

Although the new housing law recognizes “housing support”, there have not been any funds allocated to these much-needed interventions. As there are less than 1% of publicly owned apartments, it is clear that this stock does not represent a tangible solution for resolving housing needs in Serbia. Part of the answer might lie in non-profit housing development.

3.4. REAL ESTATE MARKET IN SERBIA

3.4.1. APARTMENT COST

Before we see what kind of room for manoeuvring exists for non-profit housing, we should first understand how the housing market currently works. The market share of real estate in the Serbian GDP was about 7.4%. A total of 37,500 apartments were sold in 2018,²⁶ with 31% of them newly built – 11% more than in 2017.²⁷

Besides an increase in volume, there was a steep increase in price. In larger cities (Belgrade, Novi Sad, Kragujevac, Čačak), the average price of apartments increased by more than 7%, almost 10% in Novi Sad.²⁸ The price of apartments in newly constructed buildings jumped even higher – 9.9% on average in Serbia, with Belgrade reaching 14.7% in a single year.²⁹ The price increase is partly justified due to the increase in construction land prices (27.5%), “other expenses” (23.9%) and construction price (5%).³⁰

The fact that saving has not been profitable for years (with an average interest rate in EUR of under 1%)³¹ explains why those with capital prefer to invest in real estate that they can lease while its value increases. The fact that only about 21% of the apartments in Serbia were bought through housing mortgage in 2018 is striking, while 79% were sold for cash (even more than in 2017, when the number was 77.2%).³²

All of these trends can best be seen in Belgrade, where the most expensive apartments are located (up to 7,866 EUR/m², 8.5 times above the national average) and where almost half the sales volume (47%) of residential space in Serbia takes place and demand continues to outstrip supply.³³

26 Izveštaj sa tržišta nepokretnosti za 2018. godinu, Republic Geodetic Authority (RGA), 01.03.2019.

27 It is worth mentioning that people who sell old apartments often buy new ones during the same year (due to a need for a different layout, location, etc.).

28 Statistika tržišta nekretnina u Srbiji, nekretnine.rs, 22.03.2019.

29 Cene stanova novogradnje u 2018. godini, SORS, 15.03.2019.

30 The price of costs is increasing due to an increased labour migration from Serbia to countries with better economic conditions. The increased demand for labour due to a growing number of active construction sites is further adding to that.

31 Analiza isplativosti dinarske i devizne štednje, National Bank of Serbia, 07.2019.

32 Statistika tržišta nekretnina u Srbiji, nekretnine.rs, 22.03.2019.

33 Ibid.

The commodification of housing into investment schemes also explains how the number of unoccupied apartments increases in step with the number of new apartments. Finally, it shows grim prospects for those without savings, a stable job, or with credit-incompatible income, looking at the market to solve their housing needs.

3.4.2. CONSTRUCTION COST

For a private investor the construction costs for a residential building in Belgrade (without the cost of construction land) are estimated between 800 and 1,300 EUR/m², and largely vary depending on the infrastructure, construction zone, size of the building, etc. As confirmed by construction companies (clients of Učajev Office), the typical structure of building costs is as follows:

- The average cost of construction land is 20% to 30% of the total;
- The construction land development fee ranges between 5% and 8%;
- The cost of developing technical documentation, monitoring and obtaining all necessary approvals and permits is typically estimated at 2 to 3%;
- Construction works (structure, roof, façade, installations, etc.) account for 55-60%;
- 2% is estimated for marketing, legal services and sales commissions;
- Project financing costs are estimated at 7 to 9%;
- Connections to the infrastructure network (heating, electricity, water and sewage, etc.) are estimated at 4 to 5%;
- Exterior landscaping costs are estimated at around 1%;
- Various unforeseen costs are set at 1-3%.

The difference between the market price of a new apartment (an average of 2,097 EUR/m² in Belgrade in 2018) and the cost of investment in its construction represents the profit, which generally ranges from a minimum 15% to a (for investors) desirable 25%, although unofficially this profit often increases to over 50%. This margin shows potential room for reducing apartment price and increasing the affordability of housing through non-profit development, without any financial support from the state. If such support were to be introduced, the effects could be beneficial to an even bigger portion of the population.

The following graph³⁴ is based on data from 2009. It gives an idea of the level of affordability that could be achieved for a household through non-profit housing construction for sale (column 3) and for rent with subsidy (column 4), compared to obtaining the same apartment through market conditions (column 1) or with a subsidized housing loan (column 2). It makes it clear that there is lots of room for improving housing affordability, just as it is clear that there is a surging demand for any kind of institutional intervention in this direction.

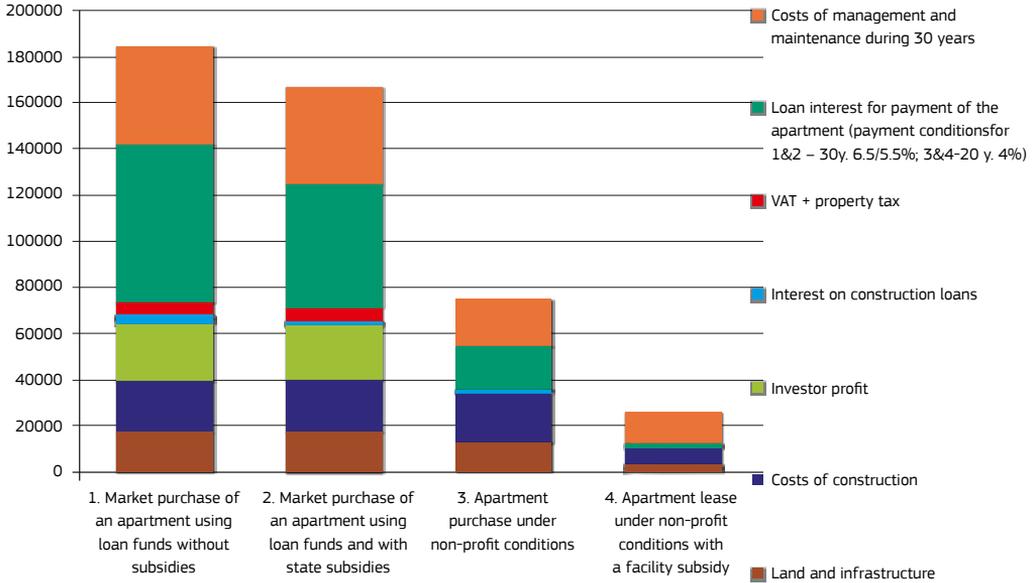


Image 3.3. Comparison between prices for an apartment purchased on the market, with state subsidies, or under non-profit conditions, sources: Statistical Office of the Republic of Serbia, National Bank of Serbia, Ministry of Construction, Transport and Infrastructure.

³⁴ Introduced in the Analysis accompanying the Draft Law on Housing and Building Maintenance, 2016.

SUMMARY OF 3.4.

REAL ESTATE MARKET IN SERBIA

This real estate market analysis indicates that apartments in Serbia are increasingly being purchased as an investment. As a result, their prices are rising and acquiring an apartment is becoming less and less accessible to an ever-increasing number of people. This intensifies the need for an intervention in the housing sector with a non-profit development.

Analysing the cost structure of an apartment building, we can identify the main elements that make up the market price of apartments. Apart from construction work and materials, these include the investor's profit (15-50%), the cost of land (20-30%), construction land development fees (5-8%) and project financing (bank interest rate on a mortgage). Reducing these costs, primarily the aspects of profit and project financing cost, opens up room for introducing innovative and effective non-profit housing developments.

As the state has not been developing such interventions so far, we will examine what possibilities housing cooperatives based on mutual home ownership can provide. This model successfully functions in multiple different contexts, where it managed to make housing more accessible to greater number of people, but also to expand the construction market, raising the GDP of the entire country.

CHAPTER 4

LEGAL IMPLICATIONS OF THE MHO APPROACH

Given the social and commercial reasons for the introduction of housing cooperatives and the MHO model in Serbian practice, this chapter introduces the main characteristics of the MHO model and its advanced forms, describes the current legal framework, tests whether the MHO model is possible under current legislation, and examines the legal risks for its functioning.

As indicated in the previous chapter, statistical data shows that there is a lack of market supply of affordable housing that matches the needs of the population in Serbia. This is especially the case in large cities where the pressure is the highest and the housing situation often remains unresolvable. This in turn points to an urgent need for a diversification of housing models that broaden the possibility for a greater number of people to meet their basic housing needs, with room for provision by proactive public institutions, as well as for a citizen driven approach.

In the context of the latter, the introduction of housing cooperatives based on mutual home ownership could prove relevant for those categories of the population who don't qualify for existing programs of housing support (social housing), nor have credit ability (are "unbankable"), but are in need of affordable housing. MHO addresses this significant category of population – who currently remain locked out of the real estate market – by reducing

housing costs (primarily developer profit), while shielding individuals from direct exposure to a bank loan.

The lead for such a novel (scalable, replicable) MHO approach in Serbia is given by the association Ko Gradi Grad, and its flagship development Pametnija Zgrada. It aims to introduce a limited equity-based leasehold for cooperatively owned housing which prevents residents from investing in the property merely for speculation – an approach that has proven successful in other European countries (like Switzerland, Germany, or recently Spain). The model unites three crucial aspects of housing provision that in Serbia are conventionally operated through separate providers with conflicting ambitions: housing construction, financial mediation and property management.

4.1. THE MHO APPROACH

The mutual home ownership model as presented in this study is a non-profit and non-speculative model of cooperative housing. The main goals of the model are: (1) to provide housing “at cost” and (2) to prevent speculation by locking property from sell-off.

Crucial characteristics of this MHO approach are:

- Apartments remain in cooperative ownership, thus preventing selling of the apartments and speculation;
- Mortgages are taken collectively, not individually, thus providing access to mortgage for those individually not eligible;
- Occupancy rights are based on a lease agreement;
- Payments are set on a non-profit principle: to cover only the repayment of a mortgage (used for construction) and housing costs (maintenance, utilities), thus making housing affordable;
- Access to the apartments is given collectively, thus providing an influence on neighbourhood selection;
- The apartment building has less individual, and more collective facilities (lower investment per apartment whilst having a stronger community).

4.1.1. ADVANCED MHO MODELS

In addition to these basic MHO principles, three advanced MHO models are introduced here based on: partial equity ownership, gradually built full equity ownership and cross-holding of apartment buildings. They offer insight into various affordability and anti-speculation mechanisms for collectively owned housing. Not all of the examples have a cooperative organizational form.

a) Cooperative models based on a partial equity (share) ownership

Recent Zurich based housing coops (Switzerland) – Kraftwerk1, Kalkbreite, Mehr als Wohnen – all belong to a generation of cooperatives established during the last twenty years. They operate based on the following not-for-profit model:³⁵

- Prospective tenants pay a refundable membership fee (CHF 1,000 at Kalkbreite), gaining eligibility to rent apartments as they become vacant.
- Once a unit opens up, the occupants-to-be pay for shares in the coop according to its size, in the form of a refundable deposit.
- Rents are priced per square meter at the cost of the land lease plus construction loan, they also include maintenance and operational costs (of the building). Currently, rents at Kalkbreite are 20% below market levels, in other cases they may offer a reduction of up to 40%.³⁶
- Once the loan is paid-off, rents only have to cover ongoing maintenance and operations.
- When residents leave the coop, their deposits are returned, while other members are offered the vacant flat.

³⁵ Co-op City: Zürich's experiment with non-profit housing, by Alexis Kalgas, assemblepapers.com.au

³⁶ Real Utopias: Switzerland's Housing Co-ops, by Douglas Murphy, tribunemag.co.uk, 18.06.2019.

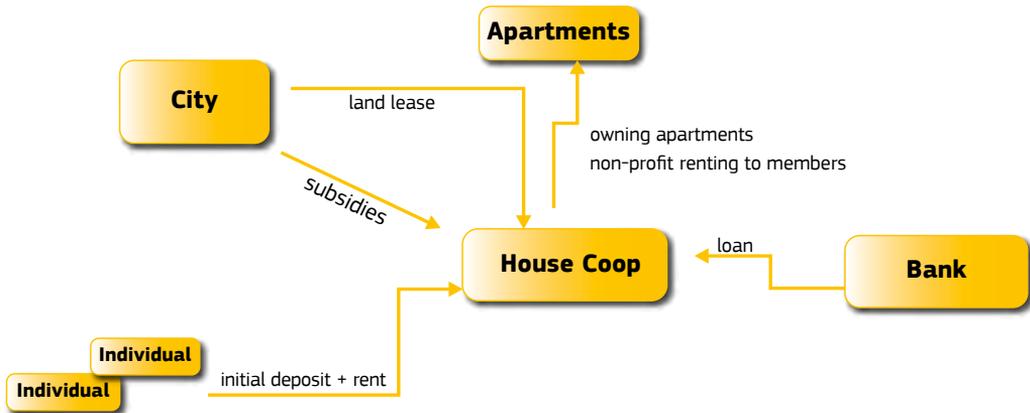


Image 4.1. Zurich based housing coops and their relations with individual tenants (members), the city and the bank

The city of Zurich leases land to the coops under favourable conditions. Stability of rents is supported through regulation, which limits the lessor's power to evict and controls rents over the lifetime of a lease. In the Zurich referendum held in November 2011 the population voted in favour of a measure mandating that affordable, non-profit apartments are to make up one-third of the city's total rental stock by the year 2050.

Urban Coop Berlin (Germany) is a new professional developer for cooperative housing projects in Berlin and beyond. It operates on principles similar to those of the Zurich coops.³⁷

- Urban Coop Berlin develops housing projects and connects future residents.
- Interested individuals pay an initial membership fee (EUR 96 per year) to Urban Coop to help initiate new projects and prove their interest. *Candidacy* is a necessary condition for participation in any of the projects. Once the architectural layout of the building and its overall costs have been determined, apartments can be reserved by candidates.
- A separate housing cooperative is created for each individual project. All those who successfully reserve an apartment become members of the housing cooperative formed for the respective project. At this point, future residents create a common fund. The fund is needed to obtain a bank loan which, in turn, is needed to proceed with the planning and building process. Banks usually expect 20% of the total loan volume to be raised up front. The *financial contributions* are determined per square meter. What is more, the contributions are also used to pay for the planning work done by Urban Coop Berlin.

³⁷ <https://urbancoopberlin.de/english/>

■ Affordability is due to the following factors: (1) Urban Coop does not maximise profits, (2) the creation of cooperative housing is subsidized by the state in various ways, and (3) the sharing of spaces and facilities is very cost-effective.

Apart from state subsidies, common characteristics for the above examples of partial equity (share) ownership cooperatives are: (1) a fee to gain access to the housing cooperative; payments as a combination of (2) a refundable deposit (usually 20% of the cost value of the desired apartment) and (3) non-profit rent determined per square meter “at cost” (to cover loan repayment, maintenance, land lease, etc.).

b) Cooperative model based on gradually built-up full equity (share) ownership

Low Impact Living Affordable Community (LILAC)³⁸ from Leeds (UK) is a door opener for an intermediate housing market where rents are above those of social housing, but below market price. In 2006, this intermediate housing market was estimated at 40% of UK households. Lilac is established as a cooperative (Mutual Home Ownership Society), whereas members of the cooperative are also occupants of apartments (tenants). This way the tenants also manage the building (cooperative). Lilac is the owner of the building and the land. Tenants (leaseholders) use the apartments based on a lease contract. Construction costs are financed by the mortgage.

The cost of purchasing the land and building the apartments is divided into equity shares so that each share is worth GBP 1. Each member is allocated an amount of equity related to the size of their apartment. Members buy shares by paying 10% of the subscribed shares through a deposit payment right at the beginning, and subsequently at 35% of their household’s net monthly income, until all subscribed shares are paid off. Part of the monthly payment is for house expenses – utilities, building maintenance, communal facilities accessible to all households. The value of the shares purchased by each of the members may not differ more than 10% from the value of the apartment they live in. **Equity shares are an instrument that vests ownership rights to their owners, allowing members to hold an equitable interest in the value of the housing assets owned by the cooperative. The number of equity shares allocated to each member depends on a combination of the member’s household income and the cost of their home.**

³⁸ Mutual home ownership: A new route for permanently affordable communities, by Paul Chatterton, University of Leeds

Once they have acquired all equity, members pay a fee equal to 10% of their monthly income.

Members can sell their shares. A member who leaves the cooperative before the expiry of a period of three years will receive the nominal value of his/her shares. Members who leave the cooperative after this period will receive the nominal value of their shares plus interest on these shares, set at 75% of the value of the increase in national/local income. In both cases, money paid towards shares that cover interest repayments are not repaid to departing members.

The Lilac model has the following advantages:

- Increased affordability and equality by linking members' payments to their monthly income. For example, annual household minimum incomes in 2013 ranged from just under GBP 15,000 for a one-bed apartment to GBP 49,000 for a four-bed house;
- Member's payments go to building up equity that a member can withdraw when leaving the cooperative (unlike standard tenancy), thus allowing members to save up to the full investment value of the apartment;
- Reduced speculation, by decoupling the value of the apartments from local real estate prices: individual equity shares are index-linked to changes in average national/local income changes, thus protecting members' equity and preventing the use of apartments as a speculative asset;
- Shares allocated to a member cannot exceed 110% of the value of the leased property, thus providing sustainability;
- Members cannot unilaterally decide to terminate their lease agreements, stop payments and withdraw money – this is possible only if the cooperative can buy back their equity shares (through allocating shares internally to other members, using surplus from the equity fund, or re-mortgaging from the bank) or if members find a new incoming member willing to buy them (and the cooperative is willing to take them on as a new member).

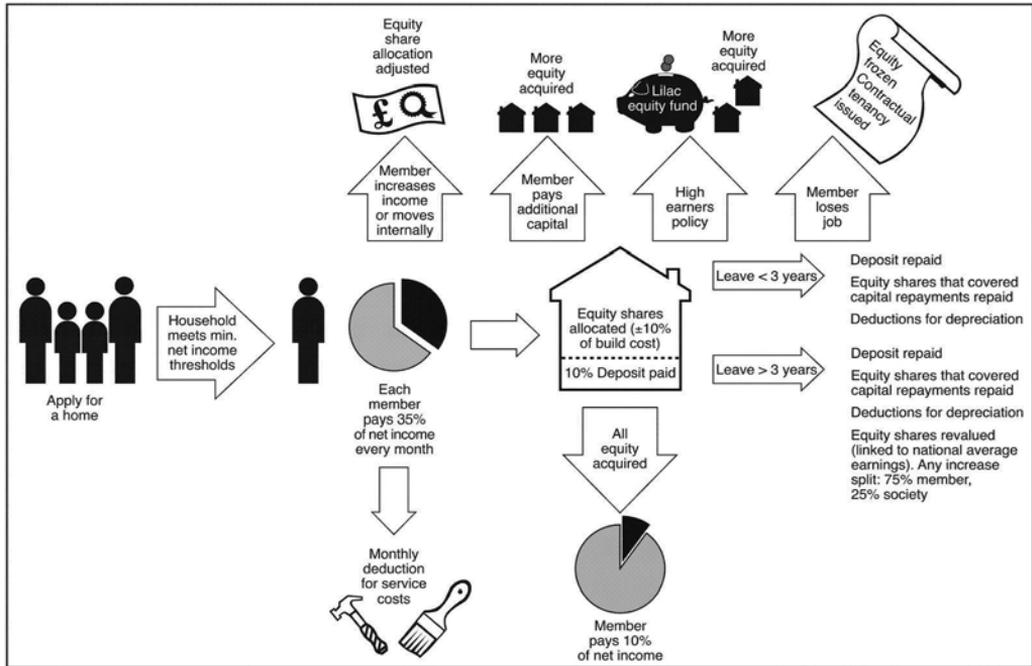


Image 4.2. MHO model as practiced by Lilac, source: Lilac

The Lilac model provides increased affordability; however, it has its limitations. A minimum income is needed in order to finance loan repayment, though a member can earn less and pay more than the determined proportion of 35% of income. Issues arise when a member's income falls below this minimum (loss of employment, disability) and he/she cannot pay enough to cover their loan repayment (related to his/her apartment):

- In the short term this is solved by balancing between members with low and high earnings. Each member can buy between 90% and 110% of the individual equity shares, thus allowing members with high income to finance those with less. More than 110% is not allowed in order to prevent an imbalance. Total monthly payments have to cover at least the repayment of the loan.
- If equity shares cannot be allocated to other members, the internal Equity Fund can be used for this purpose, with inputs from members with higher earnings.
- If none of the above is available, the lease will be converted to a standard rental tenancy or the member can sell his/her equity share.

c) Model of cross-holding of apartment buildings

The Mietshäuser Syndikat³⁹ (Germany) is a rapidly growing investment company for the joint acquisition of residential buildings. The “Rental Apartment-building Syndicate” has been started in 1992 in Freiburg, and consists of 149 buildings and 27 projects in preparation (as of November 2019). The primary aim of the Syndicate is to provide financial, organisational and planning support to low-income groups that have few (or no) assets, when they wish to purchase buildings for residential purposes. All tenants, who are paying socially fair rent levels, are at the same time members of the Syndicate. They are not obliged, but are advised to give direct credits to the projects they join.

The key innovation of the Mietshäuser model is its locking mechanism against the sale of assets, through a cross-holding mechanism and mutual voting rights. It is a system of cross-holding between the umbrella organizations (Mietshäuser Syndikat GmbH and Mietshäuser Syndikat Verein) and the legal entities formed around individual buildings – Hausbesitz GmbH (“house holding LLC”) and Hausverein (“house association”).

The model is functioning in the following manner:

- Hausbesitz GmbH (“house holding LLC”) is the legal entity formed for each separate building (149 at present) that owns the building. Hausbesitz GmbH has two shareholders with 50% voting rights each: Hausverein (EUR 12,600 share in the capital of Hausbesitz GmbH) and Mietshäuser Syndikat GmbH (EUR 12,400 share in the capital of Hausbesitz GmbH). The total capital stock of Hausbesitz GmbH is EUR 25,000.
- Hausverein (“house association”) is an autonomous entity formed for each separate building that operates the building, and has the right of veto on: selling the building, statutory changes and the use of the income of Hausbesitz GmbH. Members of the Hausverein are future tenants of that particular building.
- Mietshäuser Syndikat GmbH (“Rental Apartment-building Syndicate LLC”) is an umbrella organization, it has a share of EUR 12,400 in the capital of every Hausbesitz GmbH and has the right of veto on: selling the building, statutory changes and the use of incomes of Hausbesitz GmbH.
- Mietshäuser Syndikat Verein (“Rental Apartment-building Syndicate Association”) is the single shareholder of Mietshäuser Syndikat GmbH. All Hausvereins together form the Mietshäuser Syndikat Verein. Each member is obliged to bring a one-time deposit of EUR 250 (or more) into Mietshäuser Syndikat Verein.

- The main financing for the purchase of buildings comes from direct loans with max. 2% interest rate/year (friends, sympathisers) to Hausbesitz GmbH, as well as select banks (mainly GLS bank with whom the Syndikat has a long-term partnership).
- Solidarity Fund: each Hausverein pays a monthly contribution to Mietshäuser Syndikat Verein of 0.1 EUR/m² with an annual increase of 0.5% of base rent (limited in the long run to 80% of the market rent level). The Solidarity Fund is used to finance the Syndikat's initial contributions to new house LLCs as well as the costs of infrastructure and joint public relations work.

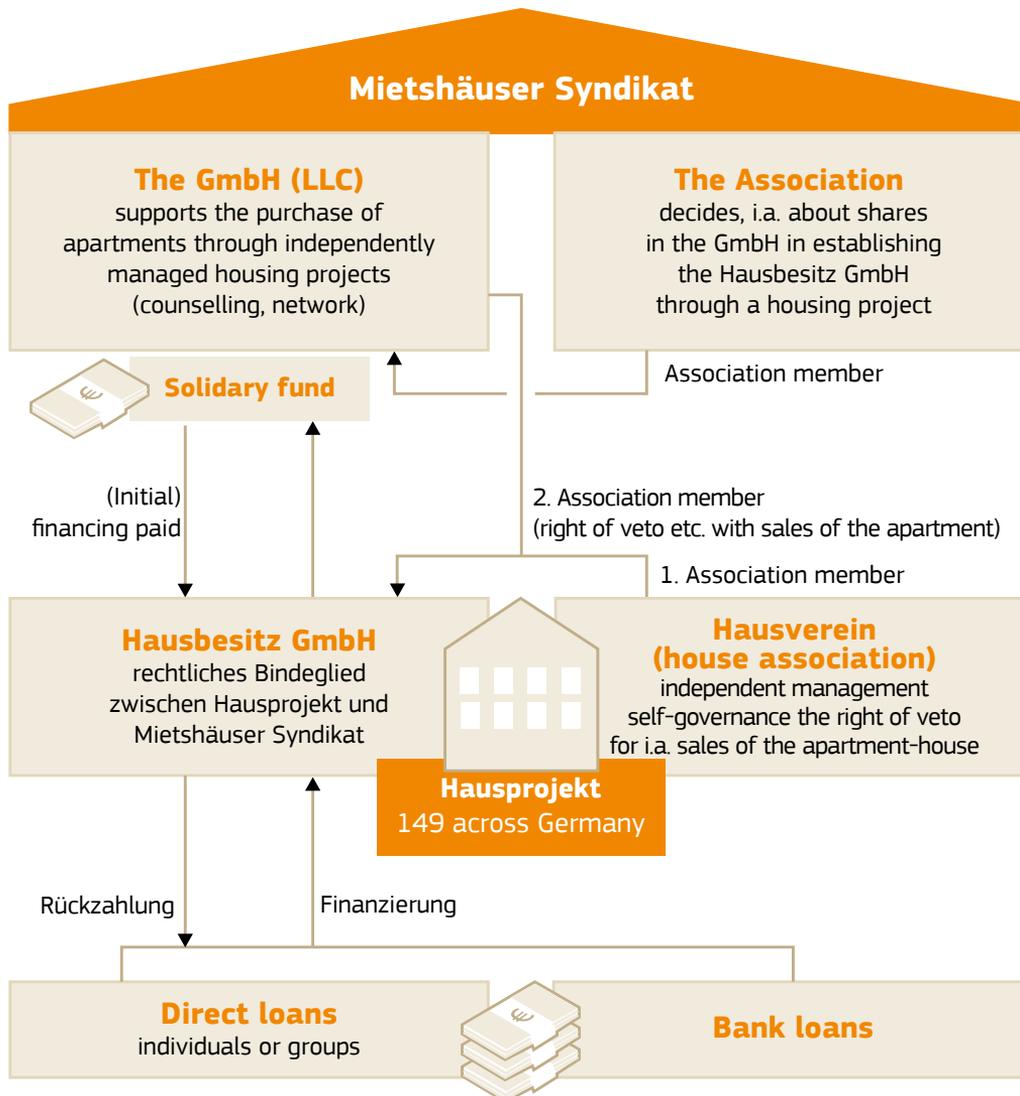


Image 4.3. Structure of the Mietshäuser Syndikat ("Rental Apartment-building Syndicate"), source: Mietshäuser Syndikat, version January 2018

4.2. A COOPERATIVE AS THE APPROPRIATE ORGANIZATIONAL FORM FOR MHOS IN SERBIA

Previous examples show that MHOs can have various legal forms, as well as combinations that work well when upscaling to multiple collectively owned housing properties. For implementation in the Serbian context, we have considered three organizational forms – the limited liability company, the association and the cooperative.

A **limited liability company (LLC)** has certain advantages for the MHO approach. The main one is that each member has a transferable share in the LLC, thus by definition providing equity for its members and facilitating changes of members (if one wants to exit). On the other side, an LLC is not an adequate form to prevent speculation. Namely, an LLC is a company, meaning it is a legal entity conducting activities with the aim of gaining profit.⁴⁰ Therefore, it is the right of each of its members to question the operation of an LLC on a non-profit basis. As long as all LLC members are in agreement, this will not be a problem. However, members cannot be prohibited from selling and earning when the value of the property rises. If a member wants to sell a share in the LLC (due to the increase of the value of the property, the share values rise too), an LLC can introduce some restrictions to control the entry of new members (the pre-emptive right of the LLC to buy shares off of an exiting member, the LLC's right to designate the buyer). However, it cannot prevent selling nor can it influence the selling price of the share, thus it cannot prevent using shares as a speculative asset.⁴¹

The association as a legal entity is not suitable for MHO due to the prohibition on conducting economic activities as its main activity.⁴² An association can perform economic activities only in smaller volumes, and as the core activities under the MHO model are the building, maintenance and leasing of apartments, the association is clearly not the adequate organizational form. Other limitations are the prohibition to allocate profit or property to its members under any circumstances,⁴³ even in case of termination of member status or the association itself, thus exiting members with no equity at all.

⁴⁰ Article 1 of the Company Law (Official Gazette of the Republic of Serbia No 36/2011, 99/2011, 83/2014, 5/2015, 44/2018 and 95/2018).

⁴¹ Article 217 and 376 of the Company Law.

⁴² Article 37 of the Law on Associations (Official Gazette of the Republic of Serbia No. 51/2009, 99/2011 – other law and 44/2018 – other law).

⁴³ Article 37, 41 and 42 of the Law on Associations.

Considering the above, **the cooperative** is the only legal form that may reconcile the performance of economic activities on a non-profit base, thus making it suitable for the MHO model as proposed here. However, keeping property under collective ownership and out of speculation has not been practiced in the historical model of housing cooperatives in Serbia. Instead, these coops have been acting as developer companies delivering private property to individual – temporary – member households. The introduction of the model of collective ownership opens up new possibilities for the application of cooperative MHOs.

4.3. LEGAL FRAMEWORK FOR HOUSING COOPERATIVES IN SERBIA

The relevant provisions regulating the area of housing cooperatives in Serbia are primarily contained in two basic laws:

- Law on Cooperatives (Coop Law),⁴⁴
- Law on Housing and Building Maintenance (Housing Law).⁴⁵

The provisions of the Company Law⁴⁶ related to limited liability companies apply accordingly to cooperatives, and consequently to housing cooperatives, in areas not regulated by the Coop Law. Similarly, the Bankruptcy Law⁴⁷ applies as subsidiary regulation, regarding the issue of bankruptcy and distribution of assets after the liquidation of a housing cooperative.

As a housing cooperative represents a business entity operating on the market like any other company, all other laws governing their activities apply (Law on Contracts and Torts,⁴⁸ Law on Planning and Construction,⁴⁹ etc.). Regarding by-laws, the only relevant regulations are General Rules of Housing Cooperatives of Yugoslavia,⁵⁰ adopted by the general assembly of the Union of Housing Cooperatives of Yugoslavia in 1998. This is an autonomous general act whose provisions are still in force, except those in collision with subsequent regulations. Other relevant by-laws do not refer

44 Official Gazette of the Republic of Serbia No 112/2015.

45 Official Gazette of the Republic of Serbia No 104/2016.

46 Official Gazette of the Republic of Serbia No 36/2011, 99/2011, 83/2014, 5/2015, 44/2018 and 95/2018.

47 Official Gazette of the Republic of Serbia No 104/2009, 99/2011, 71/2012, 83/2014, 113/2017, 44/2018 and 95/2018.

48 Official Gazette of the SFRY, No 29/78, 39/85, 45/89, 57/89 and Official Gazette of the SRY, No 31/93.

49 Official Gazette of the Republic of Serbia, No 72/2009, 81/2009, 64/2010, 24/2011, 121/2012, 42/2013, 50/2013, 98/2013, 132/2014, 145/2014, 83/2018, 31/2019 and 37/2019.

50 1998 Yugoslav Union of Housing Cooperatives

specifically to cooperatives, they are common to all business, and therefore applicable to cooperatives.

Although there is a legal framework provided for housing cooperatives, challenges arise due to the *de facto* loss of recognition of cooperatives in Serbia. Housing cooperatives have been side-tracked during the early 2000s by changing regulation (losing advantages in terms of land provision, taxation, etc.), the introduction of commercial banks (without credit lines for housing cooperatives) or the abolition of savings-credit cooperatives introduced in the 2006 Law on Banks, to name just a few.

4.3.1. LEGAL REGULATION OF HOUSING COOPERATIVES

A detailed review of the legal regulation of cooperatives in Serbia is provided in Annex 1. The main characteristics are summarised below.

A housing cooperative is a type of cooperative, defined by its registered predominant activity. It is a democratically governed legal entity, operating on the principle of “one member-one vote”.

Members of a cooperative can only be individuals (natural persons). A cooperative cannot be transformed into another legal form, but it can be the founder or member of other legal entities (such as an LLC).

The documents regulating the structure and activities of a cooperative are the Agreement on Association and the Cooperative Rules – a general act on cooperative management and internal organization.

The cooperative’s bodies: the General Assembly of the members as the supreme decision-making and controlling body, the Board of Directors and Director as managing bodies, and the Supervisory Board as the controlling body. Collective bodies make valid decisions if half of all members of the body are present, and the majority of the present members vote for the decision. A majority vote of all members is needed for a decision on status changes, sale of real estate and changes to the Agreement of Association and the Cooperative Rules, while a two-thirds majority of all members is necessary to initiate a liquidation procedure.

Cooperatives are founded and operate either through **share capital or through a membership fee**. Share capital is formed from contributions, refundable when a member exists, while contributions don’t have to be equal. Membership fees shall be paid if a cooperative is founded without contributions from cooperative members, and it must be equal for all members.

Cooperative assets are under cooperative ownership, formed from the members' contributions or membership fees, generated from business activities, or from other sources. In case of sale of real estate, received payments cannot be distributed to members or employees on the basis of membership, contributions or employment. A cooperative is liable for its obligations with all its assets, while members are liable up to the amount of each contribution (except in case of a misuse of the cooperative for illegal or deceptive activities, when they are liable with all their assets).

The General Assembly, if it wants, can establish investment or reserve funds (to cover losses, repayments of returned contributions, or any other costs). The General Assembly also decides on the allocation of profit; however, it must first cover previous losses and resources used for the established funds.

In case of liquidation or bankruptcy, any surplus in cooperative property shall be transferred to the national or territorial cooperative union that the dissolute cooperative was a member of (or was headquartered in).

SUMMARY OF 4.3.

LEGAL FRAMEWORK FOR HOUSING COOPERATIVES IN SERBIA

Housing cooperatives are regulated in Serbia, although without a specific structure or rules for this specific type of cooperative. They are legal entities, founded by their members, and managed based on the democratic principle of “one member-one vote”.

They may have assets under their ownership, and disposal of real estate is under special regulation – it is not possible to sell them unless the majority of all members decide so, and revenue generated in this way cannot be allocated to cooperative members.

If a cooperative is founded by members’ contributions as share capital, contributions must be returned to a member upon termination of member status.

4.4. FUNCTIONING OF MHO UNDER SERBIAN LEGISLATION

Aspects of the previously introduced MHO approach, based on cooperative ownership of apartments while cooperative members lease them, are entirely feasible under Serbian regulations.

Member-tenants control the cooperative, which is the owner of the property. The cooperative as the investor and contractor will organize the construction/purchase of homes. The cooperative remains the owner of the homes, and as such, the cooperative will conclude lease agreements with its member-tenants. Rent and new contributions will be determined in accordance with the principles set in the Cooperative Rules and elaborated in the relevant documents of cooperative bodies.

The construction/purchase of homes will be financed from cooperative share capital (formed from members contributions) and mortgage loans, and potentially from other sources as well (donations and similar). Repayment of the loan can be financed from rent paid by members and new contributions in share capital from members.

Cooperative members can finance the cooperative with membership fees. However, according to the Coop Law,⁵¹ the membership fee must be equal for all members, and it is not refundable upon termination of member status. Therefore, this is not suitable for the MHO model.

Crucial characteristics of the MHO under Serbian cooperative housing regulation would be:

- Apartments are under cooperative ownership, managed by all members with equal voting rights (regardless of the size of contribution), while a majority of all cooperative members is necessary to sell the apartments without the right to acquire profit made through this sale, thus in principle preventing speculation.
- The provision of access to apartments is collectively arranged.
- If the majority of the members wishes so, the cooperative operates on a non-profit principle, thus providing that members' payments are set to cover building and operating costs related to apartments, without profit for the cooperative.
- The cooperative is the entity taking out a bank loan, thus providing access to mortgage for all its members, regardless of individual credit ability.

51 Article 22, paragraph 2 of the Coop Law

The characteristics described fall within cooperative values and principles, and this functioning is in accordance with the provisions of the Coop Law.

The following sections will analyse the feasibility of advanced MHO models under Serbian legislation. Annex 2 contains a Roadmap template for the possible implementation of the MHO model in Serbia.

4.4.1. ADVANCED MHO CHARACTERISTICS UNDER SERBIAN LEGISLATION

This chapter will test the following characteristics of advanced MHO models introduced in section 4.1.1. under Serbian regulation:

- Virtual share capital as a way of protecting members' investments (as in Lilac);
- Reduced speculation, by decoupling the value of the apartments from local real estate prices (Lilac);
- Increased affordability by linkage of coop members' payments to their income (Lilac);
- Cross-holding and mutual voting rights as an advanced sale locking mechanism (as in Mietshäuser Syndikat);
- Solidarity Fund (Mietshäuser Syndikat).

Virtual share capital (as in Lilac)

Equity shares are an instrument used to change the character of payments, i.e. instead of paying a non-refundable rent, the members acquire shares with regards to the coop equity. In addition to this, equity shares have the following functions:

- They provide transferability of capital – a member who wants to exit the cooperative may sell his/her equity shares to a new coop member (relieving the cooperative of this cost, thus providing additional financial stability) or the cooperative can buy them back;
- They have a built-in equity value protection mechanism, as they are indexed to income growth, which at the same time prevents speculation on changes in asset value;
- They provide sustainability by setting the rule that each member can buy between 90% and 110% of equity shares linked to the apartment they occupy (depending on his/her future income), thus avoiding the risk that a larger part of the property is linked to one member; on the other hand it allows members with high income to buy more shares and in the short-term

support members with less income who cannot finance their part of the equity shares at that moment.

It is not possible for the cooperative to issue equity shares in Serbia. Coop members don't have equity, they have their contributions, refundable in case a member exits. Somewhat similar effects can be achieved with contributions to the share capital of the cooperative:

- The initial contribution of each member will be set at (for instance) 10% of the building cost related to the apartment that member will use. Coop Rules shall set the principle that upon termination of each year share capital will be increased by new contributions, and the contribution of each member will be equal to the annual mortgage cost related to the apartment of that member and paid in 12 monthly instalments.⁵² Each year the General Assembly must decide to increase the share capital in the described manner, until the mortgage is paid off.

- Upon leaving the cooperative, only contributions paid into share capital will be returned to a member. These can be valorised (similar to indexation in the Lilac model), if prescribed in the Cooperative Rules. However, this is not necessary and the value of the returnable contribution can be entirely de-coupled from income growth or housing prices.

- However, contributions in share capital cannot provide stability as in the Lilac model. In the short term, a member with a lack of financial resources can delay payment while still subscribing to the contribution in the required amount, according to the Coop Rules. The major challenge is the departure of a cooperative member. As it is not possible to issue equity shares, contributions are non-transferable, and the obligation of the coop is to return contributions paid to the exiting member. This may impose financial difficulties on the coop if it has no resources (reserve fund) to pay off the exiting member. The smaller the number of coop members and the later the moment of the exit, the greater the risk for the coop's financial stability.

Affordability (as in Lilac)

In the Lilac model, affordability is achieved by linking members' monthly payments to 35% of their net income. In Serbia, Cooperative Rules may set the principle that upon termination of each year the share capital will be increased by new contributions, while the contribution of each member will be equal to 35% of the member's annual income and paid in 12 monthly instalments. However, this may bring considerable uncertainty due to instability and incomplete traceability of incomes in Serbia. Therefore, it is advisable to stick to the determination of payment per square meter, on a non-profit base.

52 It is possible to set a rule that contributions will be paid each month equal to last monthly income, however this is an administratively inefficient, long and more expensive procedure.

Cross-holding and mutual voting rights (as in Mietshaüser Syndikat)

The Mietshaüser Syndikat as a housing model, providing an increased locking effect from selling of the property, may have the following structure under Serbian legislation:

- A House Holding would be formed for each building in the form of an LLC. It would have two shareholders each with 50% voting rights in decision making: (1) House Coop (its members would be future tenants) and (2) House Union LLC as an umbrella organization.
- Each House Coop would be a member of the House Union Coop, which, similar to Mietshaüser Syndikat, would be a single shareholder in the House Union LLC.

Basically, the whole model is replicable in Serbia with the same system of financing and the same locking effect, except that instead of an association the coop would be used as the proper organizational form in Serbia.

Solidarity Fund (as in Mietshaüser Syndikat)

In the Mietshaüser model, this is a fund built from contributions by house associations, and operated by the House Union Association. In the Serbian context, the concept is legally viable and easily made workable through the Cooperative Rules, although instead of through house associations it would work through the format of House Coops while the House Union Association would be a House Union Coop.

SUMMARY OF 4.4.

FUNCTIONING OF MHO UNDER SERBIAN LEGISLATION

The MHO model, as a specific non-profit and non-speculative model of a housing cooperative based on cooperative ownership of the assets and members leasing the apartments, can be introduced into the Serbian context.

Having apartments in the coop's ownership prevents speculation, since the sale of real estate owned by the coop requires the majority vote of all members. Furthermore, if the majority of the members agree, the cooperative may operate on a non-profit base, meaning that rent for the lease of the apartments may be set "at cost", covering only the mortgage and costs related to maintenance and management of the apartments.

Advanced MHO models provide additional features that can be replicated in Serbia, with certain adjustments. Instead of rent, member payments may be in the form of contributions to the share capital of the coop, thus providing members with equity they can take with them if they leave the coop. Since only the value of the paid contribution will be returned to exiting members, this is also a measure to prevent speculation with the increase in apartment prices. However, an exiting member would impose a financial burden on the coop, as in that case it would be obliged to return the member's contribution.

The described chain of cross-holding between associations and LLCs in the Mietshäuser model is a good way to prevent the unwanted sale of assets, and is entirely replicable in Serbia. The same applies to a Solidarity Fund. However, it implies a network of several operational housing coops.

4.5. RISKS FOR TENANTS-COOP MEMBERS AND PROTECTION MECHANISMS

In an effort to anticipate all risks that participants (members, residents and the cooperative itself) may encounter, it is necessary to ensure that the Cooperative Rules (and preferably also the Agreement on Association) provide precise conditions and a clear procedure for acquiring occupancy rights, with all potential financial (or other) burdens that could arise for the members or tenants, thereby indirectly protecting the cooperative. Special, strict conditions for changing these rules should be applied.

In order to further reduce risk, the most efficient way would be to conclude a contract between the members and the housing cooperative. This contract should regulate all issues important for a member, excluding the possibility for the cooperative to unilaterally make decisions that would deny previously established member rights.⁵³

4.5.1. RISKS SPECIFIC TO THE MHO MODEL

The main risks for cooperative members are those that affect the affordability of the apartment and sustainability of the coop.

Income decline

A minimum income is needed to finance loan repayment under the MHO model. Issues arise when a member's income falls below this minimum (loss of employment, disability) and he/she cannot cover loan repayment (related to the apartment).

As mentioned above, this risk cannot be solved in Serbia by means of equity shares. However, Cooperative Rules can provide similar solutions – a member can register his/her contribution, with a certain (delayed) payment period (on the condition that overall payment of loan is secured through other contributions) or the cooperative can establish a special (reserve) fund for these purposes, or a loan to a member from other members or the cooperative.

Member exit

Once a member leaves the cooperative, his/her contribution will be returned to him/her, while the apartment remains under cooperative ownership. This

53 Article 11 of the Law on Cooperatives

return of contribution is obligatory in Serbia, while there is no share in cooperative nor equity share based on cooperative assets that can be sold. If the member exit happens later during the repayment period, the cooperative will have to return a considerable amount to the exiting member, disrupting the cash flow of the whole project. In the Lilac MHO model, new members buy equity shares allocated to former members. In Serbia this is not possible, thus raising the question of financing the return of contributions. A new member can make a payment in the amount of the contribution returned to the former member, however if this amount is considerable it is questionable if somebody would be willing to pay such high initial contribution (new members get a lease with affordable rent; however, this may not be interesting enough if the initial payment is high). As a final solution, although also the most expensive under current conditions, a re-mortgage from the bank could be possible given that the entire project will increase in value year on year. If none of this works, the coop asset can ultimately be rented or sold in order to avoid bankruptcy.

4.5.2. GENERAL RISKS

There are several categories of more general risks that a member of a housing cooperative or a cooperative itself may encounter. Most notably:

Dissolution of the cooperative

In case of liquidation, forced liquidation, bankruptcy, or a status change that results in the dissolution of the cooperative, the surplus of the assets (if any) shall be treated in accordance with bankruptcy regulations. Bankruptcy Law stipulates that in this situation, after settling all creditors and any obligations and costs of the bankruptcy proceedings, the surplus shall be transferred to the national cooperative union or territorial cooperative of which the dissolute cooperative was a member of (or was headquartered in).

Regarding liquidation, this risk is lower due to the provisions of the Coop Law that a two-thirds majority of all cooperative members is necessary to start the liquidation procedure, and the coop won't be liquidated if at least five members are against this decision. If liquidation is enforced, it is advised to allocate and pay any non-allocated profit to the members before initiating the liquidation process. Of course, it would be useful if the cooperative has special and reserve funds established for this purpose – to avoid liquidation or bankruptcy.

SUMMARY OF 4.5.

RISKS FOR TENANTS-COOP MEMBERS AND PROTECTION MECHANISMS

The risks to which members and cooperatives are exposed can be classified into two categories:

(1) Risks specific for the MHO model – income decline (this can be solved in Serbia by means of a registered but delayed payment, reserve funds, etc.) and a member exiting (the Coop Law stipulates that members leaving a cooperative must get back his/her contribution, disrupting the cash flow of the project, especially if there are no protection mechanisms in place).

(2) General risks – liquidation, bankruptcy, etc. where any surplus of assets is transferred to the cooperative union, not the members. To deal with these risks it would be advisable for the cooperative to provide additional reserve funds and precise rules for acquiring occupancy rights and regulating relations within the coop.

4.6. MECHANISMS FOR THE LEGAL PROTECTION OF COOPERATIVE OWNERSHIP

An important aspect of MHO is safeguarding real estate from speculation throughout its lifetime. Even when the Serbian government is supporting initiatives that build and sell housing apartments under favourable conditions (like the Stepa Stepanović neighbourhood in Belgrade) it only prevents the sale of these apartments on the market during the first five years.⁵⁴ In effect, individual households benefits financially from such support, but the stock of affordable housing is not maintained. In this respect, MHO provides a much more sustainable approach, which is why we examine the risks and mechanisms for protecting coop ownership.

1. Coop Law stipulates that real estate under cooperative ownership can be sold only if such a decision is supported by the majority of all cooperative members (qualified majority). Furthermore, if real estate is sold, the revenue generated in this way cannot be paid to cooperative members or employees on the basis of their membership, contributions or rights under employment. This makes it hard to sell cooperative real estate based on speculative reasons and allocate it to members, even if the majority of the members support this.
2. It is possible to misuse a cooperative, through so-called “pumping” of debts, where real estate is sold in order to settle a cooperative’s fictional debts. This could be prevented with internal acts (Cooperatives Rules) – prescribed business control, pre-signing, co-signing, approval of the Assembly, frequent controls by the Supervisory Board, etc.
3. A specific risk in the MHO model is related to the termination of member status and return of contribution. As already stated, the cooperative is obliged to return his/her contribution to an exiting member. If this is a considerable amount and there are no reserve funds, a cooperative can find itself unable to repay the loan, or pressured to sell the apartment in order to return the contribution. To prevent any member leaving due to speculative reasons, in the Serbian context it would be preferable to return only the contribution actually paid (more specifically – the money that was used towards repaying the principal of the loan), without valorisation. Furthermore, Cooperative Rules should prescribe a special procedure and period for the return of contributions (a six-month period is acceptable, according to current practices). Reserve funds should be established for this purpose, although in cooperatives with a small number of members this is not a feasible option.

54 Article 531 of the Law on Contracts and Torts

However, as it is unlikely that a new member will replace an old one and bring in an equal contribution as the one returned, the most probable solution is re-mortgaging the loan, although it is also the most expensive solution.

SUMMARY OF 4.6.

MECHANISMS FOR THE LEGAL PROTECTION OF COOPERATIVE OWNERSHIP

The Coop Law stipulates a qualified majority (majority of all cooperative members) for the sale of cooperative real estate, and prohibits the revenue thus generated to be allocated to cooperative members and employees based on their member or labour status. Furthermore, to protect a cooperative ownership from misuse, internal cooperative procedures should prescribe appropriate measures, such as co-signing, pre-signing, assembly approval, and other legal instruments developed under company and contract legislation.

A cooperative is placed at a significant risk in case of some of its members leaving, due to the obligation to return their contributions. This can be mitigated through reserve funds or delayed payment, or as a final solution, re-mortgaging.

CHAPTER 5

FINANCIAL AND FISCAL ASPECTS OF MHO

This chapter analyses the tax treatment of the MHO model in Serbia through its three phases: raising capital, construction and operation. When possible, different tax options as well as tax risks are highlighted, and loan repayment mechanisms due to member equity withdrawal are presented.

As indicated in the previous chapter, there are no legal obstacles to implementing the MHO model in Serbia. However, the true test of the model's feasibility is how it performs financially – does it live up to the expectation of being affordable. The decisive element in this regard is the tax regime.

Tax implications do not differ based on the type of legal entity that implements the MHO model. For this reason (as it is the most appropriate legal form), we use the cooperative as the main vehicle for the MHO approach throughout the text, but the same tax implications could apply to an LLC or any other legal form. Existing housing cooperatives in Serbia essentially function and pay taxes exactly as any other company that builds apartments to sell them.

What influences different financial outcomes are the types of financial transactions that are predominant in the specific implementation of an MHO model. In this chapter, tax implications for both models based fully on contributions into the equity and non-profit rent are examined in detail. Finally, their financial performance will be compared with a model in which

the cooperative sells apartments at no profit to its members, but also without preventing further speculation. This will allow us to see what room is there realistically for sustainability in the realm of affordable housing in Serbia, given the current legal and fiscal framework.

5.1. TAX IMPLICATIONS RELATED TO RAISING CAPITAL

Initial capital necessary to start cooperative activities and construction of a building can be raised from the following sources: (1) cooperative members' contributions in cooperative share capital, (2) a bank mortgage loan and (3) donations.

Members' cash contribution

Not subject to taxation.

Loan

Not subject to taxation.

Unconditional donations and gifts

Subject to gift tax at a rate of **2.5%** (for amounts exceeding RSD 100,000), although there is a **moderate risk** that the Tax Authority will consider this as income subject to a **corporate income tax at a rate of 15%**.

We considered the possibility of using tax relief under the Law on Donations and Humanitarian Aid⁵⁵ (exemption from excise and VAT on the import of goods that are the subject of donation). However, as the current cooperative form is legally not considered a non-profit organization and following that its purchasing of goods would be difficult to regard as "improvement of the life of the population" – such relief is not available.

Important note:

According to the Law on Corporate Income Tax, any cooperative selling products on the market and providing services for a fee is subject to corporate income tax. Our opinion is that a cooperative is not subject to corporate income tax during the phase of raising capital due to the fact that at this stage it does not provide services for a fee. On the other side, **if during this phase the cooperative provides services for a fee to its members (for instance services related to the development phase),**

⁵⁵ Official Gazette SRJ No. 53/2001, 61/2001, 36/2002 and Official Gazette RS No 101/2005.

corporate tax will be paid, even on donations.

However, it is worth noting that the current tax practice is defined only in the case of cooperatives financed solely from membership fees (or members' contributions) and providing services only to its members without additional payments. According to a ruling of the Supreme Court, such cooperatives are not subject to corporate income tax.⁵⁶ Apart from this, there is no relevant practice or official opinions.

In order to prevent tax avoidance, the Tax Authority may treat donations as taxable with corporate income tax, due to the following reasons: (1) a cooperative will provide services for a fee during its existence, thus it will qualify to be taxable; (2) a cooperative will not be financed by members only, as it will take out a loan; (3) therefore, donations should be considered as income.

This risk of paying corporate income tax on donations can be reduced, although not completely avoided, by obtaining a favourable official opinion from the Ministry of Finance, which is binding for the Tax Authority.

Conditional donations

Just as with unconditional donations, conditional donations are subject to the gift tax at a rate of **2.5%** (for an amount exceeding RSD 100,000) with a moderate risk of being treated as an income subject to corporate income tax at the rate of 15%.

However, if a conditional donation is considered to be subject to corporate income tax, it has different tax effects. It won't be regarded as income during the period when it has been received, but during the period when the cost for which the donation is given is realized, and in the amount of that cost. This means that if a conditional donation is given for the construction of a building, taxable income will be equal to the depreciation of the building and will arise during periods of depreciation of the building (meaning 2.5% of the accounting value of the building per year).

56 Decision of the Supreme Court of Serbia U. 223/2003 on 18.6.2003.

5.2. TAX IMPLICATIONS RELATED TO DEVELOPMENT PHASE

This section, examines the tax aspects of the land acquisition and construction of the apartments. Before a detailed analysis, it is necessary to highlight that if the raised capital is used for the purchase of real estate that is then sold further, these costs will be recognized as an expense and will result in a reduction of the income tax base. However, if the real estate is acquired for usage (by cooperative members) or (income generation through) rent, as is the case in the MHO model, the costs of such purchases will not be recognized as an expense, and thus the income tax base will be higher for the value of the purchase.

Land Acquisition

■ **Purchasing of land** (or transfer of the right to use construction land or lease of construction land under public ownership for a period longer than one year) for the purpose of constructing buildings is subject to the tax on the transfer of absolute rights at the rate of **2.5%**. The tax base is the contracted value of the land (or other right), except when it is lower than the market value. In that case, the tax base is the market value of the land (or other right). In the case of purchase, the taxpayer is the seller. In the case of a transfer of the right to use or lease of construction land, the taxpayer is the user of the land.

■ **In-kind contribution** of land (or any other property) into the cooperative share capital is **not subject to taxation, the same as for an LLC**. However, there is a low risk that the Tax Authority may take an opposite view, which can be mitigated by obtaining an official opinion from the Ministry of Finance.

Note: According to Article 13 of the Coop Law, regulations related to the legal status of LLCs will be implemented for any issues not regulated by the Coop Law. It is our opinion that this does not only apply to the Company Law, but any other law related to LLCs if there is no specific provision for a cooperative. Therefore, the tax treatment of an in-kind contribution to a cooperative should be the same as with an LLC – these contributions are not subject to taxation.

■ **Donations, gifts and conditional donations of land** (or other property) to the cooperative have the same tax treatment, and bear the same tax risks as any other donation (as described in the segment covering tax implications related to raising capital). If they are not taxable with corporate income tax (which in our opinion they should not be until the cooperative starts to provide services for a fee), they are subject to a gift tax at

the rate of **2.5%**. **An exception is when the donor is the Republic of Serbia, an autonomous province or a local municipality, in which case it is not subject to the gift tax.** Furthermore, no gift tax will be paid if the right of use of the construction land is donated, regardless of who the donor is, for land up to 1,000 m².

■ **The tax treatment of the lease (rent)** without a fee, for an indefinite period of time, of publicly owned construction land for the purpose of constructing facilities, is an open question. Our opinion is that this should have the **same tax treatment as a gift**. However, there are no official opinions by relevant tax authorities. Applicable tax legislation generally states that the transfer tax will be levied on such a lease, as well as on the acquisition of the right to use publicly owned construction land, without determining whether this also applies to cases where there are no usage fees. This leaves room for an interpretation that there is a tax liability, but it also allows for the opposite interpretation. This uncertainty can be mitigated with an official opinion by the Ministry of Finance.

Construction of apartments

A cooperative will not be entitled to deduct or refund the input VAT (VAT contained in the value of purchased goods and services), if used for the construction of apartments that won't be sold but instead used by its members or leased for housing purposes. VAT treatment should be neutral even if input VAT is not deducted, as VAT is not payable for apartment rent. However, this will have a negative cash flow effect. Namely, the VAT contained in goods and services procured during construction will be payable immediately by the cooperative (as the tax debtor). On the other hand, members' contributions/rents that should pay off the purchasing value of goods and services and the relevant VAT are generated over a long period. If the input VAT could be deducted, but payable through rent, this would immediately lower purchasing costs, thus having a positive cash flow effect (smaller loan or more money available during the initial period of the project).

It is important to note here that the state gives a full VAT refund to individuals purchasing their first apartment for the first 40 m² (and an additional 15 m² per each additional household member). Since members of MHO-based coops would not qualify for this relief (although they would satisfy all other conditions but becoming owners), the financial burden would be increased by the value of VAT.

Purchase of buildings

A cooperative can decide to buy a building instead of constructing it. The purchase of a new building (if there was no earlier ownership transfer) comes with a 20% VAT taxable transaction. However, in general, such transactions are VAT exempt, but the cooperative will not have the right to deduce the input tax as it will not sell the apartments, but rent them (considered a commercial purpose).⁵⁷

The purchase of older buildings (if this is not the first transfer of ownership), is subject to a tax on the transfer of absolute rights at the rate of 2.5%, calculated as per the market or contracted value of the real estate.

5.3. TAX IMPLICATIONS RELATED TO THE OPERATING PHASE

During the operating phase the cooperative will be repaying the bank loan, providing maintenance and other services related to the housing in the building it constructed and enabling its members to use the apartments. Member payments should service these expenses, and they can take the form of contributions in the cooperative share capital, regular rent and charges for services. Different forms of these payments have different tax implications. This is why it is important to fully understanding them in order to design the best MHO model for the Serbian context. Therefore, the following section analyses the tax treatment of rent, maintenance fee and member contributions to share capital during the operating phase. Furthermore, we will look into two important taxes relevant for an MHO-based cooperative: income tax and property tax.

Rent

The service of leasing for residential purposes is **not subject to VAT** taxation and consequently there will be no VAT consequences. However, the rent increases the taxable income base which is explained in more detail below, under the section “Cooperative income”.

Maintenance Fee

The maintenance of apartments and buildings (as well as utility costs) is a VAT taxable service at the rate of 20% (10% for heating) if independently rendered, and if the provider is registered as VAT taxpayer.

⁵⁷ In order to avoid additional VAT costs, when new buildings are purchased and there is an obligation to calculate VAT, a tax-optimal solution would involve diverting direct financing.

However, **if it is provided within the leasing of the apartment as an auxiliary service**,⁵⁸ the tax treatment will be the same as for the lease service – **it will not be subject to VAT taxation.**

If the MHO-based cooperative will not perform VAT taxable activities at all, there is no reason to be registered as a VAT taxpayer, as it won't be entitled to withhold the input tax. However, if its income exceeds eight million RSD during a period of 12 months, it must be registered as a VAT payer. Even in that case it will not be obliged to pay VAT for maintenance services, when these are provided as an integrated service within the lease.

Member contributions to the cooperative share capital

Contributions to the cooperative share capital are not taxable.

Important note:

In the case of a full equity-based MHO model (similar to Lilac) – a smaller part of a member's monthly payment would go towards utility costs and building maintenance (in the form of rent), while a larger part would represent their contribution to the coop share capital (servicing repayment of the mortgage). Under these circumstances, there is a moderate risk that the Tax Authority will consider contributions as fictional transactions intended to reduce cooperative income tax. Their argument could be that members are in effect paying rent for the apartments they are using, and that this sum should therefore be part of taxable income, unlike investments into share capital. However, there is a strong counter argument – what differentiates contributions from rent is that contributions have to be returned to members upon termination of their status, they are refundable, while rent is not. In the MHO model, members have equity kept in the cooperative share capital. Therefore, the intent of member contributions in share capital is not to avoid corporate income tax, but to preserve member equity. This is also a strong argument for any further advocacy efforts to recognize MHO-based cooperatives as non-profit organizations, as it does not have rental or any other income from its members, while maintenance services are provided at their real cost.

In order to reduce this risk, the rent should not only cover the cost of the maintenance and utilities but also some part of the monthly loan repayment, thus part of the payment is actually related to the use of the apart

58 It would be auxiliary service if leasing and maintenance are provided as an integral (single) service, at an integral price (it is not fractioned into a part for leasing and a part for maintenance), and in the price structure its value is smaller than the value of the leasing. For example, if under the current lease agreement a tenant is obliged to refund the cost of electricity to the lessor, it is considered part of the rent; on the contrary, if the tenant is a registered service user and pays directly to the electricity provider, it is not part of the rent.

ments, not just maintenance and utilities (the greater this part, the smaller the risk). This is also a way to reduce another moderate tax risk, related to the personal income tax of cooperative members. In tax practice, when cooperatives provide their members with usage of tourist apartments in cooperative ownership without a fee, this is considered an income of a member equal to the market value of renting the tourist apartment, and would be taxed as other income. **In the MHO model, this would mean that a market value of renting the apartment a member is using would be taxable as other income at an effective tax rate of 16% according to the Law on Personal Income Tax.** Our opinion is that this practice is contrary to the Law on Personal Income Tax and the very nature and purpose of a housing cooperative. However, it is better to mitigate this risk by paying rent related to the usage, maintenance and utilities (although considerably lower than on the market), than to challenge a decision by the Tax Authority if this risk is realized (if there is no rent payment).

Cooperative income

Income from rent and the maintenance fee is taxable with corporate income tax, at a rate of **15%**. Members' contributions to the cooperative share capital are not income, therefore they don't have an impact on cooperative income tax.

Cooperative membership fees also represent cooperative income, increasing the income tax base. However, they are not suitable for the MHO model, and therefore not relevant.

Most probably, the MHO-based cooperative will have income below the market revenue of such a building. This brings a low risk that the cooperative income would be regarded as income from affiliated persons who are in control of the cooperative and are gaining an advantage (housing at a cost lower than market value) because of their member status. Therefore, the income tax base would be additionally increased to equal the market value of these services. Namely, affiliated persons are regarded to be those who have the possibility of controlling or having a controlling influence on decision making in a business. The legal prerequisite is that these persons have 25% or more shares in the capital or management bodies. As none of the members would have this percentage of share/voting rights, this legal prerequisite is not fulfilled.⁵⁹ However, the Tax Authority may argue that members are persons with factual influence regardless of the stated limits.

⁵⁹ Official opinion of the Ministry of Finance No. 401-00-3218/2016-04 on 20.10.2016.

On the other hand, only direct costs will be recognized as expenses that reduce the taxable income base. **Most notably, loan repayment is not recognized as a direct cost, except for paid interest – thus the nominal value of the loan is subject to tax. Depreciation of real estate will be recognized as a cost at 2.5%** of the acquisition value of real estate on an annual basis, which in accordance with applicable regulations reduces the annual tax liability for income tax by 0.375% of the acquisition value of real estate.

Property Tax

There is tax relief for land under the building: if the plot has less than 1,000 m²—it is not taxable.

Tax on property owned by a cooperative is **up to 0.4%**. The precise rate is determined by a local government body for each municipality. This tax rate is applied to the accounting value, if determined by the fair value method, or to the adjusted value (of the building and accompanying land) in accordance with decisions by the local government body, depending on the zone it is located in and the value of a square meter determined by the local government body. The building's net surface area is used to determine the tax base and there is tax relief (under prescribed conditions)⁶⁰ for the land under the building. The net surface area is the sum of the floor surfaces between the inner sides of the perimeter walls of the building, excluding: the surfaces of balconies, terraces, loggias, stairways outside the building volume, non-adapted attics and spaces in the indivisible common property of all owners of special parts of the same building (except the surface below the supporting walls and columns passing through the building, which are also a separate and common part of the building). However, if a cooperative is the sole owner of a building, there are no spaces in common indivisible property of all owners of special parts of the same building, therefore collectively used spaces will be taxable⁶¹ (if they are not balconies, external stairs, non-adapted attics and loggias).

If the taxpayer is an individual, the tax base is the adjusted value of the apartment (with the deduction the items already mentioned and without counting collectively used space). For individuals, a depreciation rate of 1% annually is recognized when determining the tax base, while there is an additional tax relief of 50% of determined tax if the owner lives in the apartment.

⁶⁰ Official opinion of the Ministry of Finance No. 011-00-00392/2014-04 on 30.11.2015.

⁶¹ Official opinion of the Ministry of Finance No. 011-00-01077/2016-04 on 24.11.2016.

5.4. LOAN REPAYMENT MECHANISMS

Financial risks in the MHO model are primarily related to the minimum net income of every household that is needed to finance the shares or the rent allocated to them. For a cooperative to be able to service the debt, the total sum of all incomes has to meet this overall minimum. Temporary fluctuations can be covered from reserve funds, but the viability of the model depends on the ability to absorb bigger impacts.

If the MHO model is entirely based on contributions to equity, the risk of the coop not being able to service its debt is greater when members are leaving the cooperative. The cooperative is obliged to return his/her contribution to a member, and it could be hard to find a new member that can bring in the same amount of contribution that was refunded to the exiting member. Even if that was not a problem, limiting entry to those who can afford the full value of the apartment would go against the basic MHO principle to offer housing under affordable conditions. Solutions developed in MHO models elsewhere are also feasible in Serbia, though they would make the whole project more expensive. These solutions are the establishment of mandatory reserve funds (feasible in the mature stages of a project, when there are enough funds and in the case of a small number of members leaving the coop) or re-mortgaging of the debt. Insurance of loan repayment in case of withdrawal of deposits is currently not a service present on the Serbian market, though they might be found on foreign markets, since the Law on Insurance⁶² allows for the possibility of obtaining insurance abroad when such insurance is not available on the domestic market.

5.5. COMPARISON OF THE TAX EFFECTS OF THE MHO MODEL AND THE CONVENTIONAL COOP MODEL BASED ON INDIVIDUAL OWNERSHIP

To provide a better overview, in this part we will present the tax effects for three different scenarios/models of non-profit housing: a cooperative model based on rent (Mietshäuser like), an MHO model based fully on contributions to equity share (Lilac like) and one with individual ownership of apartments. This last model, where the apartments are built by a cooperative for sale to its members, is the conventional coop model present in Serbia (with a significant exception – conventional coops make profit in their operation).

⁶² Official Gazette of the Republic of Serbia, No. 139/2014

Although this model would not meet the basic criteria of mutual home ownership (as apartments would be private at the end), it is important to consider it in order to compare the financial performance of MHO models to what can be achieved with individual ownership. The following table provides only a general overview, with ideal interactions and no residues. The precise financial and fiscal burden may vary depending of the exact input values, sources of financing, interpretations by tax inspectors in case of tax control, etc. As there is no practice of housing cooperatives based on rent (including non-profit rent) or equity share, there are many unknowns.

The expected costs and necessary revenue streams for each of the models being compared are given based on the same case study of the construction of an apartment building provided by Ko Gradi Grad: the value of the total investment – EUR 1,376,000, built within the 4th construction zone of Belgrade, member contributions and donations of 10% of total investment each, a bank interest rate of 3%, a repayment period of 30 years, 1,640 m² gross floor area, 1,140 m² net floor area (with 1,010 m² for housing units, 130 m² for collective space) on a plot of 950 m².

It is worth mentioning here that there is no bank product currently in Serbia that would be adequate for financing MHO-based construction. Such a credit line would have to have a repayment period and interest rate closer to a housing loan than to investment loans. With this lack of actual bank products and for the sake of easier comparison, we are using the same loan parameters for all scenarios, regardless if the loan is paid out by the coop or by individual owners.

MHO model based on non-profit rent	MHO model based on gradually built-up full equity shares	Members ownership model (non-MHO)
Raising capital		
<ul style="list-style-type: none"> Member contribution (10%) EUR 137,600– no taxation; 	<ul style="list-style-type: none"> Member contribution (10%) EUR 137,600– no taxation; 	<ul style="list-style-type: none"> Member contribution (10%) EUR 137,600– no taxation;
<ul style="list-style-type: none"> Donation (10%) EUR 137,600– gift tax at a rate of 2.5% (EUR 3,440); 	<ul style="list-style-type: none"> Donation (10%) EUR 137,600– gift tax at a rate of 2.5% (EUR 3,440); 	<ul style="list-style-type: none"> Donation (10%) EUR 137,600– gift tax at a rate of 2.5% (EUR 3,440);
<ul style="list-style-type: none"> Tax risk of being considered income taxable at a rate of 15% - EUR 20,640); 	<ul style="list-style-type: none"> Tax risk of being considered income taxable at a rate of 15% - EUR 20,640); 	<ul style="list-style-type: none"> Tax risk of being considered income taxable at a rate of 15% - EUR 20,640);
<ul style="list-style-type: none"> Coop takes bank loan (80%) EUR 1,101,000 – no taxation (interest rate of 3%, for a period of 360 months, on a proportional base – monthly repayment EUR 4,641.86, total interest EUR 570,069.75); 	<ul style="list-style-type: none"> Coop takes bank loan (80%) EUR 1,101,000 – no taxation (interest rate of 3%, for a period of 360 months, on a proportional base – monthly repayment EUR 4,641.86, total interest EUR 570,069.75); 	<ul style="list-style-type: none"> No bank loan taken by the coop.⁶³
Construction phase⁶⁴		
<ul style="list-style-type: none"> Coop pays for the land acquisition EUR 260,000 – tax on transfer of absolute rights 2.5% = EUR 6,500; 	<ul style="list-style-type: none"> Coop pays for the land acquisition EUR 260,000 – tax on transfer of absolute rights 2.5% = EUR 6,500; 	<ul style="list-style-type: none"> Land acquisition EUR 260,000 – tax on transfer of absolute rights 2.5% = EUR 6,500;
<ul style="list-style-type: none"> Coop pays for the construction goods and services 1,106,060⁶⁶ (VAT EUR 184,343 included), no VAT deduction⁶⁷; 	<ul style="list-style-type: none"> Coop pays for the construction goods and services 1,106,060⁵ (VAT EUR 184,343 included), no VAT deduction⁶⁸; 	<ul style="list-style-type: none"> Coop pays for the construction goods and services 1,106,060 (VAT EUR 184,343 included); Coop is refunded for input VAT⁶⁹ = EUR 184,343;
		<ul style="list-style-type: none"> Coop sells apartments “at cost” – EUR 916,457⁷⁰ + 10% VAT EUR 91,646 = EUR 1,008,103; as it is “at cost”, no profit realized, thus no coop income tax; paid VAT on the sale of the apartments – EUR 91,646;
		<ul style="list-style-type: none"> Members take out a loan of EUR 1,008,103 (interest rate of 3%, for a period of 360 months, on a proportional base – monthly repayment EUR 4,250, total interest EUR 521,970) – over a period of 30 years loan repayment is EUR 1,530,073, to buy apartments – no taxation;
		<ul style="list-style-type: none"> If all members fulfil conditions⁷¹ for VAT exemption for the purchase of their first apartment, they will be refunded up to EUR 86,995 (VAT included in purchase price);

Operating phase

- Rent over a period of 30 years – EUR 1,832,232 (to cover repayment of the bank loan with interest, property tax and coop income tax) – not VAT taxable;
 - Members contributions over a period of 30 years – EUR 1,791,513 (to cover the repayment of the bank loan with interest, annually EUR 55,072 and property tax EUR 120,444, annually EUR 4,015) – no taxation;
 - Tax risk that contributions will be taxed as coop income = EUR 268,727;
-
- Utilities and maintenance fee⁷² EUR 945,360 over a period of 30 years (annually EUR 31,512) – VAT at a rate of 20% = EUR 189,072 (assuming the cooperative will be a VAT taxpayer, as its revenue will be over RSD 8 million annually, according to these estimations);
 - Utilities and maintenance fee⁷³ EUR 945,360 over a period of 30 years (annually EUR 31,512) – no VAT, assuming that cooperative is not a VAT taxpayer, as its revenue will be below RSD 8 million annually, according to these estimations;
 - Utilities and maintenance fee over a period of 30 years EUR 945,360 (annually EUR 31,512) – no VAT, if Coop ceases to be a VAT taxpayer;
 - If the coop is not providing any other services, and its revenue is below RSD 8 million yearly, it is advisable to request the cessation of VAT taxpayer status, therefore there will be no VAT on these services.
-
- The cooperative profit over a period of 30 years – if utilities and maintenance are provided at cost value, will be the revenue from rent, minus asset depreciation, interest paid to the bank and property tax, total depreciation EUR 829,545, interest EUR 570,070, property tax EUR 120,444) = EUR 312,173;
 - The cooperative profit over a period of 30 years – if utilities and maintenance are provided at cost value, there will be no profit, therefore no coop income tax, while depreciation of the assets⁷⁴ (annually EUR 27,651, total depreciation EUR 829,545) interest paid to the bank (EUR 570,070) and property tax (EUR 120,444) are tax recognized expenses;
 - The cooperative profit over a period of 30 years – if utilities and maintenance are provided at cost value, there will be no profit, therefore no coop income tax;
-
- Coop income tax – approx. EUR 46,826 over a period of 30 years (at a tax rate of 15% calculated against the cooperative profit in the previous section);
 - Coop income tax – the coop will have a tax credit for income tax at 15% on the loss of EUR 1,520,059 = EUR 228,009 that can be used if the tax risk related to contributions is realized;
 - Coop income tax – no coop income tax as there will be no profit;
-
- Members' income due to rent below market price⁷⁵ – a moderate risk that the Tax Authority will tax the market value as the members' other income; it would be a monthly income of EUR 5,050, over a period of 30 years this is EUR 1,818,000, taxable at rate of 16% – tax risk = EUR 290,880;
-
- Property tax payable by the cooperative⁷⁶ over a period of 30 years (the taxable surface area of the building is 1,140 m²) 0.4% against the building's value determined according to the Property Tax Law⁷⁷ = RSD 14,212,425, or cca. EUR 120,444;
 - Property tax payable by the cooperative⁷⁸ over a period of 30 years (the taxable surface area of a building is 1,140 m²) 0.4% against the building's value determined according to the Property Tax Law⁷⁹ = RSD 14,212,425, or cca. EUR 120,444;
 - Property tax payable by members – owners during the course of 30 years (the taxable surface area of housing units is 1,050 m² and land 700 m²) 0.4% against the land and building value determined according to the Property Tax Law, less depreciation and tax relief⁸⁰ = RSD 4,708,339, or cca. EUR 39,901;
-

Overall fiscal and financial burden

- | | | |
|--|--|---|
| ○ Cooperative:
payable taxes – EUR 366,282; | ○ Cooperative:
payable taxes – EUR 130,384; | ○ Cooperative:
tax – tax refund EUR 184,343; |
| ○ Total financial burden of members –
EUR 3,104,262 ⁸¹ ; | ○ Total financial burden of members –
EUR 2,874,473 ⁸² ; | ○ Total financial burden on members –
EUR 2,652,934 ⁸³ with the share of
property tax – EUR 39,901 |
| ○ tax risk – up to EUR 20,640 | ○ tax risk – up to EUR 311,520 | |
-

63 Donations and member contributions will serve to start construction; after the start of construction, the coop may sell apartments during the construction phase to raise money to finish construction, while members will take out a bank loan to buy apartments. In this way the overall cost is lowered as the coop is not taking a bank loan and not paying interest to the bank, only its members are. An alternative is that the coop takes out a bank loan, pays for the construction, deducts input VAT, while members would take out a loan to buy finished apartments though their loan will be reduced for the VAT that the coop has deducted.

64 Under the assumption that the capital raised is used entirely for land acquisition and construction, and that the apartments are sold “at cost” value, with no profit for the coop.

65 Raised capital EUR 1,376,000, minus land acquisition price and transfer tax, minus gift tax on donation.

66 As coops don’t have the right to deduct or refund the input VAT, and in this phase, the coop doesn’t provide services for a fee, there is no need to register as a VAT taxpayer.

67 Raised capital EUR 1,376,000, minus land acquisition price and transfer tax, minus gift tax on donation.

68 As coops don’t have the right to deduct or refund the input VAT, and in this phase, the coop doesn’t provide services for a fee, there is no need to register as VAT taxpayer.

69 Due to the right to deduct input VAT, the coop is encouraged to register for VAT at this stage, while it will become a VAT taxpayer upon selling the apartments as it will be above registration threshold of RSD 8,000,000. During later phases, if the coop’s income during a 12-month period is less than RSD 8,000,000 there is no need to be VAT taxpayer any more.

70 Total cost of land and construction, minus contribution, donation and refunded VAT.

71 The conditions for a VAT refund on the purchase of the first apartment prescribe that the beneficiary of this tax benefit doesn’t own another apartment and that the contract price is fully paid to the account of the seller; the VAT refund is limited to the first 40 m² of surface area for the purchaser and an additional 15 m² per each of the members of the purchaser’s household.

72 Under the assumption that utility cost is 2.6 EUR/m², payable for the surface area of housing units – 1,010 m².

73 Under the assumption that utility cost is 2.6 EUR/m², payable for the surface area of housing units – 1,010 m².

74 Depreciation is recognized as a tax expense for real estate (excluding land) at an annual rate of 2.5% (40 years basis), until the asset is amortized.

75 Under the assumption that average market rent is 5 EUR/m², for a surface area of housing units of 1.010 m².

76 Under the assumption that the gross floor surface area is 1,640 m², the net floor surface area is 1,140 m² (excluding balconies, stairs, loggias, non-adapted attics etc. but including common spaces under the collective ownership of all owners), the housing units' surface area of 1,010 m² and space used collectively of 130 m². The land under the building is assumed at 450 m². Land surface area is 950 m² – it is important to know that according to Article 2 of the Property Tax Law if land is below 1,000 m² it is not taxable with property tax. The land under the building is also not taxable with property tax.

77 For property tax purposes for the year 2019, the estimated value of 1 m² of construction land is RSD 3.776, of an apartment for housing purposes RSD 87,410, of commercial buildings RSD 103,892. The value of 1 m² is determined each year, based on the average value for the previous year, therefore the actual cost of the property tax for a 30 year period is completely unpredictable. For the calculation of coop property tax, the tax base is the value of the land surface area (excluding the surface under building), if the land is at least 1,000 m², and building surface (excluding balconies, loggias, non-adapted attics, stairs and similar, but including common spaces used and owned by all owners). No depreciation for property owned by the legal entity.

78 Under the assumption that the gross floor surface area is 1,640 m², the net floor surface area is 1,140 m² (excluding balconies, stairs, loggias, non-adapted attics etc., but including common spaces under the collective ownership of all owners), the housing units' surface area of 1,010 m² and space used collectively of 130 m². The land under the building is assumed at 450 m². Land surface area is 950 m² – it is important to know that according to Article 2 of the Property Tax Law if land is below 1,000 m² it is not taxable with property tax. The land under the building is also not taxable with property tax.

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80 Depreciation of 1% per year, and tax relief of 50%, but maximum RSD 20,000 per apartment if the taxpayer lives in it.

81 Initial contribution of the members, rent, utilities and maintenance fee with VAT payable by members.

82 Initial contribution of the members, contribution, utilities and maintenance fee payable by members.

83 Initial contribution of the members, loan plus interest, utilities, maintenance fee and property tax payable by members.

This overview of financial performance and the consequent burden on cooperative members for different model designs of coop-led housing development is indicative. Tax incentives for individual home ownership favour those who qualify for a housing loan, especially those that qualify for VAT exemption for the purchase of their first apartment. Therefore, an MHO model is not economically attractive to them. The end price of the MHO model based on rent is so high that it would not outperform rent on the market. The price achieved by MHO based primarily on equity is somewhat better, given that no tax risks are realized, but its biggest advantage is that it allows those who could not afford a housing loan to build up equity.

However, the most significant takeaway from this comparison is the grim perspective for the development of affordable housing. Not only are there no incentives for such development in Serbia, but mutual home ownership models, which safeguard built apartments from any speculation, cost significantly more (and bear many tax risks) than if there were no such safeguards. If an attempt was to be made to introduce non-speculative measures in individual ownership, this would be limited to a five year period only, according to the Law on Contracts and Torts. After that, regardless of the form of ownership (sole, co-ownership, or similar), there is no way to prevent a member from selling on the market, as it is a member's constitutional right to dispose of his/her private property. This is why any systematic initiative towards enabling wider access to housing must include changes to the tax regime so that MHO-based cooperatives have at least the same tax conditions as individual home ownership.

SUMMARY OF CHAPTER 5

MECHANISMS FOR THE LEGAL PROTECTION OF COOPERATIVE OWNERSHIP

From a taxation aspect, the most significant challenges for the MHO concept include:

- 1. Income from the lease of apartments (rent) and maintenance services increases the base of corporate income tax. On the other hand, the repayment of the loan, except for interest, will not be regarded as an expense and these revenues increase the income tax base.**
- 2. A negative cash flow effect on the input VAT for the purchase of goods and services for the construction of apartments. VAT is calculated in the purchasing price of goods and services for the construction of apartments, but since they are used for performing activities exempt of VAT without the right to withhold input tax (leasing), the cooperative will not be able to deduct input VAT. Although VAT should be a neutral transaction (there is no right to withhold input VAT, but also no obligation to calculate it against the lease so it will be repaid through time), as it cannot be refunded (like in the case of an individual purchase of one's first apartment) it will increase overall members payments.**
- 3. For these reasons, mutual home ownership comes with significantly higher costs and tax risks than individual ownership. This means that housing is taxed more heavily for those already without credit ability, perpetuating the housing deadlock. This discrepancy must be resolved at a systemic level.**

The current situation in Serbia is that the construction or purchase of a building for the residential renting business is disadvantageous regarding finances and tax compared to constructing a building for sale –not only is the profit higher for the latter, but profit return is quicker. Thus, investors prefer the sale of the apartments. This regulation affects housing cooperatives in a similar manner, making it financially much more viable to construct apartments for individual owners than to develop mutual home ownership.

The main tax advantage for individual buyers (when compared to MHO), is that upon purchasing an apartment, if they meet the legal conditions, they have tax relief available. Compared to this, MHO members don't have any tax incentive in case the cooperative owns the apartment and VAT contained in the value of apartments is paid through monthly contributions by tenants.

Tax-wise, the more favourable model of MHO is the one which preserves member equity. Under this model, a greater part of the monthly payments by members should be in the form of a contribution, thus it will not be taxable with corporate income tax. Consequently, members' monthly payments in the form of rent will be much lower than market rent. The Tax Authority may consider this difference to be income for the members and tax it accordingly. Although our opinion is that such a practice would not be legal, it is worth noting that MHO, due to its novelty, comes with different tax risks.

For the MHO model to have the possibility to fully flourish in Serbia, it is necessary to introduce a number of changes in the tax treatment of such housing initiatives.

CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

6.1. NEED FOR A NEW APPROACH TO SOLVING HOUSING NEEDS IN SERBIA

The housing situation in Serbia needs significant improvements. More than 30% of the apartments are overcrowded or close to being classified as such. Housing affordability is very low – according to Eurostat 2018 data, if the rent were to be paid 66% of households in Serbia would be under a heavy financial burden. Only 1.9% of households are not financially overburdened by housing costs. Furthermore, we may only speculate about the number of young adults and young parents that do not have their own apartment (independent living conditions) due to being unable to pay rent or take out a housing loan.

Current housing policy favours apartment ownership, thus leading people to solve their housing needs on the market through purchase. Under 30% of the households have nominal credit ability, but this number is most likely lower due to other financial obligations of these households. Although for a limited number of specific household categories there are favourable

credit conditions and apartment costs, most of the people must take out a loan under market conditions and purchase apartment at market price. Considering the low median income and high inequality of income distribution, this makes solving housing needs highly unlikely for most of the population, making Serbia the country with the least affordable housing stock among EU member states and candidate countries combined.

Non-profit housing could lower the prices by at least 25%, considering the difference between the market price and construction cost of apartments. If subsidized by the state or local authorities, the price can be reduced even more significantly.

Therefore, it is urgent to introduce a new housing model that can provide large scale non-profit housing, and credit ability for those that lack it. The cooperative mutual home ownership (MHO) model could provide an appropriate answer to this.

6.2. THE MHO MODEL IN THE SERBIAN CONTEXT

MHO is a non-speculative model of a housing cooperative, based on cooperative ownership of the apartments and non-profit renting to coop members. In the Serbian context, MHO can provide the following benefits:

- **Housing accessibility:** the housing loan is taken out by the coop, providing access to credit financing to those coop members who are not individually eligible to get a housing loan;
- **Non-profit housing:** the coop is building and renting apartments without profit, significantly reducing the price of housing (including management and utility costs);
- **Long-term affordability:** the cooperative ownership of the apartments prevents the sale of apartments on the market by individual occupants. Such a non-speculative model preserves housing affordability for each new generation of apartment users;
- **Saving individual equity:** if the dominant financing of the apartment building is via contributions to the cooperative's share capital, members will build up equity over time and retrieve it when they leave the coop;
- **Expanding the market:** by making housing available to households which currently do not have access to the market, it creates a bigger demand for the construction industry, as it would introduce a whole new market of investors and users.

It is clear that this would be a much-needed intervention, as it addresses real housing problems in Serbia and provides effective solutions. The MHO

model is legally feasible in almost all variations present in other contexts. If the funds are available and construction is performed in accordance with legislation, no issues related to operational feasibility are expected.

However, economic feasibility is a major issue. A model based on cooperative ownership is required to avoid speculation on the increase of asset values and inclusion of people who do not have credit ability, but it is tangibly more expensive and presents a greater tax risk than a model based on non-profit construction and individual members' ownership of the apartments. The main reason for this are the existing tax incentives for individual home ownership and for sales of newly constructed apartments. As a result, a non-profit, non-speculative housing cooperative would pay much higher taxes than any investor who is building (luxury) apartments for the market. This discrepancy needs to be resolved by the state.

If the state aspires to resolve the housing needs of households with medium to low income (for whom a bank loan is not an option), it can do so by increasing housing related social benefits for a significantly larger number of people (pay part of the rent or subsidize bank loans) or build a fresh stock of public apartments. However, the Republic of Serbia has extremely limited interventions in the housing sector, primarily due to the lack of substantial funds. A possible alternative that would come with no direct cost could be housing cooperatives based on the MHO model. This model is already widely accepted in many European countries like Switzerland, Germany or Austria. There, the state realized it is less costly and more efficient to subsidize housing coops than to provide social benefits for a large part of the population (while the most vulnerable ones still need social benefits). In Serbia, tax relief is much needed for the large-scale introduction of MHO model.

6.3. NECESSARY STEPS FOR THE WIDER INTRODUCTION OF MHO IN SERBIA

Article 12 of the Coop Law prescribes special protection for cooperatives in Serbia. Special protection is reflected in encouraging cooperatives through economic and housing policy measures, as well as other development policies, including the provision of adequate incentives and benefits as determined by special regulations. However, current regulation does not provide any special conditions for housing cooperatives. Such conditions, as they exist elsewhere,⁸⁴ entail the use of construction land without or with reduced compensation, support or guarantees related to loans taken out by the housing coop, insurance, etc.

In order to provide a beneficial environment for the development of the MHO concept in Serbia, legal and tax policies should be refined in two directions:

1. Ensuring the status of housing support provider for cooperatives in accordance with the Law on Housing and Building Maintenance (for apartment occupancy by coop members);
2. Adjustments of tax regulations in order to grant tax incentives for housing cooperatives, especially under non-commercial, non-speculative terms and conditions.

1) The Law on Housing and Building Maintenance should be amended in order to give the status of a non-profit housing organization to housing cooperatives, so they may provide “housing support” as introduced by this law.

■ This would create a legal base to **provide subsidies and special tax treatment** to non-profit housing cooperatives. At the moment, this type of support is recognized only in relation to publicly owned apartments.

■ Therefore, it would be necessary to amend **Article 94⁸⁵ of the Law on Housing and Building Maintenance** to include the non-profit lease of apartments under cooperative ownership.

■ Related to this, non-profit housing cooperatives should be legally recognized in the **Coop Law** as a special form of housing cooperatives that provide non-profit housing support to their members.

⁸⁴ For a comparative overview of such measures in certain other countries, see Annex 3.

⁸⁵ The wording of the amended Article 94 may look as follows: “Leasing of an apartment under the terms of a non-profit lease shall be the leasing of property under public or cooperative ownership, for which the tenant pays non-profit rent, under the conditions and in the manner specified in the non-profit lease contract, in accordance with the provisions of this Law.”

2) Amendments to tax regulations need to annul the severe disadvantage faced by cooperatives based on mutual home ownership, in comparison to individual home ownership. To resolve this, the following directions need to be taken:

a) It is necessary to introduce a tax exemption in the **Law on Corporate Income Tax** for housing coops if they are providing leases only to their members. This could be a legislative intervention in Article 1 of the Law, stipulating that cooperatives which provide non-profit services only to their members are not taxpayers. Alternatively, this could be formulated as a tax exemption of revenues related to non-profit housing support. Furthermore, the **Rulebook on Tax Balance** should prescribe the exclusion of revenues related to non-profit housing support from the tax base. That way, revenues related to non-profit rent wouldn't be taxed, thus avoiding this cost and providing more freedom in designing the financing structure of MHO.

b) Amending the **VAT Law**, by introducing specific tax relief related to the sale of goods and services to non-profit housing organizations, if such services and materials are used for constructing buildings and apartments that are subject to housing support. That way housing support would be VAT exempted with similar relief already available to buyers of their first apartment.

c) The **Law on Property Tax** should provide a tax incentive for apartments and buildings owned by a non-profit housing organization and used for providing housing support. This can be introduced in the form of tax credit or tax exemption. That way the taxing of apartments used for housing support should have at least the same tax treatment as the taxing of apartments under individual ownership.

d) Changes of existing **tax policies related to personal income tax** might be very significant in the case of the introduction of the taxing of synthetic income of individuals (integral taxing of income from all sources) instead of current cedular taxing. Namely, taxing of synthetic income would allow a reduction of income for housing costs (or part of it), thus lowering overall housing cost.

An important note should be highlighted: The **Law on State Aid Control**⁸⁶ stipulates that *“State aid granted in any form that distorts or threatens to distort competition on the market, unless otherwise provided by this law or contrary to international agreements concluded, shall not be permitted”*. The described tax measures have the potential to distort competition, as they favour housing cooperatives compared to other legal entities, and compared to the regular housing industry. Therefore, they must be assessed in respect of the Law on State Aid Control. Granting state aid of a social nature to individual consumers is permitted without discrimination in relation

⁸⁶ Official Gazette RS No. 51/2009.

to the origin of goods or products that constitute that particular aid, or state aid granted in order to eliminate damage caused by natural disasters or other emergencies. While the tax measures described cannot be regarded as individual state aid (unlike social housing), it is possible to defend it as allowed state aid in order to carry out projects of special importance for the Republic of Serbia, if housing cooperatives were to be recognized as such.

Countries that recognize the significance of housing cooperatives in addressing affordability and accessibility of housing also developed a variety of tax reliefs and measures for direct support to coops. For instance, Germany exempts housing cooperatives from corporate income tax altogether. A list of other models of legal support to housing coops practiced elsewhere are presented in Annex 3.

SUMMARY OF CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

Housing cooperatives in Serbia are under-regulated if compared to contemporary frameworks implemented within the broader European context. Albeit the law prescribes the principle of special protection for coops, encouragement by economic and housing policy, including special incentives and financing, such measures are not provided. This obstructs the successful introduction of novel cooperatives, and threatens innovative solutions to the urgent issue of housing in Serbia.

In order to facilitate the development of non-profit cooperative housing and MHO, existing legislation should be refined in two ways: (1) housing cooperatives should be legally recognized as providers of housing support, and (2) tax policies should be alleviated so that housing coop members (who live in a coop building) do not pay higher taxes than individual homeowners, by (partially) exempting rent paid to housing cooperatives from income tax, VAT exemption for materials and services sold to housing cooperatives for housing support purposes, and property tax incentives for apartments used for housing support.

ANNEX 1: LEGAL REGULATION OF COOPERATIVES IN SERBIA IN THE COOP LAW – DETAILED REVIEW

A housing cooperative is a type of cooperative, defined by its predominant activity (which must be defined as such in the Agreement on Association and registered in the Business Register). According to the Law on Cooperatives, housing cooperatives, as investors and contractors, organize the construction and maintenance, building and maintenance of homes, apartment buildings, garages and office space for members of the cooperative, by engaging the resources and labour of its members and other individuals and legal entities. The engagement of the resources and personal labour of the members of the cooperative is governed by an individual agreement between the housing cooperative and its members, in accordance with applicable legislation and cooperative rules, and other relevant regulations.⁸⁷

A housing cooperative, like all other cooperatives, is a legal entity, organized by at least 5 members – individuals (natural persons). It is prohibited for legal entities to be members of a cooperative in Serbia. A cooperative cannot be transformed into a company or any other legal form, nor can it be merged with or acquired by another legal entity which is not a cooperative. However, a cooperative can be the founder or member of a company or other legal entity.⁸⁸

All cooperatives must operate according to cooperative values and principles set out in the Law on Cooperatives. Cooperative values include: self-help, self-responsibility, democracy, equality and solidarity. Cooperative principles are: voluntary and open membership, control by cooperative members (one member-one vote principle), economic participation of cooperative members, autonomy and independence of a cooperative, education, training and information, collaboration with other cooperatives, concern for the community. Cooperatives are subject to a cooperative audit, which is the control of compliance with the Law on Cooperatives, cooperative principles and cooperative values. A cooperative audit can be initiated upon a request by at least 30% of the cooperative members, cooperative bodies, the competent cooperative union, the competent ministry and cooperative creditors.⁸⁹

The main characteristics and regulations applicable to all cooperatives, including housing cooperatives and MHO if developed in Serbia according to the Law on Cooperatives, are described below:

⁸⁷ Article 11 of the Law on Cooperatives.

⁸⁸ Article 5 of the Law on Cooperatives.

⁸⁹ Article 5 and 80-82 of the Law on Cooperatives

Establishing a cooperative (Article 14-19)

A cooperative is incorporated at a *Founding meeting of members*, concluding an Agreement on Association, adopting the Cooperative Rules and electing the cooperative's bodies. An *Agreement on Association* is the founding act, concluded in written form, with notarized signatures of members-founders of the cooperative. It contains basic information about the cooperative and cooperative members, its predominant activity, director and representatives, whether it operates with share capital or a membership fee, share capital issues and other important founding issues.

Cooperative Rules are a general act on cooperative management and internal organization. Among other things, they regulate the basic business policy of the cooperative, rights and obligations of cooperative members, how to become a member and termination of their status, increase and decrease of share capital, the minimum value of share capital and membership fee, return of contributions upon the termination of member status, structure and competencies of cooperative bodies and election procedures, distribution of profits and loss coverage, and other important issues for the management and operation of the cooperative.

Cooperative bodies (Article 33-52)

A cooperative operates based on the principle "one member-one vote", and members participate in the management of the cooperative together.

The cooperative bodies are the following: General Assembly, Board of Directors, Supervisory Board and Director. Collective bodies make valid decisions if half of all members of the body are present, and the majority of the present members voted for the decision. A majority vote is needed for decisions on status changes, sale of real property and changes to the Agreement of Association and Cooperative Rules, while a two-thirds vote is necessary to initiate the liquidation procedure.

The *General Assembly* decides on the Agreement on Association, Cooperative Rules, predominant activity, participation in other legal entities, status changes, establishing various funds, increase and decrease of share capital, business policy, and it adopts financial reports, decides on the distribution of profit and loss coverage, makes investment decisions, appoints and dismisses the Director and members of the Board of Directors and Supervisory Board and President of the General Assembly (from among the cooperative members), initiates the liquidation procedure, disposes of assets and other issues, according to positive legislation.

The *Board of Directors* must have at least three members, elected from among cooperative members. It proposes and implements business policy,

the operating and financial plan, proposes business reports and the adoption of financial reports, proposes the distribution of profit and loss coverage to the General Assembly, prepares draft decisions for the General Assembly and implements its decisions, proposes decisions on investment, disposal of assets, and the election of Director.

Note: In case of housing cooperatives, the Board of Directors not only prepares, but also makes investment decisions instead of the General Assembly.

A *Supervisory Board* must have at least three members, elected from among cooperative members. It supervises the work of the Board of Directors and Director, reviews financial and other reports, controls the compliance of cooperative activities with the law and Cooperative Rules, reports to the General Assembly, etc.

The Board of Directors and Director are obliged to provide all information and access to documentation of the cooperative. The Supervisory Board shall submit a request to convene a session of the General Assembly, if it determines that the interests of the members have been affected, and particularly if it finds irregularities in the activities of the cooperative or serious violation of laws, rules or decisions of the General Assembly.

The *Director* need not be a member of the cooperative. He/she represents the cooperative, organizes business activities, ensures legality, prepares working plans, reports, executes decisions of the General Assembly, Board of Directors and Supervisory Board, and has other duties.

Members of the Board of Directors, Supervisory Board and the Director are obliged to perform their activities with due diligence in accordance with best cooperative interests, and they are responsible for damage caused to the cooperative, in accordance with the law.

Prohibition of competition – Members of cooperative bodies and employees may not be members, employees, or managing activities of other cooperatives with the same or similar activities, i.e. may not have more than 20% ownership in a company or other legal entity performing the same or similar activity as the cooperative.

Share capital and membership fee (Article 20-22)

Cooperatives are founded and operate either with share capital or a membership fee.

Share capital is formed from the contributions (monetary or in-kind, expressed in cash equivalent) of cooperative members. The minimum share capital is RSD 100. The minimum individual contribution is set by the

Cooperative Rules, along with the method and time of payment or introduction for a contribution in kind. One member may only have one contribution in a cooperative, although contributions don't have to be equal. Member contribution cannot be transferred by legal transaction, nor can they be pledged, given as security or subject to enforcement against the member's obligations, nor can they be returned as long as the member holds that status.

Share capital may be increased, if decided by the General Assembly, through the following: contributions of new cooperative members, increasing the contributions of existing cooperative members, conversion of non-allocated profit or reserves available for this purpose, contributions by cooperative members. It can also be reduced by decision of the General Assembly, but not below the legal threshold – RSD 100. The determination and payment of contributions in the event of the termination of member status are set in the Cooperative Rules.

A *membership fee* shall be paid if a cooperative is founded without the contributions of cooperative members. The amount of membership fee shall be determined by Cooperative Rules in an equal amount for all the founders, as well as for cooperative members who join the cooperative after its establishment. A membership fee is not refundable upon the termination of the status of a cooperative member. The minimum membership fee is set in the Cooperative Rules, along with the procedure for increasing or decreasing the membership fee.

Cooperative members (Article 23-32)

The status of a cooperative member is acquired by founding or joining cooperative. All members have the same status. A new member may join the cooperative if his/her request is accepted and he/she signs a statement of accession (it contains, among other things, the acceptance of rights, obligations and responsibilities of cooperative members established by the Cooperative Rules, Agreement on Accession, statement he/she is familiar with the obligations of the cooperative incurred before the signing of the statement of accession, etc.).

Member status is terminated in case of a member's withdrawal, removal, death, the termination of the cooperative, or other reasons as established in the Cooperative Rules in accordance with this Law. In case of withdrawal, a notice period of up to six months may be set. After the termination of member status, the former member remains liable for obligations incurred to the cooperative. A member shall be removed if he/she endangers the common interest of other members intentionally or through gross

negligence, if he/she does not ensure business cooperation with the cooperative in the period specified by the cooperative rules, as well as for other reasons prescribed by this Law and the Cooperative Rules.

Prior to termination of member status, the member shall settle all his/her obligations to the cooperative, within the time and in the manner set out in the Cooperative Rules. If the member's or cooperative's obligations are due upon termination of member status, they are obliged to fulfil them regardless of whether the status of the cooperative member has terminated. Upon termination of member status, the former member or his/her legal successor or heir are entitled to payment or reimbursement of contributions, in the manner and within the time limits set out in the Cooperative Rules. Contributions will not be returned until the termination of the former member's liabilities to the cooperative. Payment will be in cash, unless another form is specified in the Cooperative Rules, and upon written agreement with the former member. The cooperative shall pay non-allocated profits to former members no later than six months after the expiry of the financial year in which the cooperative member lost this status (the right to partake in the profits exists only during member status).

The cooperative is obliged to keep a book of members that registers, among other things, the value and kind of each member's contribution, the manner of payment of the membership fee, the date and reason for termination of member status, the date of payment of returned contributions. Members, cooperative creditors, and other authorized persons have the right to review the book of members.

Cooperative assets and business (Article 53-60)

Cooperative assets shall be formed from the members' contributions or membership fees, generated from business activities, and from other sources. Cooperative assets are under cooperative ownership, and the cooperative shall manage, use and dispose of its assets in accordance with this Law and Cooperative rules. In case of sale of real estate, received payments cannot be distributed to members or employees on the basis of membership, contributions or employment.

The cooperative uses cooperative assets, and may use the work and assets of its members or other legal entities and individuals on the basis of a special agreement. The cooperative may conduct activities with and for non-members, in the manner and to the extent that does not bring into question cooperative principles and objectives, in accordance with a separately concluded agreement and the Cooperative Rules.

The cooperative is liable for its obligations with all its assets, while members are liable up to the amount of each contribution (except in case of misuse of the cooperative for illegal or deceptive activities, in which case they are liable with all their assets).

The General Assembly may, although it is not obligatory, establish an investment fund or reserve fund to cover losses and for payment of returned contributions, as well as for other purposes. The General Assembly also decides on the allocation of profit, but it must be allocated in the following order – to cover losses from previous years, for established funds, for payment of profit or allocation to contributions of members (except for a cooperative operating with membership fees). Non-allocated profit shall be transferred into the next year or used to promote the cooperative.

Losses shall be covered from non-allocated profit from previous years, or if there is none, from the reserve fund or any other fund if formed, or by reducing the share capital.

Termination of the cooperative (Article 61-66)

The cooperative shall be terminated due to liquidation or forced liquidation, bankruptcy proceeding or status changes.

Liquidation shall be initiated by decision of the General Assembly, approved by two thirds of the cooperative members. However, if at least five members decide not to terminate the cooperative, those members that voted for the termination of the cooperative shall be considered to have left the cooperative. The surplus of cooperative assets remained after liquidation will be subject to the provisions of the Bankruptcy Law related to the surplus of the bankruptcy estate.

Forced liquidation shall be initiated upon court decision, if it has been prohibited to perform activities because it does not meet the requirements for performing activities, if the number of members or share capital fall below the statutory minimum, or if it is not organized according to this Law and cooperative principles and rules that must be confirmed by a competent audit association.

Status changes (merging, division, separation or consolidation) are permitted only if cooperatives participate in them or arise from them.

Complex cooperative and cooperative union (Article 67-68)

A *complex cooperative* is a legal entity that is a special form of organization of two or more cooperatives, which performs activities transferred to it by

its founders, in order to achieve the economic, social and cultural interests of the cooperatives.

A *Cooperative union* is an independent organization, formed by cooperatives and other cooperative unions, with the purpose of realization, harmonization, promotion, business connections, protecting and representing the common interests of the cooperatives and their members.

ANNEX 2: ROADMAP TEMPLATE FOR THE POSSIBLE IMPLEMENTATION OF THE MHO MODEL IN SERBIA

Considering the above specifics and risks of MHO reviewed in the Serbian context, the possible MHO housing coop may have the following characteristics and steps of development:

1. Establishment of a cooperative

- Members register the coop and pay (basic) contributions. Donations are welcome. Contributions are not subject to taxation in Serbia, nor do they increase the income tax base.

2. Coop Rules

- The Coop Rules need to be adopted by members as they regulate the way the future cooperative works.
- Coop Rules should follow the non-profit principle, thus providing that future members' contributions and rent serve only to cover repayment of the bank loan, as well as costs related to utilities and maintenance provided by the Coop, and for a Solidarity Fund.
- Coop Rules should determine that in case a member exits, the Coop has a six-month period to return the paid contribution.
- Coop Rules also determine how members qualify for apartment rent.

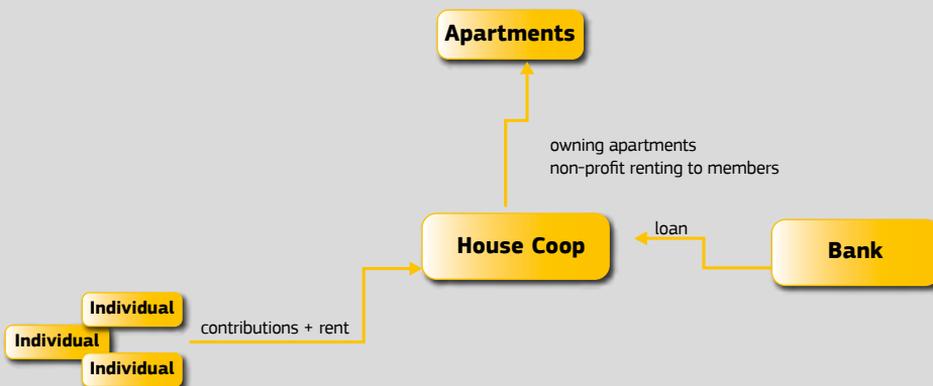


Image A2.1. Possible relations in an MHO model in Serbia

3. The financial model

- The construction and land acquisition are planned to be financed by a bank or other loan.
- The cost value of the apartments is generally equal to the cost of land acquisition and construction of the apartments, financed from a loan.
- Initial contributions (and donations) serve as a deposit for a bank loan (mortgage), thus enabling the coop to acquire land and start the construction of apartments.
- Each initial contribution to the Coop share capital is determined in relation to the proportional cost value of the apartment of the future tenant-coop member (10-20% deposit).
- Assuming that the mortgage is for 30 years (the period doesn't matter, the same principle applies), members will provide their initial total contribution to the share capital equal to one fifth of the mortgage to be paid in 60 monthly instalments, each member's contribution proportional to the share value of his/her apartment in the whole building.
- Every five years the General Assembly will decide to increase the share capital from the contributions of new members, based on the same principles.
- Since it will be the cooperative that will build the building and be the loan holder, the apartments are owned by the coop, while members lease them.
- The rent amount will be set to cover the cost of utilities and maintenance provided by the coop.
- The rent that tenants pay for the lease of the apartments is exempt from VAT taxation. However, if the fees for the services of building maintenance, heating and similar are paid separately, they are subject to VAT at the rate of 20% (10% for heating), if the coop is a VAT taxpayer (there is an obligation to register if the turnover exceeds RSD 8,000,000 within 12 months).
- The rent represents the income of the coop, taxable at a rate of 15%. Interest paid to banks and lenders will be recognized as expenses and deducted from the taxable income base. Furthermore, recognized tax expenses include the costs of maintaining the building and costs for providing other housing services, as well as expenses related to the depreciation of apartments.⁹⁰

90 As already mentioned, 2.5% per annum, which represents a decrease in the income tax of approximately 0.375% of real estate value per year.

The model described would fulfil the following requirements:

- It is a non-profit – contributions and rent are set only to cover repayment of loans and the cost of the services provided by the coop.
- The coop itself provides considerable prevention of speculation – apartments are owned by the coop, a majority of all members is needed to sell them, and even then, the generated revenue cannot be allocated to members, upon member exit only the contributions already paid will be returned (no profit on the increase of asset value).
- Instead of rent, a larger part of the members' payments are contributions refundable upon exit, thus saving members equity and lowering overall fiscal costs (explained in Chapter 5).

To replicate and scale up the MHO cooperative model, the next step could be the implementation of an interlocking model (as in the Mietshäuser Syndikat, Chapter 4.4.1). Its purpose would be to further prevent speculation with cooperative properties and create an integrated solidarity fund between a number of housing coops.



ANNEX 3: LEGAL SUPPORT MODELS FOR HOUSING COOPERATIVES IN OTHER COUNTRIES

1. The Austrian model, in addition to various forms of governmental subsidy, provides a form of grants or cheap loans that cover from 20% to 60% of the cost of housing construction, and tax exemption from corporate income taxes for housing cooperatives (regulated rent to cover only costs of construction and maintenance of buildings, cooperatives are not allowed to make a profit except on the basis of interest on the cooperative's own funds).
2. Canada supports the financing of housing cooperatives through the State Mortgage and Housing Corporation. As a condition, 15-20% of the apartments are usually rented to socially disadvantaged categories, whereby the rent is calculated in proportion to their income, and then the state refunds the amount up to the full rental price.
3. Germany exempts housing cooperatives from corporate tax.
4. Hungary also provides corporate tax exemption provided that the cooperative's income does not exceed HUF 10,000,000. VAT is not paid against so-called internal services of the cooperatives (services aimed at maintaining common premises, common services for all cooperatives, etc.).

Comment: The so-called "cedular" system is still present in Serbia, i.e. special taxation of each individual source of income. In most other countries, the total – synthetic income of an individual is taxed. Such a system allows for numerous tax reliefs and incentives, most often on the basis of rent or instalments for repayment of housing loans, which gives the state tax instruments to (de)stimulate such activities of citizens, which currently do not exist in Serbia.

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