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## TENLAW: Tenancy Law and Housing Policy in Multi-level Europe

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### **Intra-team Comparison Report for ESTONIA, LATVIA, LITHUANIA**

Author: Ave Hussar

Team Leader: prof. Irene Kull

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**NOTICE.** This comparative report discusses various aspects of housing policies and legal framework of rental market in Baltic States. Substantial part of this report is based on the national reports available at <http://www.tenlaw.uni-bremen.de/reports.html>. For full list of sources please see respective national report.

# 1. THE CURRENT HOUSING SITUATION

## 1.1. General Features

### 1.1.1. Historical evolution of the national housing situation and housing policy

ESTONIA, LATVIA and LITHUANIA share **common inheritance of Soviet regime** (1940-1991). After WW II, the former housing policy based on private ownership of land and housing was largely replaced by **state-ownership of land and housing**.

Only dwellings that did not exceed certain limits of living space<sup>1</sup> were left as private property. Rented<sup>2</sup> dwellings belonging to enterprises, the state or other public entities became the dominant tenure types in the urban centres. There were also housing associations (co-operatives) that provided right to use a dwelling against certain amount of contribution.<sup>3</sup> All aspects of housing and urban policy were subordinated to central planning, since the Constitution comprised the right to housing<sup>4</sup>. Housing law was understood as legal rules about management, operation and repair of the housing fund, registration of individuals whose housing conditions have to be improved, distribution and provision of residential premises, as well as rental relations, participation in housing construction cooperatives and property rights on a single family living house.<sup>5</sup>

**Immigration** from rural areas to urban areas, as well as immigration from other areas of the Soviet Union resulted in **expansion of the urban population**.<sup>6</sup> At the same time, period of 1950-1990 can be characterized as the period of **active residential construction** (mainly multi-stored apartment houses) in all three countries.<sup>7</sup>

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<sup>1</sup> The individuals could have only one house as their private ownership, which could be not bigger than 130 sq/m area. Lithuanian Report, 4.

<sup>2</sup> Once the dwelling was allotted to a given tenant, public housing tenants enjoyed almost unlimited occupancy rights for their dwellings comparable to “owning” the dwelling: open-term leases, the right to inherit or transfer to relatives, the right to carry out maintenance work, etc. In fact, such ‘personal use’ became an institution separate from that of rental tenure. Cf. Kährik & Kõre (2013), 164-165, Lux et al (2012), 143.

<sup>3</sup> Cooperative housing was often organised via employers, being partly subsidised. Maintenance, however, was mainly the responsibility of members of the cooperative. approx. E.g. in Estonia, 5% of the total housing stock in 2000 belonged to cooperative housing sector.

<sup>4</sup> SSR Constitution of 1978 (unlike the 1922 constitution), provided the right to housing. This right included fair distribution under the state supervision of residential dwellings according to the program of building of comfortable living residences, a low-rent payment price and payment for rent and utilities. Еран, П.П. (ed.) Советская Латвия. Рига: Главная редакция энциклопедий, 1985, 27, 461 through Latvian Report, 55.

<sup>5</sup> Юридический Энциклопедический словарь. Главный редактор А.Я. Сухарев. Москва: Советская Энциклопедия, 1984, 96-98, through Latvian Report, 61.

<sup>6</sup> E.g., in Estonia, by 1989 the share of urban population was already 71%. Statistics Estonia, Population, 1881, 1897, 1922, 1934, 1959, 1970, 1979, 1989 (urban population, %) <<http://www.stat.ee/26385>>, (last visited 15 Dec. 2013);

<sup>7</sup> E.g., in Estonia, residential construction peaked between 1960 and 1990, when an average of 13,000 new dwellings (approx. 700,000–800,000 m<sup>2</sup>) were built annually. For comparison, in 2013 only 2,079 new dwellings were registered.

Construction was the primary method for solving the housing shortage in that period and only little attention was paid to renovation and maintenance of existing dwellings. Also, the building quality was quite low and no professional maintenance was carried out during 50 years of Soviet regime. As a result, housing stock in all Baltic States was in need of a large-scale comprehensive energy efficient renovation.

**The period after regaining independency in 1991** signifies a radical turning point in the housing policies in the Baltics. More particularly, over the last 25 years, the availability of residential housing in Baltics has been influenced by wide-range **privatization**<sup>8</sup>, **restitution**<sup>9</sup> and general **liberalization** of housing market.

As a result, the housing market in Baltics is commonly characterized by a **high rate of private ownership** of housing stock (up to 97 % of the housing stock in ESTONIA and LITHUANIA) and **high rate of owner-occupancy**.<sup>10</sup> In LATVIA, as a particularity, the split of property rights<sup>11</sup> and the compulsory lease<sup>12</sup> which is characteristic for the current rental market are the main problems which followed denationalisation and privatisation.

As to the **migration** processes, firstly, high positive net migration rate during the period of Soviet regime should be emphasized. Second significant turn in migration was

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<sup>8</sup> In Estonia, privatization of public housing stock was launched by the Privatization of Dwellings Act and Privatization Act adopted in 1993. All adult residents had a right to a specific amount of National Capital Bonds (rahvakapitali obligatsioonid, RKO) based on their years of active employment and service to the economy. Public tenants, except tenants of dwellings subject to restitution, were entitled to privatise their dwellings at a calculated price using RKO as privatization vouchers until December 1st 1994. Cf. Purju, The Political Economy of Privatisation In Estonia. Centre for Economic Reform and Transformation, 32. <<http://www.sml.hw.ac.uk/cert-repec/wpa/1996/dp9602.pdf>> (last visited 16 Dec. 2013).

<sup>9</sup> E.g. in Latvia (as also in other Baltic States) tenants of the denationalized houses could not privatize the apartments, therefore the restriction of rental payments was one of the mechanisms, which ensured balance between the interests of the tenants and landlords and reached a socially fair aim. The restrictions of rental payment should be temporary, but only in the year 2007 the Constitutional Court declared the said lease restrictions as unconfirmable with the Constitution and invalid (Judgement of the Constitutional Court of the Republic of Latvia of 8 March 2006, Case No. 2005-16-01, <[www.satv.tiesa.gov.lv](http://www.satv.tiesa.gov.lv)> (last visited 2 Nov. 2014).

<sup>10</sup> For further data, see section 1.1.2 below.

<sup>11</sup> The split property means that there are at least two different owners of an immovable consisting of a (living or non-residential) building and land plot who are not co-owners, since one of them owns the building, another one – the land plot. The law concerning denationalisation or restitution of land plots offered an opportunity to receive compensation or an equal land plot unit if during the Soviet time a building or several buildings has been constructed, thus the person applying for restitution of a land plot could choose if it wishes to acquire the particular land plot owned before confiscation or denationalisation by the Soviet authorities. Nevertheless, there were owners or heirs who chose to acquire the land plot together with an “encumbrance” - residential house on it. In practice, it means that tenants have to compensate the immovable tax which shall be paid for the land plot and they shall also pay compulsory lease payments for using the land plot in addition to rent and payment for utilities as well. Latvian Report, 3, 7, 18.

<sup>12</sup> Owners of a building (or buildings) and a land plot are forced to enter lease contracts with owners of land on which buildings are situated. Judgement of the Constitutional Court of the Republic of Latvia of 13 February 2009, Case No. 2008-34-01, <[www.satv.tiesa.gov.lv](http://www.satv.tiesa.gov.lv)> (last visited 2 September 2013); Latvian Report, 17.

marked by the beginning of 1990s, following the collapse of the Soviet Union, when migration from the Baltic States to the Russian Federation from 1989 to 1996 totalled 215,000 persons<sup>13</sup>. Next waves of emigration were witnessed after joining EU, and then as a reaction to the economic crisis of 2007.<sup>14</sup> In 2013, the largest decreases due to natural change and net migration among EU member states were observed in LATVIA (-4.0‰ and -7.1‰) and LITHUANIA (-3.9‰ and -5.7‰).<sup>15</sup>

**The number of population in Baltic states has decreased by 13,4 % from 2001 to 2014 (from total 7,228 thousand inhabitants to 6,259 thousand inhabitants).**<sup>16</sup>

Further decline has been projected.<sup>17</sup> Due to the trend towards smaller households, the number of households is expected to decrease relatively less than the size of the population.

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<sup>13</sup> Romaniszyn, K. "Current migration in central and eastern Europe: peculiar or integrating into European migration system?" Institute for Social Studies, University of Warsaw, (Warsaw, 1997); Lithuanian Report, 5.

<sup>14</sup> E.g. after Latvia's accession to the European Union, emigration increased, however, before the crisis migration sank again and immigration grew due to wage increase: 9.7% (2005), 15.6% (2006), 19.9% (2007) and 6.2% (2008). In the year 2008 emigration started to grow again and decreased only recently, thus, if in 2008 approx. 1.1 million people between 15 and 64 years lived in Latvia, in 2013 the number decreased for approx. 10.1% or 111 000 inhabitants. The reason of emigration was a high level of unemployment when people were forced to look for jobs in other countries. In the group of young people (23-31 years old) emigration is the highest at the moment. Reduction of this social group amounts to more than 14%. The most popular destination is the United Kingdom and Ireland. Central statistical bureau of Latvia: <<http://www.csb.gov.lv>> (last visited 2 September 2013); Housing Europe Review 2012. <[http://www.housingeurope.eu/www.housingeurope.eu/uploads/file/HER%202012%20EN%20web2\\_1.pdf](http://www.housingeurope.eu/www.housingeurope.eu/uploads/file/HER%202012%20EN%20web2_1.pdf)> (last visited 2 March 2014). In general, starting from 2000 13% or 307000 of population left Latvia because of low salaries, opening of EU labour markets to Latvian workers and a sudden increase in unemployment. The Latvian government tried to eliminate the negative consequences working out the re-emigration plan and focusing on young families with kinds and, specialist necessary for the Latvian internal market and young people studying abroad. Latvian Report, 12.

<sup>15</sup> Respective numbers for Estonia: -1,3 ‰ and -2,0‰; EU28: 1,5 and 1,3. The crude rate is calculated as the ratio of the number of events to the average population in a given year. For easier presentation, it is multiplied by 1 000; the result is therefore expressed per 1 000 population. <[http://epp.eurostat.ec.europa.eu/cache/ITY\\_PUBLIC/3-10072014-BP/EN/3-10072014-BP-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/3-10072014-BP/EN/3-10072014-BP-EN.PDF)> (last visited 27 Nov. 2014).

<sup>16</sup> Statistics Estonia <[www.stat.ee](http://www.stat.ee)> (last visited 29 Nov. 2014); Central statistical bureau of Latvia <[http://data.csb.gov.lv/pxweb/en/Sociala/Sociala\\_ikgad\\_iedz\\_iedzskaits/IS0020.px/table/tableViewLayout1/?rxid=562c2205-ba57-4130-b63a-6991f49ab6fe](http://data.csb.gov.lv/pxweb/en/Sociala/Sociala_ikgad_iedz_iedzskaits/IS0020.px/table/tableViewLayout1/?rxid=562c2205-ba57-4130-b63a-6991f49ab6fe)> (last visited 29 Nov. 2014); <[http://epp.eurostat.ec.europa.eu/portal/page/portal/pgp\\_ess/news/ess\\_news\\_detail?id=157815786&pg\\_id=2737&cc=LT\\_LITHUANIA](http://epp.eurostat.ec.europa.eu/portal/page/portal/pgp_ess/news/ess_news_detail?id=157815786&pg_id=2737&cc=LT_LITHUANIA)> (last visited 29 Nov. 2014).

<sup>17</sup> By 2030 EE - 1.2 million; LV – 1,7 million; LT - 2,6 million, <<http://www.euromonitor.com/countries-and-consumers>> (last visited 27 Nov. 2014).

### 1.1.2. Current situation

In the Baltics, the **overall offer of dwellings is sufficient** and over the two last decades the housing conditions have been improved steadily.<sup>18</sup> Yet, the access to the housing market is **problematic mainly in bigger cities**.<sup>19</sup> Young households encounter housing problems more frequently than other groups who mostly participated in housing privatization and have now become owners of their housing. Also, there is lack of housing options for **families of lower income**, as residualized social housing sector run by municipalities does not cover the demand for low-cost or specially accommodated (e.g. for persons with disability) housing.<sup>20</sup> In practice, it has been observed that it is more complicated to find suitable place to live in Tallinn than in Vilnius or Riga.<sup>21</sup>

The main dwellings' characteristics in Baltic States are presented in

Table 1.

**Table 1 Current housing situation in Baltic States.**

	EE	LV	LT
No of conventional dwellings (thousands, 2011) <sup>22</sup>	649,7	1018,5	1298 <sup>23</sup>
Conventional dwellings per 1000 inh (2011)	502	492	441
Useful floor area of dwellings per capita, in sq m	30,1	27,2	29,5 <sup>24</sup>
Vacant <sup>25</sup> dwellings, %	14,4	20	14,4
Private ownership, % of total stock <sup>26</sup>	96	94	98
Housolds having home-ownership, % of all households <sup>27</sup>	79	67	91

<sup>18</sup> E.g. in Estonia, since 2000, the number of dwellings has increased by 5.2%. The number of dwellings counts for 502 dwellings per 1000 inhabitants (compared to 453 in 2000). The average area of dwellings per inhabitant had increased from 24 m<sup>2</sup> in 2000 to 30.5 m<sup>2</sup> by 2011. At the same time, the number of permanent residents has decreased by more than 5% compared to 2000, but the number of households has grown by 3% (size of the average household decreased from 2,33 persons to 2,13 persons). Estonian Report, 15, 29.

<sup>19</sup> Marika Kivilaid, Mihkel Servinski. Urban Audit. 4/13. Quarterly Bulletin of Statistics Estonia, <<http://www.stat.ee/65375>> (last visited 29 Nov. 2014), 78.

<sup>20</sup> National Statistics, Census 2011; <<http://osp.stat.gov.lt/services-portlet/pub-edition-file?id=2348>> , last visited 29 Nov. 2014; Statistical Yearbook of Lithuania 2014 Statistics Lithuania 2014, <<http://osp.stat.gov.lt/services-portlet/pub-edition-file?id=2910>>, last visited 29 Nov. 2014.

<sup>21</sup> Answers to the statement "It is easy to find good housing at a reasonable price in [city name]" in EU capitals, 2012 Marika Kivilaid, Mihkel Servinski. Urban Audit. 4/13. Quarterly Bulletin of Statistics Estonia, <<http://www.stat.ee/65375>> (last visited 29 Nov. 2014), 78.

<sup>22</sup> National Statistics, Population and Housing Census 2011.

<sup>23</sup> (2013) Statistical Yearbook of Lithuania 2014 Statistics Lithuania 2014, <<http://osp.stat.gov.lt/services-portlet/pub-edition-file?id=2910>> (last visited 29 Nov. 2014).

<sup>24</sup> Ibid.

<sup>25</sup> Dwellings without permanent resident, possibly reserved for secondary or seasonal residence.

<sup>26</sup> In Latvia ( Census 2011): 86.1% of all housing stock belongs to natural persons, 7.7% to legal persons, 7.2% to persons with different status, 1.5% to local municipalities, 0.1% to the State; In Lithuania (Census 2011): 96.6% of conventional dwellings were owned by natural persons, 1.4% by the State or municipalities, 0.3% by private legal persons; 0.5% by other entities (joint ownership of natural and legal persons etc.); Estonia (Census 2011): 96 % private, 4% public (state – 1 %, local gov – 3 %).

<sup>27</sup> National Statistics, Population and Housing Census 2011.

New constructions per 1000 inhabitants (2013)	1,6	1,1	2,0
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LITHUANIA has a comparatively disadvantaged position in terms of number of dwellings per capita, but relatively intensive construction activity creates basis for further improvement. At the same time, LITHUANIA holds highest private ownership rate: as of 31 December 2013, private property accounted for 97.9 % of the total stock of dwellings, State and municipal property only 2.1 %.<sup>28</sup>

By statistics, there is an oversupply of dwellings, although the situation of housing demand and supply varies between regions and municipalities. For example, the total share of unoccupied dwellings<sup>29</sup> in ESTONIA is 14% (in Tallinn 9%, in urban areas 11%, rural areas 21%)<sup>30</sup>. There are no specific measures foreseen to induce landowners to offer vacant dwellings for rent in any of the three countries under review.

As to the **housing quality**, ESTONIA has relative advantage, but in general, the housing quality in Baltics is below EU average. Randomly chosen quality parameters in **Table 2** show that housing conditions in Estonia are better than in other Baltic States.

**Table 2 Type of dwelling and housing quality.**

	EE	LV	LT	EU28
Type of dwelling <sup>31</sup>				
Proportion of population living in flat, (2012), %	65,1	64,4	56,9	41,3
Average size of the dwelling sq m (2012)	74,2	69,1	68,1	102,3
Average size of the dwelling sq m (2012), tenant at market price	53,2	48,3	45,4	78,6
Housing quality <sup>32</sup>				
Overcrowding rate <sup>33</sup> (2012)	14	36,6	19	17,0
Severe housing deprivation rate <sup>34</sup> (2012)	4,7	16,4	7,1	5,1
Households having indoor flushing toilet, %	88 <sup>35</sup>	85 <sup>36</sup>	81 <sup>37</sup>	97 <sup>38</sup>

<sup>28</sup> Statistical Yearbook of Lithuania 2014 Statistics Lithuania 2014, <http://osp.stat.gov.lt/services-portlet/pub-edition-file?id=2910>, 219.

<sup>29</sup> However, the figure for unoccupied dwellings does not reflect the housing supply available for new occupants, since part of the units (approx. 25%) are occupied for some secondary use or may not be in suitable condition for habitation.

<sup>30</sup> Statistics Estonia database, [http://pub.stat.ee/px-web.2001/I\\_Databas/Population\\_census/PHC2011/02Dwellings/02Dwellings.asp](http://pub.stat.ee/px-web.2001/I_Databas/Population_census/PHC2011/02Dwellings/02Dwellings.asp) (last visited 5 Dec. 2013).

<sup>31</sup> Eurostat.

<sup>32</sup> Eurostat.

<sup>33</sup> Percentage of the population living in an overcrowded household, i.e the household does not have at its disposal a standard minimum number of rooms ( one room for the household; one room per couple in the household; one room for each single person aged 18 or more; one room per pair of single people of the same gender between 12 and 17 years of age; one room for each single person between 12 and 17 years of age and not included in the previous category; one room per pair of children under 12 years of age.

<sup>34</sup> Percentage of population living in the dwelling which is considered as overcrowded, while also exhibiting at least one of the housing deprivation measures. Housing deprivation is a measure of poor amenities and is calculated by referring to those households with a leaking roof, no bath/shower and no indoor toilet, or a dwelling considered too dark.

<sup>35</sup> Statistics Estonia database. <http://pub.stat.ee/px-web.2001/Dialog/statfile1.asp> (last visited 29 nov. 2014).

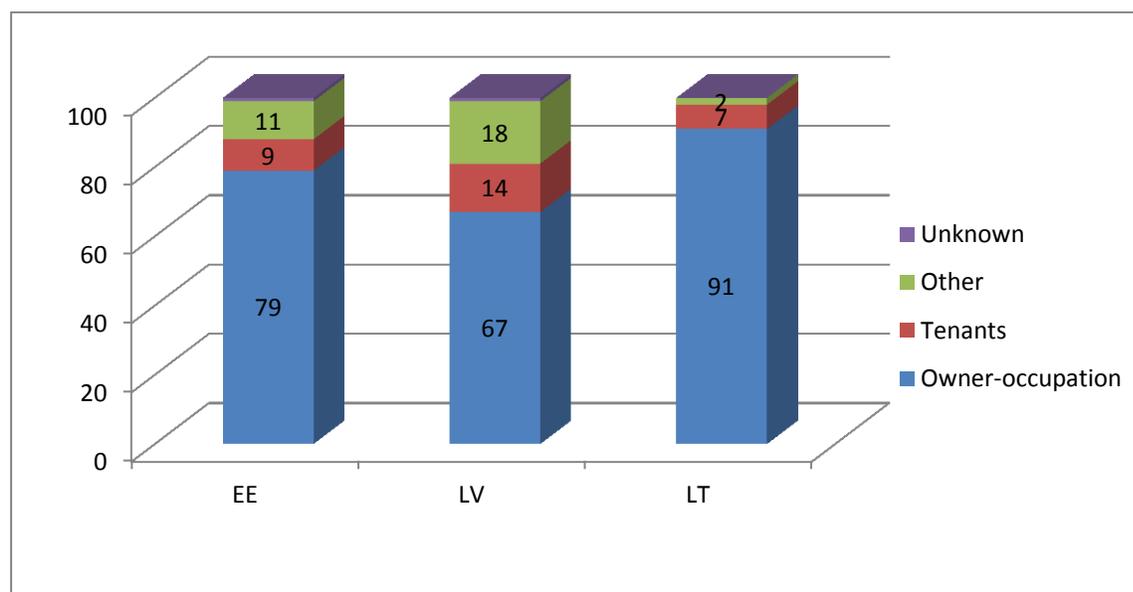
Households having bath or shower, %	87	82	82	97 <sup>39</sup>
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Relatively high proportion of the population lives in flats.<sup>40</sup> This is because of shared history of extensive multi-apartment housing construction in Soviet period.

As a result of wide-range privatization and restitution carried through in 1990s, **owner-occupancy is strongly prevailing tenure type** in all three countries.

**Figure 1** illustrates the structure of households by tenure status according to national censuses in 2011<sup>41</sup>.

**Figure 1 Households by tenure status (2011).**<sup>42</sup>



<sup>36</sup> Income and Living Conditions in Latvia 2013. EU-SILC SURVEY 2013, <<http://www.csb.gov.lv/en/dati/e-publikacijas/income-and-living-conditions-latvia-2013-40554.html>> (last visited 29 Nov. 2014).

<sup>37</sup> Statistical Yearbook of Lithuania 2014, 420. <<http://osp.stat.gov.lt/en/statistikos-leidiniu-katalogas?publication=2910>> (last visited 29 Nov. 2014).

<sup>38</sup> Source: SILC [ilc\_mdho03]

<[http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=ilc\\_mdho03&lang=en](http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=ilc_mdho03&lang=en)> (last visited 29 Nov. 2014).

<sup>39</sup> Source: SILC [ilc\_mdho02]

<[http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=ilc\\_mdho02&lang=en](http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=ilc_mdho02&lang=en)> (last visited 29 Nov. 2014).

<sup>40</sup> In 2012, the share of persons living in flats was highest among the EU Member States in Estonia (65.1 %), Spain (65.0 %) and Latvia (64.4 %). <[http://epp.eurostat.ec.europa.eu/statistics\\_explained/index.php/Housing\\_conditions#Type\\_of\\_dwelling\\_and\\_tenure\\_status](http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Housing_conditions#Type_of_dwelling_and_tenure_status)> (last visited 24 Nov. 2014).

<sup>42</sup> National Statistics, Census 2011; <<http://osp.stat.gov.lt/services-portlet/pub-edition-file?id=2348>> (last visited 29 Nov. 2014).

Statistical Yearbook of Lithuania 2014 Statistics Lithuania 2014, <<http://osp.stat.gov.lt/services-portlet/pub-edition-file?id=2910>> (last visited 29 Nov. 2014).

By estimatitons<sup>43</sup>, proportion of the **rental housing** is 15 % in ESTONIA and LATVIA, and 12 % in LITHUANIA<sup>44</sup>. Thus, by any statistic or estimation, LITHUANIA has the highest owner-occupancy rate and relatively modest rental market.

### 1.1.3. Types of housing tenures

Although there is a slight trend in favour of renting, specifically in segment of young couples, the general mentality in Baltics is clearly **in favour of home ownership** as the only reliable way to guarantee permanent housing.

As stated earlier, relatively high proportion of population lives in apartments. In LATVIA, apartments are qualified as the **residential property**. Similarly, in ESTONIA, condominium as a single unit of real estate in a multi-unit development is known as **apartment ownership**, i.e. space of the physical share of a construction together with a legal share of common ownership to which the physical share belongs.<sup>45</sup>

Most common source of financing the building of family homes or apartments is mortgage loan. According to Eurostat<sup>46</sup> the share of the tenures financed by mortgage and loan is highest in ESTONIA - approx. 18,9 % of all tenures (LATVIA - 9,1 %, LITHUANIA – 7,7 %).<sup>47</sup>

In LATVIA<sup>48</sup> and ESTONIA **intermediate forms of tenures** between ownership and renting in regards to residential premises are **not relevant**. There are limited amount of cooperatives (partnership for construction of residential buildings) left in LITHUANIA.<sup>49</sup>

According to ESTONIAN law only a **building association** can be considered as a special (intermediate) type of tenure. Residential building associations (co-operatives) are being transferred into apartment ownership (privatized), and by 2011 there were no longer any cooperatives in existence.

Mostly informal **private rental market** exists in all three countries. There is one major type of **private rental tenure** - contracts which are concluded between the private

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<sup>43</sup> As it is unclear how many respondents did not admit the tenancy relations because of their informatlity. As there is no need for registration, there is no official reliable data on private renting available either. Without exact data for the number of people living in rented dwellings, we have to rely on information from reports based on surves and/or evidence from other sources.

<sup>44</sup> Swedbank, < <http://www.swedbank.lt/lt/articles/view/1647> >, Lithuanian Report, 8.

<sup>45</sup> Estonian Report, 18.

<sup>46</sup> Source SILC [ilc\_lvho02].

<sup>47</sup> For comparison, according to a survey released by Swedbank, 69 % of Lithuanians have purchased their dwelling using their own funds, 18 % have inherited the dwelling or live in the dwelling which belongs to their relatives (family members), remaining 13 % Lithuanians purchased their dwellings using mortgage based loans/personal loans. <<http://www.swedbank.lt/lt/articles/view/164>> (last visited 02 Feb. 2014).

<sup>48</sup> Latvian Report, 20.

<sup>49</sup> Partnership for construction of residential buildings may be founded by municipalities, companies, institutions, organizations and individuals with the aim to supply their member's with residential houses or apartments. There were 408 registered Partnerships for construction of residential buildings at the beginning of 2012. Its activity is regulated by the Resolution No. 280 of the Government of Lithuania, 23 April 1993. Lithuanian Report, 15.

parties in market terms within the framework of civil law. However, **regulatory basis** for contracts on market rent is structured quite differently.

In ESTONIA, since 1 July 2002, residential lease contracts as a special kind of lease contracts are regulated in the Law of Obligations Act<sup>50</sup> (hereinafter LOA) Part 3 (Contracts for Use), Chapter 15 (Lease Contracts) Arts. 271-338. General rules regulating the lease contracts are applicable in so far as there are no special, mainly tenant-protective rules applicable to residential lease contracts as *lex specialis*. In most of the aspects, the regulation is mandatory and could not be modified by the parties to the detriment of the tenant.<sup>51</sup>

Similarly in LITHUANIA, residential lease contracts are regulated within the Civil Code (2000), but in special Chapter XXXI „Lease of dwellings“ as *lex specialis* in relation to Chapter XXVIII Lease and General Part of CC. In most of the aspects, the law is dispositive.

Somewhat differently, in LATVIA, special law – Law on Residential Tenancy (1993) - governs residential tenancy agreements. In essence, the contents of tenancy contracts are left subject to parties' agreement. Civil Law<sup>52</sup> as *lex generalis* apply in the matters not covered by the Law on Residential Tenancy. The non-consistency of the norms as *lex specialis* and *lex generalis* has been brought out as the reasons for contradicting case law and legal commentaries.<sup>53</sup>

Estimated **share of the private rental market** is to 10-15 % of the total occupied dwelling stock.

In ESTONIA, for example, the ownership of the dwellings offered for rent in the private sector is divided as following: (1) resident(s) of Estonia - 80,7 %, (2) resident(s) of foreign country - 8,5 % and (3) other<sup>54</sup> – 10,7%. Similar structure of the ownership of the dwellings offered for rent may be presumed also in case of LATVIA and LITHUANIA.

**Public rental tenure** in the Baltics comprises of all state or municipally owned dwellings let for leases. **Social housing is a targeted residual system** whereby only the most vulnerable social groups are beneficiaries. In the countries under review, **share of social housing is marginal**, maximum of 2-3 % of the total housing stock.

In 2011, the market share of public rental tenures in ESTONIA was only 1,7 % of all occupied dwellings.<sup>55</sup> It should be noted that Tallinn is the only municipality which offers public housing to targeted groups (young families and key municipal workers) which can not strictly be categorized as persons in need of social welfare services in the meaning

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<sup>50</sup> Model for the regulation was taken from German BGB and Swiss Civil Code.

<sup>51</sup> This is considered as one of the shortages of the existing regulation.

<sup>52</sup> Adopted 1937, restored 1991.

<sup>53</sup> Latvian Report, 175.

<sup>54</sup> I.e. company, non-profit association, legal person governed by public law, etc. (except state or local government).

<sup>55</sup> Statistics Estonia. PHC 2011.

of Social Welfare Act.<sup>56</sup> In LATVIA the share of social apartments and social dwelling houses in the housing stock amounts approx. to 0.4% of the total housing stock and only 2.5% of the rental stock. In LITHUANIA, after the privatisation of the housing stock, only ca 2% remained as public social housing, which is now let for rent to particularly disadvantaged groups.

#### **1.1.4. Other general aspects of the current housing situation in comparative perspective**

It is characteristic to Baltic rental market, that the **role of institutional investors is marginal** or almost non-existent. Majority of the apartments for rent are offered by private (small) investors or just by 'incidental' landlords. Private landlords, however tend to have no proper means for professional maintenance, often opt for tax evasion, are more risk averse and may face urgent need to get the dwelling back for own use.

There are **no influential lobby groups of tenants** in any of the Baltic States. There are no lobby groups or umbrella groups specifically active in any of the tenure types in LATVIA. Associations aimed at supporting management of the housing stock exist in LITHUANIA<sup>57</sup> and in ESTONIA.<sup>58</sup> Additionally, interests of home owners are forcefully represented by Estonian Central Association of Owners.

**Tax evasion** by landlords is a common phenomenon in all three countries. The housing market is in general an open market as all purchases with immovable property must be entered into the Land Register. Rental contracts are not subject to registration, neither is written form obligatory<sup>59</sup>. Therefore, there is also no official reliable data on private renting. Rental income from renting out private dwellings by individual households is not officially declared to tax authorities. This unfortunately leads to the practice of oral contracts resulting in disputes over contract terms, constraints for the tenants to register the place as their permanent place of residence, or blackmailing from the part of the tenant.

### **1.2. Economic factors in comparison**

#### **1.2.1. Comparative view of the housing market**

As the home-ownership is favourable type of tenure for permanent residence, rental market in the Baltic countries has only share of 10-15 % from total housing stock. At the same time, only marginal proportion (2-3%) of the dwelling stock is owned and rented out by the public sector, mainly municipalities.

It can be generally concluded, that despite the possible regional or seasonal disparities, overall supply of housing (incl. rental housing) in Baltics is sufficient. Yet it is commonly reported, that housing for low-income groups is not sufficient.

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<sup>56</sup> *Sotsiaalhoolekandeseadus*. - RT I 1995, 21, 323.

<sup>57</sup> Lithuanian Chamber of Housing Management and Maintenance; Lithuanian Report, p 15.

<sup>58</sup> Estonian Union of Cooperative Housing Associations.

<sup>59</sup> Written form is obligatory in Lithuania, but courts recognize factual tenancy relationships.

### 1.2.2. Comparative view on price and affordability

House prices, as measured by the **House Price Index**<sup>60</sup> (HPI), remained stable in the euro area and rose by 1.7% in the EU in the second quarter of 2014 compared with the same quarter of the previous year. It is noteworthy, that among the Member States for which data are available, the highest annual increases in house prices in the second quarter of 2014 were recorded in ESTONIA, i.e. +14.5%.<sup>61</sup> Obviously, if real estate prices continue to rise, Baltics may face next real estate boom.

Changes in the rents of residential property are directly related to their selling prices – rising residential property prices lead to an increase in rents. Rent prices in ESTONIA in 2013 grew 10-15% depending on the location, being 6-7 EUR per sq m, and 9 EUR per sqm in the centre.<sup>62</sup> Also in LATVIA, due to the growing demand, average rents increased by 10% to 15% in 2013. The typical monthly rent for an unfurnished, renovated three-room apartment (approximate size 70 sqm) in a pre-war building in the city centre ranges from 750 EUR to 900 EUR per month and in a newly built project from 800 EUR to 950 EUR per month.<sup>63</sup> In LITHUANIA, rent prices 2013 saw an average 4% increase in apartment rents, after rising 8% in 2012 in Vilnius. Typical two-room old construction apartment in Vilnius residential districts rents for 160 to 230 EUR per month in the end of 2013. The same size new construction apartment rent starts from 260 EUR per month. Rents for fully equipped two-room apartments (old or new) in the central part and prestigious districts of Vilnius range from 230 to 430 EUR per month, and for three-room apartments from 260 to 700 EUR per month.<sup>64</sup>

Next, the comparison of the HAI (**housing affordability index**)<sup>65</sup> in three Baltic States deserves attention (see **Figure 2**). Apparently among Baltic capitals the affordability of

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<sup>60</sup> The House Price Index (HPI) measures the price changes of all residential properties purchased by households (flats, detached houses, terraced houses, etc.), both newly built and existing, independently of their final use and independently of their previous owners.

<sup>61</sup> Respective figures for LATVIA were +8.2 and +6,5 for LITHUANIA. Eurostat newsrelease 151/2014 - 9 October 2014, [http://epp.eurostat.ec.europa.eu/cache/ITY\\_PUBLIC/2-09102014-AP/EN/2-09102014-AP-EN.PDF](http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-09102014-AP/EN/2-09102014-AP-EN.PDF) (last visited 27 Nov. 2014).

<sup>62</sup> Ober House: Real Estate market report Baltic States Capitals, <[http://ober-haus.lt/wp-content/uploads/2014/09/Ober-Haus\\_Market\\_Report\\_Baltic\\_States\\_2014.pdf](http://ober-haus.lt/wp-content/uploads/2014/09/Ober-Haus_Market_Report_Baltic_States_2014.pdf)> (last visited 29 Nov. 2014).

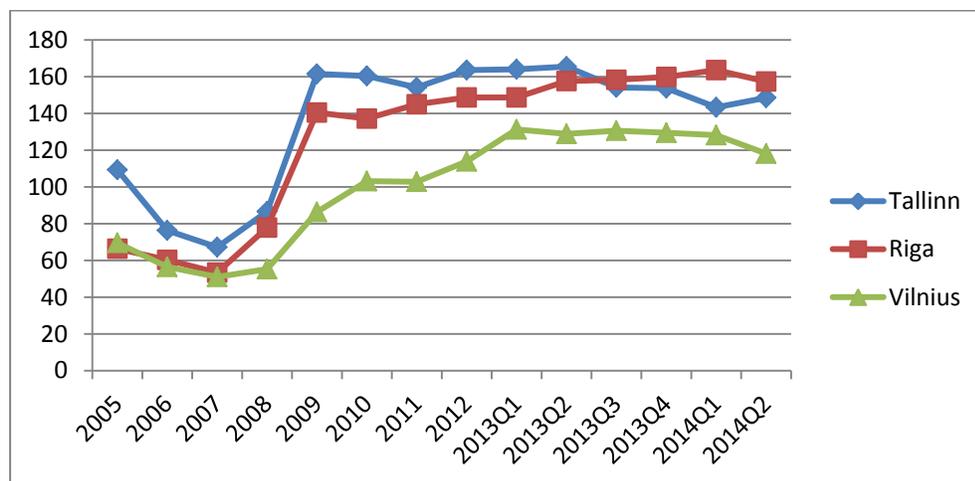
<sup>63</sup> Ibid.

<sup>64</sup> Ibid.

<sup>65</sup> The housing affordability index (HAI) is calculated for a family whose income is equal to 1.5 of average net wages with an average-sized apartment of 55 square meters. The HAI is 100 when households use 30% of their net wages for mortgage costs. When the HAI is at least 100, households can afford their housing, according to the established norm. The higher the number, the greater the affordability. Swedbank, Baltic Housing Affordability Index <[http://www.swedbank-research.com/english/baltic\\_housing\\_affordability\\_index/2014/q3/hai\\_2014q2.pdf](http://www.swedbank-research.com/english/baltic_housing_affordability_index/2014/q3/hai_2014q2.pdf)> (last visited 28 Sept. 2014).

housing is greatest in Riga. The time needed to save for a down payment is 24,8 months in Riga compared to 28.3 months in Tallinn and by 37.4 months in Vilnius.<sup>66</sup>

**Figure 2 Housing affordability index (HAI) in Baltic capitals (2005-2014).**<sup>67</sup>



The average **interest rate of housing loans** in ESTONIA and in LITHUANIA is on a **very low** level (2,5 % p.a.). In 2014, there is still room for the interest rates to fall in LATVIA.<sup>68</sup>

Selection of affordability parameters can be found in **Table 3**.

**Table 3 Selected housing affordability parameters.**

	EE	LV	LT	EU28
Housing affordability				
Housing cost overburden rate <sup>69</sup> (2012)	8	11	9	11
Share of housing costs in disposable household income (2012) <sup>70</sup>	19	22	20	22
Share of rent related to occupied dwelling in disposable household income (2013) <sup>71</sup>	20	10	13	25

<sup>66</sup> Changes over the past year (2013Q2- 2014Q2) are commented as follows: In Tallinn, affordability diminished by 16.3 points in the second quarter this year compared with the same period in 2013, due to a 16.3% annual increase in apartment prices. In Riga, the HAI declined marginally (by 0.3 point) because of a 10 basis point increase in mortgage interest rates. Contrary to other Baltic countries, wages in a year rose faster than apartment prices in Riga. In Vilnius, the HAI fell by 10.7 points because of a 14.4% annual increase in apartment prices. Swedbank: Baltic Housing Affordability Index.

<[http://www.swedbank-research.com/english/baltic\\_housing\\_affordability\\_index/2014/q3/hai\\_2014q2.pdf](http://www.swedbank-research.com/english/baltic_housing_affordability_index/2014/q3/hai_2014q2.pdf)> (last visited 27 Nov. 2014).

<sup>67</sup> Ibid.

<sup>68</sup> [http://www.seb.ee/sites/default/files/web/files/uudised/BHO\\_aprill2014\\_tallinn.pdf](http://www.seb.ee/sites/default/files/web/files/uudised/BHO_aprill2014_tallinn.pdf).

<sup>69</sup> The housing cost overburden rate is the percentage of the population living in households where the total housing costs ('net' of housing allowances) represent more than 40 % of disposable income ('net' of housing allowances).

<sup>70</sup> Source: SILC [ilc\_mded01]

<sup>71</sup> Source: SILC [ilc\_mded02].

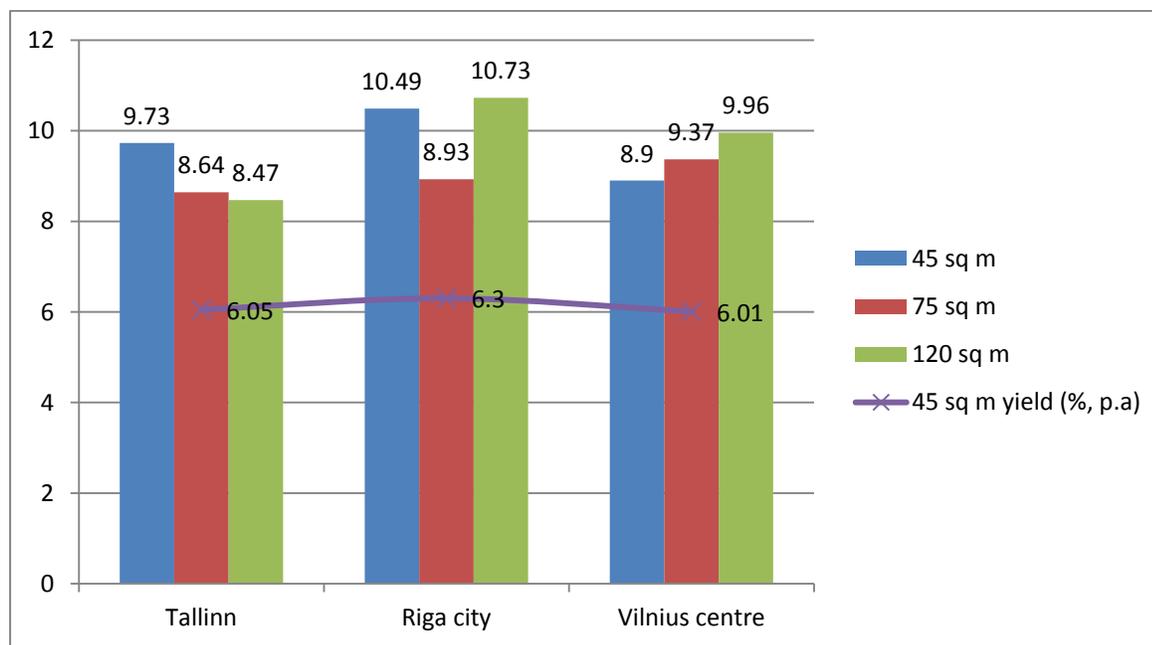
In ESTONIA and LITHUANIA, the share of any kind of arrears (on utility bills, rent, hire purchase or loan repayment) is close to the EU average (11,4 %).<sup>72</sup> Unfortunately, this does not apply to LATVIA, as as much as 24,4 % of total population report arrears.<sup>73</sup> In ESTONIA, 30% of all households feel heavy financial burden of total housing costs (expenses on utilities, rent or mortgage payments) which is lower than the EU average (38%).<sup>74</sup> In LITHUANIA, the respective figure is 36 % and exceptionally high in LATVIA – 46 %. Hence, there are more households which can improve their living conditions without facing difficulties in ESTONIA than in its Baltic neighbouring countries.<sup>75</sup>

### 1.2.3. Tenancy contracts and investment

**Return for rental dwellings** in Baltic residential market is commonly valued as **moderate** in between 4-6 % p.a. average. Average figures of residential investment yield is 4.8% for LITHUANIA, 4.3% for LATVIA and 5.2% for ESTONIA.<sup>76</sup> Average rent prices and rental yields for 45 sq m apartment in the city centre are shown in

**Figure 3.**

**Figure 3 Rent prices (EUR/sq m) and rental yields (% p.a. for 45 sq m apartment) in Baltic capitals (2014).<sup>77</sup>**



<sup>72</sup> [http://www.seb.ee/sites/default/files/web/files/uudised/BHO\\_aprill2014\\_tallinn.pdf](http://www.seb.ee/sites/default/files/web/files/uudised/BHO_aprill2014_tallinn.pdf)

<sup>73</sup> Ibid.

<sup>74</sup> 2013, source: SILC) [ilc\_mdcd04].

<sup>75</sup> Ibid.

<sup>76</sup> Ober Hous Market Rerport Baltic States 2014, <[http://www.ober-haus.com/files/lt/files/reports/Ober-Haus\\_Market\\_Report\\_Baltic\\_States\\_2014.pdf](http://www.ober-haus.com/files/lt/files/reports/Ober-Haus_Market_Report_Baltic_States_2014.pdf)> (last visited 29 Nov. 2014).

<sup>77</sup> Global Property Guide, <<http://www.globalpropertyguide.com/>> (last visited 29 Nov. 2014).

Tenancy contracts are not relevant to professional and institutional investors because return on rental dwellings is not attractive. Considering higher rates of return for alternative investments and unfair competition due to the large proportion of black market rentals (for tax evasion purposes), the rental market will remain dominated by private landlords for many years.

#### **1.2.4. Other economic factors**

The **role of estate agents is modest** in all Baltic States.<sup>78</sup> Potential parties to the rental relationship often do not use services of real estate agents since rental contracts do not have to be registered by notary, fees of the agents are quite high (normally equal to one month's rent), and the quality of their services is not always guaranteed. As already mentioned earlier, landlords tend to avoid to conclude written lease contracts because the taxes. It also means that they tend to avoid using agents' services as the agents in their practice work only with written contracts between lessor and lessee – only the concluded contract gives ground for claim for the commission. There are professional associations<sup>79</sup> which perform supervision over their members' activities, but it is not prohibited to act as a broker even without any official attestation.<sup>80</sup>

The agent's usual fee is 50 %-100 % of the amount of one month base rent. There are no statutory limitations on the commission.

If the size of the brokerage fee has not been agreed, it shall be deemed to be the size of the standard local brokerage fee or, in the absence thereof, a reasonable amount of remuneration. The person - landlord or tenant - assigned a task to the estate agent usually pays the commission. As it is a common practice, at least in ESTONIA, to „agree“ that the commission fee is paid by the lessee even if the agent was assigned by the landlord, most prospective tenants prefer to negotiate directly with the owner of the dwelling.

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<sup>78</sup> Lithuanian Report, 91; Latvian Report, 26; Estonian Report, 42.

<sup>79</sup> Estonian Chamber of Real Estate Brokers was founded as a non-profit organization in 1997. The Lithuanian Association of Real Estate Agencies was established in 2007.

<sup>80</sup> E.g. The Estonian Chamber of Real Estate Brokers is authorized to grant professional qualification to a real estate broker. The professional title of a real estate broker who has successfully passed the professional examination is Licensed Real Estate Broker. Yet, through the number of acting brokers is around 2000, there are only about 150 Licensed Real Estate Brokers since it is not forbidden to act as a real estate broker without a licence. There are no legal requirements about education, knowledge, experience, reputation, etc. of estate agents in Latvia. Basically, anyone can become an estate agent, even if this person is not a merchant in the meaning of the Commercial Law, that is, a person who is registered in the Commercial Register.

### 1.2.5. Effects of the current crisis in comparative perspective

The global financial crisis hit the Baltic States much harder than other countries in the EU.<sup>81</sup> **Households of LATVIA were hit the most** during the crises while **households in ESTONIA suffered the least**.

More than 50 per cent of households in all Baltic countries experienced some kind of drop in their income. There is very slow recovery after the recession regardless the drop of unemployment rate and the rise in average real wage.

High and accelerating house price inflation was a characteristic of many European countries during the decade preceding the crisis, with the Baltic States experiencing increases above those of the euro area. Both supply and demand factors played important roles. Favourable lending standards, the absence of a cap on loan-to-value ratios and low real interest rates created easy access to finance and growing demand for housing. The demand for housing was reinforced by low real estate taxation, partial deductibility of mortgage interest payments, nominal convergence and rather underdeveloped rental markets.<sup>82</sup>

A strong correction in house prices started in 2007-2008 and was particularly pronounced from mid-2008 to mid-2010 when the housing prices in LATVIA dropped over 52%. Rent prices also decreased, but not so dramatically. All this put pressure on the banking system and, combined with lower disposable incomes, led to a deterioration in the quality of the banks' loan portfolios.<sup>83</sup> The share of **non-performing housing loans** (NPL) has been at **very high level in LATVIA**. The highest peak in non-performing loans (NPL) was in Latvia (16.5% in 2011 Q3) while the ESTONIAN households have showed the least difficulties in repaying their housing loans.<sup>84</sup>

December 2008 to March 2013 the **home loan portfolio decreased** by 11.1% in Estonia, by 15.6% in Lithuania and as much as by 34% in LATVIA. As a result, the home loan portfolio grew most in LITHUANIA (ca 6 times in 2005-2008), whereas the **setback has been greatest in LATVIA**.<sup>85</sup>

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<sup>81</sup> The cumulative output loss in 2008 and 2009 was 18.3% in Estonia, 21.0% in Latvia and 11.9% in Lithuania.<sup>81</sup> In all three countries, unemployment rates at least trebled from 2007 to 2009. Latvia—from the 2007 level of 6.0% to 18.7%, making it the largest increase in the EU—but closely followed by Estonia (from 4.7% to 16.9%) and Lithuania (from 4.3% to 17.8%). Rainer Kattel & Ringa Raudla (2013): The Baltic Republics and the Crisis of 2008 – 2011, *Europe-Asia Studies*, 65:3, 426-449, <[http://www.networkideas.org/featart/apr2013/pdf/Kattel\\_Raudla.pdf](http://www.networkideas.org/featart/apr2013/pdf/Kattel_Raudla.pdf)>, (last visited 29 Nov. 2014), 249

<sup>82</sup> Real estate price dynamics, housing finance and related macro-prudential tools in the Baltics. ECFIN Country Focus, vol. 9, Issue 2, December 2012.

<[http://ec.europa.eu/economy\\_finance/publications/country\\_focus/2012/2012/cf\\_vol9\\_issue2\\_2012.pdf](http://ec.europa.eu/economy_finance/publications/country_focus/2012/2012/cf_vol9_issue2_2012.pdf)> (last visited 29 Nov. 2014).

<sup>83</sup> SEB: Baltic Household Outlook, <[http://www.seb.ee/sites/default/files/web/files/uudised/BHO\\_aprill2014\\_tallinn.pdf](http://www.seb.ee/sites/default/files/web/files/uudised/BHO_aprill2014_tallinn.pdf)> (last visited 29 Nov. 2014).

<sup>84</sup> In Estonia, the peak was at 4.5% in 2010 Q3. The repayment problems are related to the income declines during the recession which were experienced by majority of households.

<sup>85</sup> Ibid.

Banks in Baltic countries have been more reluctant to grant new housing loans in view of worsening perceptions of risk and tighter credit standards, while demand for housing loans declined, resulting in higher debt financing costs, greater uncertainties about future incomes, job insecurity and thus increased risk regarding the future affordability of mortgages.<sup>86</sup> The pronounced reduction of the bank lending activity has had significant implications for the housing market, leading to a dramatic decrease in housing prices and implicitly the diminishing real estate collateral, which threatened the financial stability.<sup>87</sup>

No current figures on **repossession** are available for LATVIA and LITHUANIA. In ESTONIA, since 2007, the number of forced seizures of dwellings due to mortgage loan default by the buyer has been on the rise year by year: in 2007 - 222, in 2009 – 631 and in 2012 the number of repossessed dwellings was already 1300.<sup>88</sup>

Effective **real estate taxation** (in particular in ESTONIA and LITHUANIA) is below the euro area average and the supervisory constraints are milder than in most of the euro area countries (seemingly with an exception for Lithuania). LITHUANIA is the only Baltic country that has introduced measures aimed at ensuring responsible lending. Since November 2011, banks - when granting new mortgage loans – have been obliged to respect an 85% cap on the loan-to-value ratio, a 40% cap on the debt-to-income ratio and a 40 year maturity limit. In addition, requirements have been tightened for the assessment of creditworthiness and transparency with regard to possible risks affecting the borrower.<sup>89</sup> However, Eesti Pank (Bank of ESTONIA) is planning to introduce three limits on the issuing of housing loans by commercial banks at the start of 2015, as a precautionary measure to reduce the risks of a lending boom in the future.<sup>90</sup>

All Baltic countries are still below the EU average in housing conditions and the improvement of housing conditions implies new home purchases. As home purchases and improvements were postponed during the crisis, households are expected to show

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<sup>86</sup> E.g. in 2010, the value of outstanding housing loans in Estonia was 41% of GDP. Since 2010, the household debt-to-GDP ratio has decreased considerably, due to both the decrease in the loan portfolio and GDP (income) growth, and stands currently at 30 per cent.

<sup>87</sup> Lithuania and Estonia - 46%.

<sup>88</sup> Bank of Estonia. Statistical data is only partly correct because the purchase of mortgaged property will be registered not as transaction in expropriation proceedings but as regular purchase by notary

<sup>89</sup> Ibid.

<sup>90</sup> The first limit is on LTV (loan-to-value), and states that the loan amount can only be up to 85% of the value of the collateral. If the loan is guaranteed by KredEx then the loan amount can be for up to 90% of the value of the collateral. The second limit is on DSTI (debt service-to-income), and states that all the monthly loan and lease principal and interest payments of the borrower taken together may amount to only 50% of the borrower's monthly net income. Net income is regular income that reaches the bank account after taxes have been deducted. The third limit is that the maximum maturity of housing loans is to be 30 years. Real estate price dynamics, housing finance and related macro-prudential tools in the Baltics. ECFIN Country Focus, vol. 9, Issue 2, December 2012.

[http://ec.europa.eu/economy\\_finance/publications/country\\_focus/2012/2012/cf\\_vol9\\_issue2\\_2012.pdf](http://ec.europa.eu/economy_finance/publications/country_focus/2012/2012/cf_vol9_issue2_2012.pdf) > (last visited 29 Nov. 2014).

increased interest in enhancing their living conditions.<sup>91</sup> Currently, only in Estonia real interest rates on mortgages are negative and are significantly below the euro-area average. Accordingly, lending conditions remain favourable for the uptake of mortgage debt in ESTONIA, in particular.<sup>92</sup>

Quite a few regulatory changes introduced in response to the crisis also has direct or indirect effect to housing market.

Firstly, home-owners subsidy in the form of **mortgage interest deductibility** was limited in all Baltic States. In ESTONIA, the limit on deductible interest expenses was reduced by 40%<sup>93</sup> from 2012 onwards. In LATVIA and LITHUANIA, mortgage-interest deductibility was phased out.<sup>94</sup>

Secondly, the recession prompted several changes to **insolvency proceedings for private individuals** in Baltics.<sup>95</sup> In ESTONIA, separate law on restructuring personal debt<sup>96</sup>, in addition to a more established bankruptcy procedure was introduced.<sup>97</sup> The act which was primarily aimed at protecting overly indebted (and possibly unemployed) home owners, however, did not prove to be very useful in practice.<sup>98</sup> In LITHUANIA<sup>99</sup> the Law on the Bankruptcy of Natural Persons which came into force in Lithuania on 1 March 2013. Until then, there was no law regulating insolvency of private individuals at all. In LATVIA, new insolvency regulation of natural persons was introduced in 2010 in

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<sup>91</sup> <[http://www.seb.ee/sites/default/files/web/files/uudised/BHO\\_aprill2014.pdf](http://www.seb.ee/sites/default/files/web/files/uudised/BHO_aprill2014.pdf)> (last visited 29 Nov. 2014).

<sup>92</sup> Ibid. The gap between the interest rates in Latvia and other Baltic countries is still ¾ percentage points. Due to higher repayment problems and borrowing risk in Latvia compared to other Baltic countries the interest rate will not yet reach the same level as in Estonia and Lithuania.<sup>92</sup>

<sup>93</sup> From 3196 EUR to 1920 EUR per taxpayer during a period of taxation. Income Tax Act § 28<sup>2</sup>.

<sup>94</sup> On 1 January 2009 the Law on Profit Tax of Republic of Lithuania came into force and the housing credit benefit was withdrawn. Real estate price dynamics, housing finance and related macro-prudential tools in the Baltics. ECFIN Country Focus, vol. 9, Issue 2, December 2012. <[http://ec.europa.eu/economy\\_finance/publications/country\\_focus/2012/2012/cf\\_vol9\\_issue2\\_2012.pdf](http://ec.europa.eu/economy_finance/publications/country_focus/2012/2012/cf_vol9_issue2_2012.pdf)> (last visited 29 Nov. 2014)

<sup>95</sup> Cf. Ruda, Kallas, Petkevicius. Treatment of insolvency for private individuals: developments in the Baltics. Insolvency and Restructuring International, Vol 5 No 2, September 2011, available at: <<http://www.sorainen.com/UserFiles/File/Publications/article.treatment-of-insolvency-for-private-individuals-developments-in-the-baltics.2011-09-30.eng.insolvency-and-restructuring-international.girtsr-kadrik-mantasp.pdf>> (last visited 29 Nov. 2014).

<sup>96</sup> Debt Restructuring and Debt Protection Act (DRDPA) was adopted in November 2010 and entered into force 5 April 2011.

<sup>97</sup> The major idea behind the new legislation was to prevent massive repossessions of mortgaged houses by facilitating the restructuring of the debts of a natural person having solvency problems (debtor). The law tries thereby to take account of the legitimate interests of the debtor as well as of the creditor. In debt restructuring proceedings, the financial obligations of a debtor are made more manageable by extension of the term of performance of an obligation, by performing the obligation in instalments or by reducing the size of the obligation (Art 2 of DRDPA). The respective procedure should be initiated by the debtor by application to the county court.

<sup>98</sup> Since the enforcement of the law, 102 applications has been filed (as at 30 Nov. 2013), of which only 7 were resolved positively (at least partially).

<sup>99</sup> The Law on the bankruptcy of natural persons of the Republic of Lithuania (amended and supplemented). Official Journal, 2012, No. 57-2823.

order to make process available to more individuals by aiming at shorter duration and lower costs. Indeed, under this new law more individuals have been declared in comparison to the previous one.<sup>100</sup> Furthermore, another set of amendments will come into force on the 1<sup>st</sup> of January 2015. Continued reforms are targeted at reducing the term for abolition of debts, but most important change would be the introduction principle of “dropped-off keys”<sup>101</sup>. In sum, while one of the aims of the new law in ESTONIA was to help individuals avoid bankruptcy, changes in LATVIAN personal bankruptcy treatment has made these types of bankruptcies easier.

In LATVIA, additional requirements regarding credit contracts in which consumers are involved, in particular purchase of residential dwellings for living purposes were introduced via amendments into the Consumer Protection Law. Furthermore, licensing of private companies, which are not banks (credit institutions), were introduced and as a result activities of private credit grantors were restricted. The amendments also determine that a creditor is not allowed to ask to return a debt in full amount before the appointed time by a credit contract or ask for additional securities, if the consumer has not essentially infringed<sup>102</sup> the credit contract. The further amendments concern the Credit Register which now provides information on capacity of a prospective borrower to return a debt. Also a new law on recovering of debts out-of-court was passed.<sup>103</sup> The Civil Law amendments are the first results of the intensive discussion over onerous and

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<sup>100</sup> 2009 – 53, 2010 – 199, 2011 – 845 and 2012 - 979 proceedings were commenced. As of 25 September 2012. Source: The Insolvency Register.

<[https://www.ur.gov.lv/urpubl?act=MNR\\_STAT&stat\\_id=533](https://www.ur.gov.lv/urpubl?act=MNR_STAT&stat_id=533)> through Edvins Draba, Modernizing Insolvency Law in Latvia: Successes and Failures. The new regulation has resulted in a dramatic increase of commenced proceedings. < [http://www.insol-europe.org/download/file\\_/7782](http://www.insol-europe.org/download/file_/7782) > (last visited 28 Nov. 2014).

<sup>101</sup> This principle requires that after the property which was serving as a security is sold, the secured creditor is going to lose the right of claim and all of the remaining obligations are going to be extinguished along with the acceptance of auction act. By extinguishing the basic obligations, additional obligations are going to lapse as well. This order is only referable to cases when the selling object of debtor’s insolvency process is his dwelling. As a dwelling in the concept of the law is considered a property belonging to debtor in which for the last six months before the day when an insolvency process application has been submitted to the court he has declared his residence. This principle can only be applied during a natural person’s insolvency process to the property to which a security will be established after the 1<sup>st</sup> of January 2015. Lextal. Amendments to the Insolvency law of Latvia (Nov. 14, 2014) <<http://legalknowledgeportal.com/2014/11/14/amendments-to-the-insolvency-law-of-latvia/>> (last visited 28 Nov. 2014).

<sup>102</sup> Essential breach of credit contract is assumed if the consumer delayed payments for more than 60 days or for more than three times in a year and each time for more than 30 days. The essential breach is also using not in compliances with a contract.

<sup>103</sup> This law helps to solve the following problems which a consumer can face: (1) It eliminates costs which sometimes can considerably exceed an amount of a debt; (2) The law prohibits the use of aggressive methods recovering debts, for example, threats, coming to a working place of a debtor etc.; (3) The new law requires to provide full and true information about a debt or its component parts.

disproportionate contractual penalties.<sup>104</sup> Seemingly, LATVIA has been most radical in implementing new regulations in response to the crisis.

All three Baltic States implemented sizable fiscal consolidations<sup>105</sup> in 2008–2010. In 2010, the Baltic States started to recover and recorded GDP growth between 5.5% and 7.6% in 2011. In the light of such temporal sequences of events, there has been a temptation in policy circles, both inside the Baltic States and internationally, to draw a causal conclusion and to claim that it was the austerity that led to growth.<sup>106</sup> Moreover, the peaceful reaction of society to austerity policy in the Baltics is also emphasized.<sup>107</sup>

In 2003 there was a huge gap in average wages between ESTONIA and other Baltic countries, even exceeding 50%. The gap narrowed during the last boom years. Despite increasing inflation, during five years (2003–2008) real wages rose by 66 per cent in Latvia and Lithuania, followed by Estonia with a 54% increase. Latvians and Lithuanians experienced the largest drop in real income during the economic downturn. In Latvia and Estonia real wages started to increase in 2011, while in Lithuania real wage growth resumed only in 2013.<sup>108</sup> ESTONIA is very close to the pre-crisis level in terms of real wages.<sup>109</sup> Apparently, ESTONIA was significantly more successful with fiscal consolidation than other Baltic States.<sup>110</sup>

**Table 4** illustrates the situation in 2013. LATVIA is still in relatively weak position in terms of recovery from the crisis.

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<sup>104</sup> On 1 January 2014, amendments to the Latvian Civil Law will come into force significantly affecting all contracts where the parties have agreed on a contractual penalty. For tenancy contracts it is important, that contractual penalty imposed for undue or late performance of obligations can be set as an increasing amount, though the total would be limited to 10% of the principal debt or the amount of the main obligation. Court can reduce the amount of a contractual penalty, even where neither party applies for it. For more details, see e.g. Amendments to Latvian Civil Law limit contractual penalties. Sorainen Newsflash/Latvia (Sep 2013) < <http://www.sorainen.com/UserFiles/File/Publications/newsflash.latvia-dispute-resolution.2013-09-17.eng.html> > (last visited 29 Nov. 2014).

<sup>105</sup> By fiscal consolidation we mean the improvement of government's budget-deficit-to-GDP ratio via discretionary changes in fiscal policy (i.e. by expenditure cuts and/or revenue increases). <[http://www.networkideas.org/featart/apr2013/pdf/Kattel\\_Raudla.pdf](http://www.networkideas.org/featart/apr2013/pdf/Kattel_Raudla.pdf) > (last visited 29 Nov. 2014).

<sup>106</sup> Rainer Kattel & Ringa Raudla (2013): The Baltic Republics and the Crisis of 2008 – 2011, *Europe-Asia Studies*, 65:3, 426–449. <<http://dx.doi.org/10.1080/09668136.2013.779456> > (last visited 17 Nov. 2014).

<sup>107</sup> Kinga Dudzińska, The Baltic States' Success Story in Combating the Economic Crisis: Consequences for Regional Cooperation within the EU and with Russia, No.6(54), March 2013 © PISM <[https://www.pism.pl/files/?id\\_plik=13084](https://www.pism.pl/files/?id_plik=13084) > (last visited 29 Nov. 2014).

<sup>108</sup> SEB: Baltic Household Outlook, <[http://www.seb.ee/sites/default/files/web/files/uudised/BHO\\_aprill2014\\_tallinn.pdf](http://www.seb.ee/sites/default/files/web/files/uudised/BHO_aprill2014_tallinn.pdf)> (last visited 29 Nov. 2014).

<sup>109</sup> Ibid.

<sup>110</sup> Estonia's apparent success can be attributed to a combination of political, institutional and economic factors like: (1) early timing of reforms; (2) the availability of reserves; (3) ownership structure of banks; (4) the electoral cycle in Estonia favoured starting adjustment as early as 2008, and (5) significantly smaller revenue shock. Rainer Kattel & Ringa Raudla (2013): The Baltic Republics and the Crisis of 2008 – 2011, *Europe-Asia Studies*, 65:3, 435. <<http://dx.doi.org/10.1080/09668136.2013.779456> > (last visited 17 Nov. 2014).

**Table 4 Recovery from the crisis (2013).**

	EE	LV	LT	EU28
GDP per capita in PPS (EU-28 = 100) <sup>111</sup>	72	67	74	100
Unemployment rate (Sept. 2014) <sup>112</sup>	7,5	10,8	9,7	10,0
Average monthly gross wage, EUR	931	715	646	
The share of NPL at the end of 2013 (%) <sup>113</sup>	1,4	10,2	7,5	
The share of households who have difficulties to cover their everyday expenses (%) <sup>114</sup>	7,5	25,4	9,6	12,1
The share of households who are not able to cover unexpected expenses of 200-300 EUR (%) <sup>115</sup>	41,9	69,5	56,9	39,7
Severe material deprivation rate - tenants at market price <sup>116</sup>	14,8	33,9	23,2	13,7

### 1.3. Urban and social aspects of the housing situation in comparison

#### 1.3.1. Urban aspects in comparative perspective

There are more rented dwellings in inner cities, as well as in large-scale housing estates, compared to lower-scale suburbs. On the regional scale, there is concentration of rental dwellings, according to a settlement hierarchy – larger concentration in bigger cities<sup>117</sup>, and lesser concentration in smaller towns and rural areas.<sup>118</sup>

During the first decade after regaining independence the urban development of the Baltic cities was marked mainly by active commercial development. The second decade showed a significant trend of agricultural areas massively being converted and divided into smaller residential plots. From the beginning of the 2000s single-family houses were

<sup>111</sup> Gross domestic product (GDP) is a measure for the economic activity. It is defined as the value of all goods and services produced less the value of any goods or services used in their creation. The volume index of GDP per capita in Purchasing Power Standards (PPS) is expressed in relation to the European Union (EU-28) average set to equal 100. If the index of a country is higher than 100, this country's level of GDP per head is higher than the EU average and vice versa. Statistics Estonia, <<http://www.stat.ee/29956>> (last visited 29 Nov. 2014).

<sup>112</sup> Eurostat. Unemployment rate by sex and age groups - monthly average, % [une\_rt\_m].

<sup>113</sup> SEB: Baltic Household Outlook

<[http://www.seb.ee/sites/default/files/web/files/uudised/BHO\\_aprill2014\\_tallinn.pdf](http://www.seb.ee/sites/default/files/web/files/uudised/BHO_aprill2014_tallinn.pdf)> (last visited 29 Nov. 2014).

<sup>114</sup> Source: SILC [ilc\_mdcs09].

<sup>115</sup> Source: SILC [ilc\_mdcs04].

<sup>116</sup> Source: SILC [ilc\_mdcs17].

<sup>117</sup> However, in Estonia the highest concentration of private rental residential housing is not in capital, but in university town Tartu.

<sup>118</sup> E.g. in case of Lithuania, almost two-thirds of people (about 60 percent), who have rented apartments live in the biggest cities (Vilnius, Kaunas, Klaipėda). About one-third of people, who have rented apartments, live in the small cities, and only about one-tenth (about 9 percent) live in villages. Cf. generally Kährlik, Novák et al (2013); Tammaru, Leetmaa et al (2009); Leetmaa, Brade et al (2012); Leetmaa & Tammaru (2007); Also: Tammaru, Kulu, et al. (2004).

built in larger groups, which sometimes assumed characteristics of gated communities.<sup>119</sup>

Apart from an ageing population and a moderate decrease in the size of the population, **slow urbanisation**<sup>120</sup> is likely to continue. Urbanisation is favouring larger cities and towns.<sup>121</sup> The prevalent directions of migration are tied to a person's life cycle: the young are moving primarily into the large cities and towns, families with children into suburbs, and older working-age people and retirees into the countryside.

Even though the segregation of the Russian speaking population in ESTONIA on an intra-urban level is noticeable (there are mainly historical reasons for that, related to Soviet immigration policy and location of industrial areas) it does not translate into the phenomenon of **ghettoization**.<sup>122</sup> Although public rental (incl. social) housing tends to be concentrated in clusters in the capital city, this directly does not lead to ghettoisation.<sup>123</sup> However, ghettoization of districts where social dwellings and houses are situated is characteristic for LATVIA.<sup>124</sup> In LITHUANIAN capital city Vilnius, in district of Kirtimai for about 50 years there has been a local Roma's settlement called Tabor. This encampment is a unique phenomenon in Lithuania and indeed in the other Baltic countries. Elsewhere, Roma's live in families, but also with other nationalities. Vilnius Roma's Tabor is completely separate – geographically, socially and culturally closed community<sup>125</sup>. Today in Tabor there are more than 500 Roma.<sup>126</sup>

There is also some evidence of the **gentrification** as a new phenomenon that started mainly during the 2000s in bigger cities.<sup>127</sup> Gentrification processes are most evident in

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<sup>119</sup> Hence, the urban development of major Baltic cities generally assumes the characteristics of a phenomenon called "sprawl without growth", which defines the extensive urban sprawling in the context of rapid demographic and economic decline. *Ibid.*, 78.

<sup>120</sup> Growth in the urban population is relative: its absolute numbers are not increasing significantly yet its proportion is being boosted by the decrease in the rural population.

<sup>121</sup> Urbanisation statistics are being distorted also by urban sprawl, since residents in new urban regions constructed beyond the limits of a city yet in its vicinity are classified as rural population.

<sup>122</sup> Ghettoisation means spatial isolation of one social or ethnic group (usually cultural aspects overlapping with social). Compared to the socialist era it could be said that social differences have indeed increased at the intraurban level, and pockets of concentration of groups based on social status have emerged, these urban dynamics still do not constitute ghettoisation. Cf. Kährrik and Tammaru (2010); Hess, Tammaru, *et al* (2012), Ruoppila and Kährrik (2003).

<sup>123</sup> The clients of public housing come from quite different backgrounds, not from a particular ethnic or social group. It does lead to accumulation of some urban social problems, but not ghettoization. E.g. in Tallinn, analyses have revealed a highly spatially segregated pattern of social housing dwellings on the intraurban level, with the highest concentration of social housing in certain inner-urban neighbourhoods made up of poor quality pre-1946 housing. Kährrik and Kõre (2013).

<sup>124</sup> It happens because social dwellings are often situated in districts with poor infrastructures to lower the construction costs of such dwellings. Ekonomikas Ministrija. Sociālo mājokļu koncepts. <[www.em.gov.lv](http://www.em.gov.lv)>, (last visited 2 Sept. 2013), through Latvian Report, 30.

<sup>125</sup> They are enclosed in the sense that Romas have virtually no links to the city and do not use the city's infrastructure.

<sup>126</sup> See also first Romany Internet Site <<http://www.roma.lt>> (last visited 28 Nov. 2014)

<sup>127</sup> For example, in Vilnius this phenomenon can be found in Užupis and Žvėrynas neighbourhood, similar trend has been identified in Tallinn and Tartu.

more attractive historical housing with well sustained physical structures, where prior residents are being voluntarily or involuntarily displaced after restitution of the property to its former owners.<sup>128</sup>

**Squatting** does not appear to be a significant social or legal problem in neither of three countries.

### 1.3.2. Social aspects

The **homeownership is the most attractive tenure type** in all three Baltic States.<sup>129</sup> In general only home ownership is regarded as a safe protection for entire life.

As much as 96 percent of the population in LITHUANIA would want to live in their own property and those who rent a house or a flat see it as a temporary arrangement.<sup>130</sup> Payment of rent is considered as a waste of money if there is an affordable alternative to buy home as an investment in property for the same amount of monthly payments. Only in the age group of 16-29 is the attitude towards rental more favourable.<sup>131</sup>

Usually middle-income people would choose to rent dwelling when they search to acquire appropriate house, and young families and younger people prefer the lease when they accumulate down payment for own home purchase. Private rental is generally conceived as an unstable tenure, since private landlords often do not offer long-term tenancy contracts which is necessary in order for a renter to feel that dwelling is really a home.<sup>132</sup>

Social housing as a tenure form is often associated with asocial segment of population. But there are several reasons why attitudes towards tenants are not always positive even in private market. First and foremost is the understanding that the law protects tenants more than rights of the owners, which encourages misconduct by the tenants. Owners are afraid of the possibility that tenants will abuse their rights as for example the right to register their leased residence in the Population Register, cause damage to the property or oppose eviction for unlawful reasons causing.

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<sup>128</sup> Hiob, Nutt *et al*, Risen From the Dead: from Slumming to Gentrification, < <http://rtsa.ro/en/files/TRAS-36E-2012-7HIOB,%20NUTT,%20NURME,%20DE%20LUCA.pdf> > (last visited 7 Jan. 2013).

<sup>129</sup> About pluses and minuses of the dwelling rent and ownership. Available at (in Lithuanian): <<http://www.swedbank.lt/lt/articles/view/1647>> (last visited 29 Oct. 2012); Survey conducted by Eesti Konjunkturiinstituut (December 2013).

<sup>130</sup> Lithuanian Report, 23.

<sup>131</sup> As per most recent survey, 46 % of students in ESTONIA who currently rent from private landlords, would buy a home as the next step in meeting their housing needs. Even though more than half of the respondents (54%) consider buying a home as an important investment necessary to insure economic certainty in the future (60%), despite the accompanying risks (56%), many continue to view rental tenure as an alternative that is not entirely excluded. Ministry of Economic Affairs and Communications. Affordability and demand for rental housing. Analysis of the opinions of the students. (*Ürieluaseme kättesaadavus ja vajadus. Üliõpilaste hinnangute analüüs*) 2013, 28 <[http://www.mkm.ee/public/Uliopilaste\\_eluasemeuring2013\\_Raport.pdf](http://www.mkm.ee/public/Uliopilaste_eluasemeuring2013_Raport.pdf) > (last visited 21 March 2014).

<sup>132</sup> Ibid.

ESTONIAN residents prefer the status of owner to the greater flexibility that renting offers.<sup>133</sup> They also prefer real estate as an investment compared to financial instruments: 90% of investors considered buying their own home as an investment.<sup>134</sup> However, home ownership cannot be regarded as a safe protection after retirement without any reservation as it usually associated with maintenance costs far bigger than the pension would cover. Furthermore, there are problems regarding administration ownership as the mentality of many owners of the apartments remain as being tenants.<sup>135</sup>

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<sup>133</sup> Swedbank news (04.02.2014): Uuring: Eestimaalaste arvates on kindlaim investeering kinnisvara, <<https://www.swedbank.ee/private/home/more/newsandblog/news>> (last visited 21 March 2014).

<sup>134</sup> Since 1997, real estate prices have increased by 115%, returning a profit of 5% yearly. Turmoils and reforms, incl. monetary reforms over past 70 years have taught the lesson, that investments in real estate were best at maintaining their value the best. Ibid. .

<sup>135</sup> In the year 2009 the Law Maintenance of Residential Houses was passed. The law states that the administration (management) of a residential apartment house (including taking of decisions, entering into transactions related to the administration of the residential house) is the duty of the owner of the residential house. But only few houses started to administrate their property – apartment houses according to the proposed by the self-administration models, others prefer to use services of organisations which were established by local municipalities and which help to administrate residential houses. Private managers of residential apartment houses are not controlled effectively, i.e., law rules are insufficient, what may cause different problems, including the obligation to pay double for utilities due to unlawful conduct of their manager. There have been a number of cases when owners and tenants of apartments were not aware whether managers of residential apartment fulfil their duties. In the worst cases managers disappeared with all money, but owners and tenants had to cover payments for utilities once more.

## 2. HOUSING POLICIES AND RELATED POLICIES IN COMPARISON

### 2.1. Introduction

It seems that dominating basic principle behind the housing policies in Baltic States is neo-liberalism. It is generally assumed that a person tries to provide him- or herself with a residential dwelling. If a person cannot secure himself or herself with the dwelling, a respective local municipality should provide assistance. Thus current housing policy targets its measures to support home ownership and limited interference rental market, targeting social housing only to low-income segments of the population within the component of social policy. Municipalities should secure the minimum standard of the right to housing. In order to fulfill this obligation, the central government finances social housing measures organised by municipalities. However, the capability of the state to create an efficient and functioning social security system depends on the budgetary feasibility and the general economic situation.

The Constitutions of the Baltic States do not directly address universal right to housing.<sup>136</sup>

State provides assistance in case of need in a form of social housing or other housing support measures.<sup>137</sup> Hence, recognizing principle of welfare state as constitutional principle, in wider terms, housing policy in Baltics is not typical of a welfare state.

### 2.2. Policies and actors

#### 2.2.1. Governmental actors

LATVIA and ESTONIA differentiate two levels of housing policy actors – national and local (municipal), while in LITHUANIA, also regional level is important<sup>138</sup>.

In LITHUANIA, the Ministry of Social Security and Labour of Lithuania, which is responsible for the (national) welfare state, takes care of some housing policy aspects – specifically of Government-sponsored mortgage programs. In LATVIA, Ministry of Economics is responsible for housing policy on the national level. In ESTONIA, housing policy documents are compiled by Ministry of Economic Affairs and Communications.

Local municipalities realize the housing policy direct to inhabitants of their territories.

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<sup>136</sup> From time to time it is suggested to include the right to housing in the constitution of Latvia, last time in 2012. Till now no amendments of the constitution were made.

<sup>137</sup> E.g. The Constitution of Lithuania Article 52: The State shall guarantee to citizens the right to receive old age and disability pensions as well as social assistance in the event of unemployment, sickness, widowhood, loss of the breadwinner, and in other cases provided for by laws. Art. 28 of the Estonian Constitution: Everyone is entitled to protection of his or her health. Every citizen of Estonia is entitled to government assistance in the case of old age, incapacity for work, loss of provider, or need. Article 109 of the Latvian Constitution provides for the specific and distinctive rights such as the right to social guarantees for old age, work disability, unemployment and other cases determined by law (Article 109 of the Constitution).

<sup>138</sup> National, regional and local levels of government are responsible for designing housing policy instruments. Regional and local levels of government submit the proposals for housing policy and the national level of government adopts legal acts.

## 2.2.2. Housing policies

In ESTONIA, three main objectives set in Development Plan 2008-2013 were to: (1) ensure access to suitable and affordable housing<sup>139</sup>; (2) achieve high quality and sustainable housing in attractive residential areas and (3) ensure diversity, along with balanced and sustainable development of residential areas. However, in ESTONIA, during the year 2014, certain steps have been taken in order to facilitate state-supported private rental sector.<sup>140</sup> The national housing policy document for 2014-2020 will be intergrated into The National Development Plan of the Energy Sector. It is generally acknowledged that there is need to support labor force mobility by providing more rental dwellings, and make the rental market more transparent.<sup>141</sup>

In LATVIA, following aims have been set regarding existing dwellings: (1) the legal basis concerning maintenance and supervision of apartment houses should be amended and improved; (2) the state earmarked subsidies for measures which raise power efficiency of apartment houses should be granted; (3) the mechanism concerning crediting of renovation of apartment houses should be introduced; (4) the educational system of managers of apartment houses should be introduced; (5) the informational system for the society concerning dwellings should be introduced. As to the development of the housing sector, the following objectives should be achieved: (2) the legal basis concerning construction should be improved; (3) the social housing system which complies with current demands should be created; (4) competition in the private rental

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<sup>139</sup> Measures implemented include: deduction of housing loan, interest paid from taxable income, state guarantees to housing loans, home support for large families.

<sup>140</sup> Estonian Economy and Infrastructure Minister Urve Palo, who has been recently promoting a state subsidised rental apartments programme, said that the money spent on building such rental apartments will come back as additional tax revenues and will keep quite a few families from leaving Estonia to live in Finland. Palo said that participants of a wide-based round table meeting in the ministry on November 4 decided that the state-supported rental housing programme must be included in the forthcoming Energy Sector Development Plan 2030. The minister said all the parties agreed that publicly supported rental homes are needed in Estonia. Palo said in public television ETV's morning news programme on Wednesday that public rental housing is needed because three times more housing depreciates in Estonia than is built. Because, in Estonia the housing market is outdated, and the state has not seen any role in its development in 20 years. Today the situation is such that 2,000 new homes are built in Estonia a year, but 6,000 depreciate. The gap is 4,000. There should be demand, but they [new housing] don't emerge. People do not have the resources for that," said the minister. Palo said that it is one thing, but the other side is that the scientists believe that the state should intervene much more actively in housing policy: among other things, support the renovation of old houses and building apartment building to rent. Palo said that the situation differs in municipalities: while in Tallinn and Tartu, the problem is very high cost of decent housing, in rural areas and provincial towns, as a rule, however, no apartments in a normal condition are offered for rent at all. Consequently, it inhibits the mobility of people. Palo stressed that municipalities have the leading role in the plans as they have to show how getting state support for building rental housing would develop the economy and local environment. <[http://www.baltic-course.com/eng/real\\_estate/?doc=98851](http://www.baltic-course.com/eng/real_estate/?doc=98851)  
<<http://epl.delfi.ee/news/arvamus/urve-palo-turg-ei-lahenda-koiki-est-eluasememajanduse-probleeme?id=70132485>> (last visited 29 Nov. 2014).

<sup>141</sup> ENMAK 2030+ Eesti energiamajanduse arengukava aastani 2030 (draft), <[https://www.mkm.ee/sites/default/files/enmak\\_2030\\_eelnou\\_23.10.2014.pdf](https://www.mkm.ee/sites/default/files/enmak_2030_eelnou_23.10.2014.pdf)> (last visited Nov. 20, 2014).

market should be improved; (5) tax privileges in case of apartment house renovation and acquisition of property should be granted.

The LITHUANIAN Housing Strategy declares that one of its goals is to expand housing options for all social groups and considers important to: (1) increase the supply of non-profit and social housing to medium-and low-income households. The aim is to have share of the rental housing 18 percent of the total housing stock in by 2020, from this housing social housing amount must be ca 4-5 %; (2) construct more new dwellings for middle-and high-income households to buy or rent better dwellings, to increase the annual construction volume from the current – about 12.000-15.000 apartment in 2020; (3) increase financial support will be provided to low-income households – to cover part of their housing and rental costs, especially for families with children and disabled persons. Only in LITHUANIA, there exist housing policies targeted at foreigners who have been granted asylum, and at the Roma.

For LATVIA it can be said that the policy still favours home-ownership or is tenure neutral. In ESTONIA, lately state-supported rental sector emerged as topical issue. LITHUANIAN national housing policy does not favour certain types of tenure: the goal is to develop different housing tenure forms in order to ensure all social groups interests and for that, *inter alia*, to enlarge rental sector.

### 2.3. Urban policies

No specific urban policies to prevent ghettoization and gentrification exist in ESTONIA.<sup>142</sup> However, the city of Tallinn has purposely refurbished public rental housing in certain inner city areas in order to prevent ghettoization and to upgrade certain inner city areas. The policy aims at improving living conditions in areas already dominated by low-income groups. Social mix will probably be the result, since, inner-city areas also tend to attract wealthier groups, but it is not aim of the policy. Ghettoization of districts where social dwellings and houses are situated is characteristic in LATVIA. Although the phenomenon of gentrification exists also in bigger cities of LITHUANIA, it is not officially recognized as a problem to address with special policies.<sup>143</sup>

Generally, it is up to tenant to file a civil claim based on lease contract insisting that the landlord should guarantee the proper (agreed) status of the dwelling (e.g. by performing repairs or improving the dwelling). In case of ESTONIA, however, this is practically the only possibility, as the quality of the private rental dwellings is determined mainly by free market mechanisms as apart from the requirements set by Building Act<sup>144</sup> and various

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<sup>142</sup> National Spatial Plan Estonia 2013, <<http://eesti2030.files.wordpress.com/2014/02/estonia-2030.pdf>> (last visited 29 Nov. 2014).

<sup>143</sup> For example, in Vilnius this phenomenon can be found in Užupis and Žvėrynas Today these neighbourhoods are considered to be prestigious. The media very often report that low-income residents, who live in these neighbourhoods, receive proposals to sell their houses and if they do not agree with such proposals their houses are fired by unknown persons.

<sup>144</sup> Building Act (*ehitusseadus*), passed 15.05.2002, entry into force 1.01. 2013, RT I 2002, 47, 297.

standards<sup>145</sup> for new and reconstructed dwellings, there are no special regulations regarding the quality of private rented housing as to minimum floor area, equipment, access to technical and/or social infrastructure and/or public transport.

In LATVIA, a residential dwelling shall be fit for rent, i.e., shall comply with the mandatory construction and hygiene requirements, be suitable for long-term human accommodation, as well as for placing household items. Tenants should receive the basic services.<sup>146</sup> The criteria like minimum floor area, equipment, access to technical and/or social infrastructure and/or public transport are of no importance. Beside the tenant within the framework of the lease contract, also Rental boards<sup>147</sup> and local municipalities control the fulfilment of the requirements. Administrative commissions of a local municipality are entitled to examine the possible evasion from the duty as specified by law to maintain and manage a residential house, failure to provide basic services to a tenant of a residential premise, violation of construction regulations etc.

In LITHUANIA, the housing should correspond to Hygiene standards<sup>148</sup> and to Construction Technical Regulations.<sup>149</sup> These standards are verified and controlled in two ways. Firstly, according to the Law on the construction of Lithuania<sup>150</sup>, when the construction of dwelling is terminated, the dwelling must be assessed by special institutions<sup>151</sup>, which must confirm that dwelling is suitable to use. Secondly, there is the Construction Technical Regulation STR 1.12.05:200265<sup>152</sup>, which indicates the procedure and mandatory requirements for the dwellings use and maintenance. According to this Technical Regulation the owners of dwellings must periodically hire specialists who verify if the dwelling corresponds to special requirements.

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<sup>145</sup> EVS-EN 15251:2007- parameters for design and assessment of energy performance of buildings. EVS 839:2003 - values to assess the relative humidity of indoor air. EVS 894:2008+A1:2010 - daylight in dwellings and offices. Vabariigi Valitsuse 27. oktoobri 2004 määruse nr 315 „Ehitisele ja selle osale esitatavad tuleohutusnõuded”.

<sup>146</sup> I.e. services which are inseparably related to the use of the residential space (heating, cold water, sewerage and removal of municipal waste) and which are necessary for the Latvian climatic circumstances.

<sup>147</sup> At the moment there is only one Rental board - in Riga. Local municipalities may establish a Rental Board, which perform the following functions: (1) In the cases provided for by law and the regulations issued by a local municipalities, draw up administrative protocols for persons who have violated laws, provisions of the Cabinet of Ministers and the binding regulations issued by a local municipalities, which regulate the renting out, maintenance and management of residential space; (2) Provide consultations and recommendations to house owners (lesers), apartment tenants (owners) and tenants (owners) of the non-residential space of residential houses; (3) Perform other functions referred to in the binding regulations issued by the relevant local municipalities.

<sup>148</sup> Approved by the orders of the Minister of Health of Lithuania,

<sup>149</sup> Approved by the orders of the Minister of Environment of Lithuania.

<sup>150</sup> The Law on the construction of the Republic of Lithuania (amended and supplemented). Official Journal, 1996, No. 32-788.

<sup>151</sup> Always – by the State Territorial Planning and Construction Inspectorate; by the State Energy Inspectorate; by the Public Health Centre; by the State Fire Supervision; in some cases – by the Regional Environmental Protection Department; by the Disability Organization; by the Municipality’s authorized representative.

<sup>152</sup> Approved by the order of the Minister of Environment of Lithuania No 351, 1 July 2002.

## 2.4. Energy policies

National and local energy policies affect housing in the spheres of the energy utility requirements of the dwellings, requirements for the dwellings modernization, etc.

In case of ESTONIA, measures promoting residential energy efficiency on the national level are targeted at the renovation of apartment buildings and at raising awareness of energy conservation. The most influential measures are loans (supported by European Regional Development Fund) and renovation grants.<sup>153</sup> As of the 9 January 2013, the owner of the residential building with indoor climate control or a part of it, has to ensure, in the event of lease, the presence of an energy performance certificate where such is required and must allow it to be inspected.

## 2.5. Subsidization<sup>154</sup>

In ESTONIA, housing policy measures are mainly state level instruments implemented either on a national or local level. They are financed from the state budget through the state credit agency KredEx. Municipalities are responsible organizing social housing as a subsidized form of tenancy. Measures implemented through the municipalities include allocation of subsidized social supply-side housing and demand-side distribution of subsistence benefits (including compensation for housing and utilities cost) (tenure neutral).

There are no special subsidies for tenants (except some local measures for tenants living in restituted houses). While generally a tenure neutral measure, the **subsistence benefit** is most important demand-side incentive. However, the subsistence level is too low to enable the recipient households to live a normal decent life.

Principal **subsidies for owner-occupiers** are: (1) housing loan guarantee<sup>155</sup>, (2) home support for large families (until 2013)<sup>156</sup> and (3) tax incentives (deduction of housing loan interest from taxable income; land tax exemption).

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<sup>153</sup> The state will support residents with 15%, 25% or 35% of the total project costs depending on energy class (according to Energy Performance Certification classification) and relative energy savings intended to be achieved by renovation. Policy Paper on Renewable Energy and Energy Efficiency of Residential Housing,

<[http://ec.europa.eu/regional\\_policy/sources/docgener/evaluation/pdf/eval2007/expert\\_innovation/2011\\_synt\\_rep\\_ee.pdf](http://ec.europa.eu/regional_policy/sources/docgener/evaluation/pdf/eval2007/expert_innovation/2011_synt_rep_ee.pdf)> (last visited 7 Jan. 2014).

<sup>154</sup> The information provided by the National Reports is not sufficient for deeper comparative analysis.

<sup>155</sup> Could be considered as the most effective state measure favouring owner-occupation as the preferred form of tenure. Since the establishment of the instrument in year 2000, 21 176 households have benefited. This measure is aimed at following target groups:

- 1) young families (a parent or parents raising a child of up to 15 years (incl.));
- 2) young specialists (up to 30-year-old (incl.) persons, who have acquired at least secondary level education, and has permanent jobs occupation or have operated as registered self-employed entrepreneurs for at least a year;
- 3) tenants of restituted residential premises;
- 4) veterans of the Defence Forces or Defence League.

<sup>156</sup> The measure is targeted to allowing large families to acquire a home or improve their housing conditions (minimum of 4 children under age of 19) with average income less than 300 euros per member of the household. About 300 families have benefited yearly (since 2008) in amount of some 2,2 million euros

There are several measures aiming at increasing the quality and energy efficiency of the housing stock which apply equally to **both home-owners and landlords**:

1. a renovation grant for small houses is suitable for landlords/homeowners of small one- or two family dwelling. The grant is aimed at promoting energy efficiency and use of renewable energy;
2. renovation loans for the reconstruction and improvement of energy efficiency of apartment buildings constructed before 1993 is available from KredEx;
3. apartment building loan guarantee (KredEx);
4. reconstruction grants for apartment associations planning full-scale reconstruction (KredEx);
5. energy audit, building design and expert evaluation grants (KredEx) available for apartment associations.

LITHUANIAN Law on State Support<sup>157</sup> sets two forms of state supports to individuals and families who have a permanent residence: (1) municipal social rented housing and (2) support for housing purchase, construction (reconstruction)<sup>158</sup>. More specifically:

(i) **Subsidies for tenants** – low-income persons (families) may apply to the municipal social housing rent.<sup>159</sup>

(ii) **Subsidies for owners** – few types of loan are guaranteed by the State:

1. the loan to buy or built the dwelling if the property of the dwelling will be transferred to the borrower in 2012;
2. the loan for house construction;
3. the loan for dwelling reconstruction;
4. the loan for dwelling adaptation for needs of the disabled.

There are no specific subsidies for the landlords.

The following subsidization forms are applicable in LATVIA:

1. Allocation of allowance to cover payment for residential tenancy and payment for utilities associated with usage of the residential space<sup>160</sup>;
2. Allocation of a one-time allowance for vacation of a residential space<sup>161</sup>;

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<sup>157</sup> The Law on the Lithuanian state support for housing purchase or lease and apartment buildings renovation (modernization) of the Republic of Lithuania (amended and supplemented). Official Journal, 2002, No. 116-5188.

<sup>158</sup> According to the Statistics Lithuania in the year 2011 there were 80 households which received state supported housing credits. The amount of the subsidies allocated was 806,3 thousand Lithuanian litas (LTL).

<sup>159</sup> The Municipalities for these persons (families), who meet the requirements, settled in the Law, grant of rent social housing for specialty rental price set by the Government. This subsidy is not of the pecuniary nature.

<sup>160</sup> I.e. *accommodation allowance*. A local municipality has the right according to the procedures and the amount specified in city council (parish council) binding regulations to pay an accommodation allowance to persons who in a denationalised house or a house returned to a lawful owner use residential space, which he or she has used up to the restoration of ownership rights;

<sup>161</sup> A local municipality has the right according to the procedures and the amount specified in city council (parish council) binding regulations to grant a once-only allowance for vacating residential space to persons:

3. Allocation of a one-time allowance for renovation of a residential space or residential house<sup>162</sup>;
4. Assistance in the renovation and restoration of residential housing<sup>163</sup>;
5. Assistance in purchase or construction of a residential space<sup>164</sup>;
6. Renovation of a residential space<sup>165</sup>.

## 2.6. Taxation

Real estate (incl. housing) **taxation remains below the EU average** in the Baltic States.<sup>166</sup>

In LITHUANIA and ESTONIA **tenants do not directly pay taxes** on their rental tenancies. In LATVIA, tenants pay directly the **immovable tax** which is an obligatory part of the rental contract<sup>167</sup>. Tenants pay indirect taxes such as the value added tax (VAT) for utilities.

The value of occupying a house is not considered as a taxable income, but the **profit derived from the sale** of a residential home is taxed with **income tax**. E.g. in ESTONIA, income tax (21 %, since 2015 - 20 %) applies to sale of dwellings in which the owner did not reside prior to the sale or exchange. Furthermore, in order for there to

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<sup>162</sup> A local municipality has the right to grant a once-only benefit for the repair of residential space or residential houses rented or owned by a person, as well as the amount of such benefit shall be determined in the binding regulations of the local municipality city council (parish council);

<sup>163</sup> The State in conformity with the amount of resources provided for in the annual State budget also provides assistance to an owner (owners) of a residential house or an apartment owner for the following purposes:

- For the restoration of residential houses recognised as a cultural monument of State significance;
- For the renovation of a residential house if the technical condition thereof has been recognised as dangerous to human life or health;
- For such renovation of a residential house in which the consequences of an act of terror, accident, natural disaster or other catastrophes must be liquidated;
- For the performance of energy-efficiency measures in the residential house.

<sup>164</sup> The State provides assistance in the purchase or construction of residential space by issuing a relevant guarantee. In case of purchase or construction of residential space, local municipalities may provide assistance by fully or partly covering interest payments. A tenant or its family member may receive the mentioned assistance in purchase of construction of a residential space referred, if they are using a residential space in a denationalised house or in a house returned to a lawful owner and have been using it until the restoration of the property rights.

<sup>165</sup> A local municipality may provide assistance for low-income persons by repairing the residential space they lease if the local government is not the lessor of this space, or by repairing the residential space in the ownership of these persons. The local municipality does not have the right to provide the assistance of this type to those persons who have already received a one-time allowance for renovation of a residential space or residential house;

<sup>166</sup> Real estate price dynamics, housing finance and related macro-prudential tools in the Baltics. ECFIN Country Focus, vol. 9, Issue 2, December 2012.

<[http://ec.europa.eu/economy\\_finance/publications/country\\_focus/2012/2012/cf\\_vol9\\_issue2\\_2012.pdf](http://ec.europa.eu/economy_finance/publications/country_focus/2012/2012/cf_vol9_issue2_2012.pdf) > (last visited 29 Nov. 2014).

<sup>167</sup> Section 11 of the Law On Residential Tenancy. From 1 January 2014 the living property owned by proprietors are eligible for reduced rates (0.2% to 0.6%), but only in cases the property is rented out and the rent rights are properly registered within the Land Register of Latvia.

be an obligation to pay income tax, the selling price has to be higher than the cost of acquiring it. Additionally, the taxpayer has the right to deduct certified expenses directly related to the sale or exchange of property from the taxpayer's gain or to add such expenses to the taxpayer's loss.

Residential lease to individuals for dwelling purposes is exempted from **VAT**. Only in LITHUANIA, a VAT payer is entitled to opt for taxation residential premises, i.e. VAT can be charged on rent of the property if the customer is registered for VAT purposes and performs economic activities.

In ESTONIA, rental income received by companies only becomes subject to (21 %, since 2015 - 20 %) **corporate tax** upon distribution of profits. Rental income received by corporate entity in LATVIA is taxed at a rate of 15%. Companies can deduct all expenses related to their rental business, and the value of real estate used for commercial purposes can be depreciated for tax purposes at a rate of 10% a year under the reducing balance method. LITHUANIAN corporate income tax rate 15%.

The **most favourable taxation can be enjoyed by the private landlords in LITHUANIA**, where "passive housing rent" by a non-professional landlord<sup>168</sup> is not the object of the **personal income tax** at all, whereas rental income from "active housing rent" by a professional natural person is taxable by income tax only in the rate of 15 %.

LATVIAN taxation can be rated as second best, as for a non-professional landlord<sup>169</sup>, the income tax rate is only 10% instead of ordinary 24 %. However, in that case only immovable tax can be deducted. Landlord registered as a self-employed person in the State Revenue Service may deduct management expenses and other expenses connected with economic activity from taxable income, including, but not limited to social tax payments. If an amount of the income from rent is rather small, i.e., amount to EUR 14226.00, then the fixed tax fee – 5% can be chosen. The standard taxation rate is 24%.

In ESTONIA personal income tax is (21 %, since 2015)<sup>170</sup> from the rent payments irrespective of the status on the natural person as a landlord. The difference lies in the deduction regime: passive landlord as a regular taxpayer (natural person) has no possibility of deducting any expenses from taxable income, while landlord registered as a sole proprietor has a right to deduct expenses and amortization, but has an obligation

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<sup>168</sup> When a natural/private person rents out the dwelling, which was acquired for him or his family needs and which temporarily become unnecessary for the family use.

<sup>169</sup> A natural person who does not register as a self-employed person. However, he has to inform the State Revenue Services on the conclusion of a (sub-)rental contract.

<sup>170</sup> 20 % from 2015.

to pay social tax (33 %) on net income.<sup>171</sup> In this way **ESTONIAN tax system is most unfavourable.**<sup>172</sup>

Rental agreements are not subject to any state or notary fees.

Tenants are not able to deduct rent from taxable income, neither is tenancy as tenure specifically subsidized in any of the countries. The significantly modest subsidization measures discussed above do not have any remarkable effects on rental markets. It can rather be acknowledged that greater influence is caused by the **lack** of tax subsidies for private landlords.<sup>173</sup>

Homeowners were treated favourably via the tax system. For example, **deduction of loan interest** from taxable income was most common subsidization of the homeowners. However, recently, some steps were taken in order to contain housing demand, including phasing out mortgage interest deductibility in all Baltic States. In Estonia, the limit on deductible interest expenses was reduced by 40% from 2012 onwards. In Latvia and Lithuania, mortgage-interest deductibility was phased out.<sup>174</sup>

Secondly, homeowners profit from the **exemption from land tax.**<sup>175</sup>

**Tax evasion** is a topical issue in all Baltic States.

Rental income from renting out private dwellings by individual households is not officially declared to tax authorities. For example, in ESTONIA, it has been estimated, that maximum of 25 % of the landlords declare their income from leases. Anyway, rental markets are the ones that suffer. Tax evasion has created a situation where landlords ignoring their tax obligations have had a remarkable competitive and price advantage. The lack of written and transparent contracts creates distrust and uncertainty against both landlords and tenants, i.e. it renders the whole rental market unstable and untrustworthy, incapable of providing long-term secure housing. If the tenant agrees to pay rental and other payments in cash later he can face the situation that the landlord terminates the contract, if the tenant cannot prove that he has made payments for four

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<sup>171</sup> There is certain initiative in the Ministry of Finance to set lump sum as possible deduction from the rental income received by the non-professional landlord (natural person), e.g. <http://aripaev.ee/blog/2014/01/09/renditulult-on-raske-makse-katte-saada> .

<sup>172</sup> It has even been suggested that landlords should have the ability to deduct some expenses –such as land tax, insurance, maintenance and repair costs –made to the leased property from taxable income without the prerequisite of registering his-/herself as a sole proprietor in the commercial register.<sup>303</sup> Alternatively, there have been suggestions that rental gains should be taxed with a lower tax rate –e.g. 10% rather than 21% in force today –or exempted from taxation altogether. Yet, so far these suggestions have been rejected by the Estonian Ministry of Finance.

<sup>173</sup> Estonian Report, 65.

<sup>174</sup> Ibid.

<sup>175</sup> ESTONIA: The most important measure in subsidizing home-ownership is the opportunity to deduct housing loan interest paid from taxable income. Since 2013, all land owners and land users are exempted from the obligation to pay land tax on residential land in the use of such persons to the extent of 1500 m<sup>2</sup> in cities and 2000 m<sup>2</sup> in rural municipalities if the taxpayer's residence is in the residential building located on this land pursuant to the residence data entered in the population register. Exemption favours homeowners as it does not apply, if the respective building is rented out and not used as landowner's residence

months. The landlord can be confronted by the tenant's blackmailing to disclose all information to the State Revenue Service. At least in case of ESTONIA, landlords do not allow tenants to register their domicile and apply for subsistence benefit because some of the municipalities have responded tax authorities request to share information in tenancy contracts.

In LITHUANIA, however, due to the favourable tax regime for "passive housing rent", the majority of landlords provide rental services without a business license. This phenomenon makes rental markets non-transparent and there are no precise data about supply and demand in these markets. In Lithuania, there are only a few percent of people who are renting housing officialy. Complicated personal tax on real estate procedures is one of the reasons why Lithuania has a large informal rental housing market. Landlords do not register the rental agreements in the registers in order to avoid paying taxes.

### 3. COMPARISON OF TENURES WITHOUT A PUBLIC TASK

#### 3.1. Evaluative criteria for the landlord

##### 3.1.1. Profitability

**Rent regulation** in itself does not impede reasonable profit in any of the three countries. Rent control was abolished in year 2004 in ESTONIA<sup>176</sup> and 2007 in LATVIA<sup>177</sup>. There is no general control of the **initially agreed amount of rent** in those countries.

In general, rent is set based on current market conditions. Amount of rent supposedly covers justified management (incl. maintenance) expenses and provides reasonable profit. In LITHUANIA, in case the landlord is a legal person, theoretically the maximum amount of rent payment may not exceed the level determined in accordance with the procedure established by the Government. But this rule is not realized because the Government of the Republic of Lithuania has not yet adopted its resolution on the maximum amount of the commercial lease payment.<sup>178</sup> However, amount of rent should pass the reasonability test at any time.

In case of **contracts for unspecified term**, the **rent increase**<sup>179</sup> is relatively easier for the landlords in ESTONIA as an option for the rent increase every after 6 month is foreseen by the law by default. However, such an increase should be justified by the reference to changed market conditions or an increase in the expenses incurred in relation to the dwelling. Excessive increase may be contested by the tenant. Landlords in LATVIA and LITHUANIA could not increase the rent unless respective clause agreed

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<sup>176</sup> In Estonia, rent control was abolished by the “Act to Amend the Dwelling Act and § 121 of the Republic of Estonia Principles of Ownership Reform Act” passed by the Riigikogu on 15 June 2004. With this amendment, the delegation norm that gave authority to a local government council to establish maximum rents on its administrative territory in regard to dwellings situated in restituted houses was repealed. The respective delegation norm, Article § 371, had been inserted into the Dwelling Act on 10 June 1998. Before adoption of the referred Act (1998) the calculation of rent for a dwelling was regulated by “Methodological principles of calculation of rent for dwellings upon the lease thereof”, approved by Government Regulation no. 254 of 12 August 1993, which established the bases for calculating the amount of rent for all lessors of residential spaces on the territory of the Republic of Estonia, irrespective of the form of ownership of the dwelling. According to clause 3 of this legal act a rent exceeding the rent margin established by a local government body could not be imposed. The right to establish rent margins was given to local governments by Government Regulation no. 69 of 6 March 1992 “Amendments to procedure for calculating rent for dwellings and establishment of rent margins”. According to the explanatory letter to the draft of the Dwelling Act Amendment Act (628 SE), passed on 10 June 1998, the right of local governments to establish rate margins was to create opportunity “to gradually start to free up the rent amounts, thanks to which an actual housing market will be created as well as the interest of the owners to take better care of houses” (3-4-1-20-04 (2 Dec. 2004), available in English: <<http://www.nc.ee/?id=396>> (last visited 25 Dec. 2013).

<sup>177</sup> After the judgement of the Constitutional Court in case No. 2005-16-01351 (Judgement of the Constitutional Court of the Republic of Latvia of 8 March 2006, Case No. 2005-16-01. <[www.satv.tiesa.gov.lv](http://www.satv.tiesa.gov.lv)>, 2 September 2013), explicit rent control as the determination of the highest possible rental payments in relations of two private persons does not exist in private renting, but at the moment the Law on Residential Tenancy uses other means that can be regarded as rent control means.

<sup>178</sup> Lithuanian Report, 122.

<sup>179</sup> See section 3.2.1. for more details.

in the contract. Provided that there is an agreement to such effect, the minimum interval for rent increase may be set minimum at 6 months in LATVIA and 12 months in LITHUANIA. In case of **contracts for specified term**, respective agreement is also necessary under ESTONIAN law. Such agreement is only valid for contract with minimum term of 3 years, provided that the minimum interval for rent increase is not set shorter than 12 months and basis for calculation are precisely determined (i.e. stepped, indexed).

**Taxation of rental income** differs considerably. ESTONIAN tax regime is most unfavourable to the natural persons as passive private landlords, i.e. the largest group of landlords. See 2.6 above.

Under LATVIAN and LITHUANIAN law, the **cost of utilities** are, by default, borne by the tenant. On the contrary, under ESTONIAN law, tenant bears the accessory expenses (i.e. charges for the services and acts of a lessor or a third party which are related to the use of property) only if so explicitly agreed, which is usually the case.<sup>180</sup>

As to the other expenses to be borne by the landlord first the cost for **capital repair** should be mentioned; those costs are for the landlord in all three countries. Additionally, under ESTONIAN and LATVIAN law, also the costs of **routine repair** are borne by the landlord. ESTONIAN law is mandatory in favour of the tenants, while parties are free to agree otherwise in LATVIA and LITHUANIA. See section 3.2.1 for more details about distribution of the responsibilities and expenses related to the repair work.

Under ESTONIAN law, all taxes and duties related to a thing shall be borne by the lessor unless shifted to the tenant by agreement.<sup>181</sup>

In LATVIA, the tenant has to pay the immovable tax levied by local municipalities.

### 3.1.2. Property rights respected *de iure* and *de facto*

**Delay in rental payments** is valid ground for termination in all three countries. The basic criteria is that the tenant is delayed with payment of rent (and utilities) three month. LATVIAN law protects the interest of the landlord the most as the only prerequisite for termination is giving a notice 1 month in advance.

Under ESTONIAN and LITHUANIAN law, the landlord has to set additional period for performance first. ESTONIAN law sets clear that a lessor does not have the right of extraordinary termination if the lessee performs the delinquent obligations before receiving the notice. In all three countries the landlord may claim interest on money due. Under LATVIAN law, contractual penalty for delay may not exceed 10% of a principal claim and interest arisen<sup>182</sup>, while in ESTONIA, any agreement on contractual penalty upon violation of a contract by the tenant is void altogether.

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<sup>180</sup> Art 292 of the LOA.

<sup>181</sup> Art 293 of the LOA.

<sup>182</sup> Latvian Report, 104.

In general, the following actions by the tenant are treated as breach of contract and as such, form **other basis for the (extraordinary) termination** of the contract by the landlord in all three countries:

- 1) causing damage to or demolition of dwelling;
- 2) disturbance of neighbors;
- 3) use of dwelling not in accordance to the intended purpose;
- 4) unauthorized sublease.

Differences lie in the details which are summarized in **Table 5** below. It is important to add, that the landlords in LITHUANIA should bring an action for dissolution of the contract into court. However, if the tenant refuses to free the dwelling, court proceeding for eviction is inevitable also in ESTONIA and LATVIA.

**Table 5 Termination by the landlord in case of breach of contract by the tenant.**

	ESTONIA	LATVIA	LIHTUANIA
Causing damage to the dwelling	Violation is material or caused intentionally or continues regardless of any prior warning; <b>30 days</b> advance notice, unless violation is intentional	Systematic and essential violation; Termination without prior notification	Intentionally or through negligence; the right to bring an action into a <b>court</b>
Disturbance of neighbors	Violation is material or caused intentionally or continues regardless of any prior warning; <b>30 days</b> advance notice	Systematic and essential violation; Termination without prior notification	(no direct norm)
Use of dwelling against intended purpose	Violation is material or caused intentionally or continues regardless of any prior warning; <b>30 days</b> advance notice	Systematic and essential violation; Termination notice <b>1 month</b> in advance	The right to bring an action into a <b>court</b>
Unauthorized sublease.	If, as a result, the lessor or neighbours are so affected that the lessor cannot be expected to continue the lease contract; <b>30 days</b> advance notice	Systematic and essential violation; Termination notice <b>1 month</b> in advance	The right to bring an action into a <b>court</b>

Regulation of **deposit** varies in the countries under the comparison considerably. ESTONIAN regulation of deposit<sup>183</sup> resembles to the one in German BGB § 551, entitling the landlord to ask for the security deposit in the amount of up to **three months'**

<sup>183</sup> Art. 308 of the LOA.

rent. In practice, a deposit in the amount of 1-2 month rent is usually demanded.<sup>184</sup> The lessee may pay the deposit within three months in equal instalments. The first instalment shall be paid after entry into the lease contract. The deposit shall be kept by the lessor in a credit institution separately from the assets of the lessor and at least at the local average interest rate. The interest belongs to the lessee and increases the deposit. The lessee may demand repayment of a deposit if the lessor does not inform the lessee of a claim of the lessor against the lessee within **two months** after expiry of the lease contract. Also LATVIAN regulation<sup>185</sup> recognizes similar concept of deposit, but there is **no limitation** as to the amount of deposit that the landlord may claim for. The amount of the deposit usually equals the amount of rental and/or payments for utilities for 2-3 months.<sup>186</sup> As the law in LATVIA does not provide detailed regulation, the procedures and time periods for the payment as well as the principles of refunding are subject to agreement. If the tenant, upon the expiration of the rental agreement, owes the renter rental payments or payments for services, as well as for caused losses, the debt shall be extinguished and losses shall be compensated from the security deposit. If, upon the expiration of a rental contract, the security deposit for ensuring the fulfilment of obligations of the agreement is not used or is used partially, the whole amount of the security deposit or the remaining part thereof shall be returned to the tenant not later than **on the same day when the residential space is vacated**, unless the rental agreement states otherwise. By contrast, LITHUANIAN law **does not recognize the concept of deposit** as the security for future claims, but regulates<sup>187</sup> advance payment stating that the lessor shall have no right to demand the payment of lease in advance, with the exception of the lease payment for the **first month**. The clause of the contract for more than one month deposit payment will be null, but the contract itself will be valid.<sup>188</sup>

ESTONIAN law<sup>189</sup> recognizes a **right of security** (pledge) of the lessor comparable to *Vermieterpfandrecht* as set in § 562 BGB.<sup>190</sup> In LATVIA<sup>191</sup>, the landlord has a **lien** as a

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<sup>184</sup> Estonian Report, 130.

<sup>185</sup> Art.12.1 para 1 of the Law on Residential Tenancy.

<sup>186</sup> Latvian Report, 137.

<sup>187</sup> Art. 6.583 para 5 of the CC.

<sup>188</sup> Lithuanian Report, 126.

<sup>189</sup> Arts. 305-307 of the LOA.

<sup>190</sup> Landlord has the right of security over movables located on the leased property and, upon the lease of a room, over movables which are part of furnishings or are used together with the room. This right is accorded in order to secure claims arising from a lease contract even if the movables are not in the possession of the lessor. Claims for the payment of rent for the current year and the previous year and claims for compensation are secured by a pledge.

<sup>191</sup> Latvian Report, 128.

retention right as a personal right.<sup>192</sup> The LATVIAN CC does not provide any limitations of the retention rights in connection with a value of a claim or in cases, if other security means (deposit, pledge, personal guarantee, contractual penalties) have been contracted. Retention rights are applicable to property of the tenant which the tenant has brought into the building, but not in relation to intangible property and claims of the tenant. In LITHUANIAN CC, there are no direct articles which established the landlord's lien on the tenant's (movable) property in the house.

**Personal securities** (e.g. surety) are principally possible to agree, but this is not the common practice in the Baltics. Neither is **insurance**, although available, very widely used as a risk management tool in the context of tenancy contracts.

Summary of the risk management tools can be found in **Table 6** below.

**Table 6 Summary of the risk management tools available for the landlord**

	ESTONIA	LATVIA	LITHUANIA
Payment term	After expiration of each of the corresponding periods of time, unless the parties have agreed otherwise.	As agreed by the parties	Not later than by the 20th calendar day of the following month unless otherwise agreed.
Advance payments	May be agreed		Only first month
Earnest money	Possible	Possible	
Deposit	Up to 3 month Usual 1-2 months' rent	No limitation Usual 2-3 months' rent	-
Statutory pledge (security rights)	Covers claims for the rent of the current year and the previous year and claims for compensation	<b>NO</b>	?
Retention rights	Not applicable, see security rights	<b>YES</b>	?
Bankruptcy of lessee	The lessor may demand security. If security is not given to within reasonable term, the lessor may terminate the contract immediately.	The landlord may terminate the contract because of debts, but cannot enforce recovery of monetary claims.	?

<sup>192</sup> For this reason it does not influence *in rem* rights; consequently, the rules about pledge or acquisition of the ownership are not applicable when the retention rights are exercised. The possibility is a compulsory measure which grants the right to the creditor who is in possession of property may keep it until his claim is satisfied; the creditor has no right to sell the property in cases of the retention rights exercised in accordance with law. Retention means that the creditor gains actual control over movables which the tenant has placed in the dwellings. If the tenant does not allow to obtain actual control over his movables, the landlord may use force observing the rules about self-help, i.e., use of force should be proportional to resistance and character of actions of the tenant (Article 1733 of the Civil Law).

Interest on money due	<b>YES</b>	<b>YES</b>	<b>YES</b>
Agreement on contractual penalty	<b>NO</b> , prohibited	Up to 10% of the principal claim and interest	<b>NO</b> , prohibited

As to the **possibility to terminate contract if house is needed for own use** or close relatives or another economic use, contracts for specified and unspecified terms must be differentiated. Firstly, in case of contracts for unspecified term, under ESTONIAN and LITHUANIAN law, the landlord may terminate (ordinary termination) by giving at least three months' notice in former and at least six months in advance in latter case, unless longer term is agreed. Under LATVIAN law, controversially, contract for unspecified term may, at the initiative of the landlord, be terminated only in the cases set by the Law on Residential Tenancy<sup>193</sup>, i.e. in case of breach of contract from the part of the tenant.<sup>194</sup> Secondly, it should be emphasized that in case of the lease contract for specified term, under LATVIAN and LITHUANIAN law unilateral termination by the landlord is excluded altogether. In ESTONIA, in very rare cases extraordinary termination with good (compelling) reason is possible. In assessing the reason for the termination, one should take account all the circumstances and consider the interests of both parties. In reality, the landlord, for example, returning from abroad a year earlier than expected may not terminate the lease contract for specified term. Overview of the conditions for unilateral termination by the landlord can be found in **Table 7** below.

**Table 7 Unilateral termination by the landlord (except for breach of contract by the tenant).**

	ESTONIA	LATVIA	LIHTUANIA
Contracts for unspecified term	<b>YES</b> Ordinary termination Minimum <b>3 month's</b> notice	<b>NO (?)</b> Does <i>lex generalis</i> (Art. 2166 of the CC) apply? If yes - <b>6 months</b> notice.	<b>YES</b> 6 month's notice <sup>195</sup>
Contracts for specified term	<b>YES</b> , but only extraordinary termination with (very) good (compelling) reason .	<b>NO</b>	<b>NO</b>
Damage claim by the tenant?	<b>YES</b> , as self-induced termination is considered a breach of the contract.		

<sup>193</sup> Latvian Report, p 157.

<sup>194</sup> Section 28 of the Law On Residential Tenancy.

<sup>195</sup> Article 6.614 of the CC.

### 3.1.3. Construction and rehabilitation capabilities

There are several **public subsidies** to support reconstruction of the apartment houses as well as detached houses in all three countries. See 2.5 above.

Private arrangements in effect that the **tenant agrees to rehabilitate apartment** performance in kind) in lieu of paying rent is principally possible in all three countries through different regulation schemes. In LITHUANIA<sup>196</sup>, the law<sup>197</sup> clearly states that upon the agreement of the parties, the lease payment may be established, inter alia, by the duty of the lessee to improve the state of the leased thing at his own expense.

Under ESTONIAN law, firstly it should be noted that the repair works are all responsibility of the landlord.<sup>198</sup> It is possible that a lessee may remove a defect or obstacle and demand reimbursement of the necessary expenses incurred therefor if the lessor delays removal of the defect or obstacle or if the defect or obstacle only restricts the possibility of using the thing for the intended purpose to an insignificant extent.<sup>199</sup> Private arrangements about the tenant performing the lease agreement are possible and the tenant has the right for set-off. Also in LATVIA similar arrangements are subject to parties' agreement.

## 3.2. Important evaluative criteria for the tenant

### 3.2.1. Affordability

There is no specific definition of term "rent" under ESTONIAN law or LITHUANIAN law. LATVIAN law stipulates that rent consists of residential house (space) management expenses<sup>200</sup> and profit.<sup>201</sup> It follows that all other payments which are not residential house management expenses and profit, though they are agreed or have to be made because of law, are not rent in the meaning of the Law on Residential Tenancy.

There is no general **control of the initially agreed amount of rent** neither in ESTONIA<sup>202</sup> nor in LATVIA.<sup>203</sup> In LITHUANIA, the amount of rent for dwellings leased out on commercial grounds by enterprises, offices, organizations and legal persons shall be determined upon the agreement of the parties, though the maximum amount of the lease payment may not exceed the maximum lease payment determined in accordance with the procedure established by the Government.<sup>204</sup> However, it is reported, that the

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<sup>196</sup> Lithuanian Report, 124.

<sup>197</sup> Under the Art. 6.487 of the CC.

<sup>198</sup> This rule is mandatory in favour of the tenant.

<sup>199</sup> Art. 279 para 3 of the LOA

<sup>200</sup> Management expenses shall consist of: 1) the expenses necessary for the maintenance of a residential house (sanitary servicing and technical maintenance of the house, maintenance of administrative and service staff); 2) a deduction of depreciation (amortisation) of a residential house specified by regulatory enactments for the renovation of the house; 3) the mandatory payments specified by laws (immovable property tax, etc.); and 4) a land lease payment for land parcel use if the residential house is located on land owned by another owner.

<sup>201</sup> Art. 11 of the Law on Residential Tenancy.

<sup>202</sup> Estonia Report, 123.

<sup>203</sup> Latvian Report, 44, 123.

<sup>204</sup> CC Art 6.583 (4).

Government of the Republic of Lithuania has not yet adopted its resolution on the maximum amount of the commercial lease payment. Thus, nobody does follow this rule and nobody does control the following of the rule.<sup>205</sup>

Both in ESTONIA and LATVIA it is possible to apply general civil law concepts such as good faith, usury, violation of *bonos mores*, unconscionability, and also fairness control in standard terms in consumer law in order to indirectly control the rent level. Under LITHUANIAN CC Art. 6.223, the lessee may negotiate with lessor for change of contract condition about which establishes an excessive rent pay. If the lessor does not agree to change this condition, the lessee may apply to the court and ask to change this contract's condition.

As to the possibilities for **rent increase**, ESTONIAN law seems most liberal, but offers also most detailed regulation of how the tenant could contest the excessive rent increase.

ESTONIAN law makes difference between the contracts for specified or unspecified terms. In case of the lease contract of unspecified term the landlord may, by default, unilaterally raise the rent after each **six months** following entry into the contract. Parties may agree on a longer interval but not a shorter one.<sup>206</sup> Landlord of the lease contract of specified term may raise the rent only if an agreement on a periodical increase in the rent of a dwelling has been entered into, provided that (1) the lease contract is entered into for at least a three year term, (2) the rent increases not more than once a year, and (3) the amount of the increase in the rent or the basis for its calculation are precisely determined (i.e. stepped, indexed).<sup>207</sup> By contrast, in LATVIA and LITHUANIA the law does not make difference between the contracts for specified or unspecified terms as in any case, rent increase may only take place, if a rental contract contains the respective clause. Under LITHUANIAN law<sup>208</sup> clauses providing the lessor with the right to unilaterally perform modification of the lease payment or to demand such recalculation before the expiry of a **twelve-month** period from the date when the contract was formed or more often than once a year shall be null and void.<sup>209</sup>

### *Procedure*

LATVIAN law provides that the landlord should notify the tenant in writing regarding such increase at least **six months** in advance, unless the rental agreement states otherwise. The reason and the financial justification of the rental payment increase shall be specified in the notification.<sup>210</sup> The rent increase may not be justified by a possible inflation, other planned costs etc. The tenant has to notify the landlord within six months from the day of the receipt of the warning, if he agrees with the proposed new amount of rent, otherwise it will be presumed that the tenant has consent to rent increase. It will be

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<sup>205</sup> Lithuanian Report, 121.

<sup>206</sup> Art. 299 para 1 of the LOA.

<sup>207</sup> Art. 300 of the LOA.

<sup>208</sup> CC Art 6.583 (6).

<sup>209</sup> Lithuanian Report, 124.

<sup>210</sup> Art.13 para 1 of the Law on Residential Tenancy.

also assumed that the tenant agreed, if the tenant starts paying the new increased amount. After the consent has been given or presumed, the tenant may not withdraw it because it would be contrary to the principle of stability of civil relations.

No particular procedure is prescribed under LITHUANIAN law (?). Under ESTONIAN law, in case of open-ended lease contracts, the landlord should notify the tenant of an increase in the rent not less than **thirty days** before the increase in the rent in a form which can be reproduced in writing.<sup>211</sup> Such notification should set out terms and justification of the rent increase.

#### *Possible objections of the tenant*

ESTONIA: Provided that the landlord has delivered formally valid notice of an increase in rent, the lessee may contest an excessive increase in the amount of the rent for a dwelling within thirty days of being informing of the proposed increase.<sup>212</sup> The rent for a dwelling is excessive only if an unreasonable benefit is received from the lease of the dwelling, except in the case of a luxury apartment or house. However, if the amount of the rent for a dwelling does not exceed the usual rent for a dwelling in a similar location and condition, it cannot be considered excessive. Furthermore, an increase in the rent is not excessive if it is based on an increase in the expenses incurred in relation to the dwelling (e.g. cost of utilities, if borne by the landlord) or an increase in the obligations of the lessor or if the increase in rent is necessary in order to make reasonable improvements or alterations, including improving the condition of a part of a leased room or building such that the room or building is in the usual condition for such rooms and buildings.<sup>213</sup>

In LATVIA the tenant may raise objection against the financial justification.<sup>214</sup> Under LITHUANIAN law, the tenant can argue that increased rent payment will be contradictory to the price commonly charged of the contract for such performance in comparable circumstances in the sphere of business concerned or to a reasonable price with reference to Article 6.198 para 1 of the CC.<sup>215</sup>

Summary of the important aspects of rent regulation is presented in **Table 8**.

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<sup>211</sup> Art. 299 para 2 of the LOA.

<sup>212</sup> Art. 303 of the LOA.

<sup>213</sup> Art. 301 para 3 of LOA, Estonian Report, 140-141.

<sup>214</sup> Latvian Report, 147.

<sup>215</sup> Art. 6.198 para 1 of the CC: where a contract does not fix the price or establish an order for determining the price, the parties shall be considered, in the absence of any indication to the contrary, to have made reference to the price commonly charged at the moment of the conclusion of the contract for such performance in comparable circumstances in the sphere of business concerned, or if such price does not exist, to a reasonable price.

**Table 8 Rent regulation.**

	ESTONIA	LATVIA	LITHUANIA
Initial rent agreement	<b>NO</b> fixed rent.	<b>NO</b> fixed rent. Rent = (justified) management expenses + (reasonable) profit.	<b>YES/NO</b> Theoretical limit of maximum in case the landlord is a legal person.
Is unilateral rent increase possible?			
Contracts for unspecified term	<b>ONLY</b> if agreed, provided that: (1) minimum a 3 year term contract; (2) minimum interval 12 month, and (3) basis for calculation are precisely determined (i.e. stepped, indexed)	<b>ONLY</b> if agreed. Minimum interval 6 months.	<b>ONLY</b> if agreed. Minimum interval 12 months.
Contracts for unspecified term	<b>YES</b> , by default, min interval 6 months.		
Rent control by courts possible?	<b>YES</b> , (also lease committee) <ul style="list-style-type: none"> <li>excessiveness of rent increase.</li> </ul>	<b>YES</b> <ul style="list-style-type: none"> <li>management expenses justified?</li> <li>profit reasonable?</li> </ul>	<b>YES</b> <ul style="list-style-type: none"> <li>reasonability test</li> </ul>

For regulation of **deposit**, please see section **3.1.2.** above.

Starting point for regulation of **expenses for utilities** diametrically differs in the countries under scrutiny. In ESTONIA, by default, rent covers also utilities and the lessee shall bear charges for the services and acts of a lessor or a third party which are related to the use of a thing (accessory expenses) **only if so agreed**, while in LATVIA, as a rule, the basic, as well as all auxiliary utilities<sup>216</sup> agreed in a rental contract may be **charged from the tenant**.<sup>217</sup> LITHUANIAN law leaves the issues of payment for cold and hot water, electric energy, gas, heating and public utilities shall be determined upon

<sup>216</sup> The basic utilities are inseparably related to use of the residential space (heating, cold water, sewerage and removal of waste), while the auxiliary utilities are all other services (hot water, gas, electricity, garage, parking place, etc.). When one or several of the basic services are lacking, a residential house (residential space) does not fit for living.

<sup>217</sup> Latvian Report, 131.

the **agreement of the parties**<sup>218</sup>, considering provisions of procedure for the payment for public utilities as an essential term of the contract.<sup>219</sup>

As to the **regulation of repairs**, it is useful to analyse the division of responsibilities and expenses as per categories of the maintenance and repair works.

Firstly, as to the **minor defects**. ESTONIAN law uniquely sets clear, that a lessee shall only remove the defects of a leased thing at the expense of the lessee if these defects can be removed by light cleaning or maintenance which is in any case necessary for the ordinary preservation of the thing.<sup>220</sup> As it is a half-mandatory law in favour of the tenant, obligation of expenses of other repair works can not be shifted to the tenant.

Secondly, regulation also differs as to the responsibility for **natural wear and tear**, as well as to the obligation for **routine repair**<sup>221</sup>. Tenants are most under pressure to repair the dwelling in LITHUANIA, where by default, the tenant shall be obliged to maintain the leased thing in a proper state and to bear expenses for the maintenance of this thing and to make its *current repair at his own expense*. However, the parties may agree otherwise.<sup>222</sup>

Although the tenant in LATVIA is not responsible for the natural wear and tear of the property<sup>223</sup>, by default, he/she is responsible for the routine repairs and has the duty to maintain the occupied residential space<sup>224</sup>. The parties may also agree otherwise.<sup>225</sup> However, law does not stipulate that the tenant has to make routine repairs *at its own expense*. Thus, it can be concluded<sup>226</sup> that, if the tenant has done capital repairs or routine repairs, i.e., made necessary or useful expenditures, these expenditures shall be compensated in full by the landlord.<sup>227</sup> As said before, in ESTONIA, the tenant shall not be liable for the natural wear or deterioration of the thing or changes which accompany the contractual use.<sup>228</sup> From this mandatory rule, it follows that, at least within the legal framework of lease contract, the lessee cannot be burdened with the obligation to make routine repair at his own expense or cover any expenses thereof. This solution may not be evaluated as the flexible solution as in case the long-term contract, the tenant may well be ready to take care of routine repairs.

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<sup>218</sup> Art. 6.584 para 3 of the CC.

<sup>219</sup> Art. 6.580 of the CC: Content of a contract.

<sup>220</sup> Regulation resembles to OR Art. 259 and ABGB § 1096 para 2.

<sup>221</sup> Routine repairs are, for example, handing of wall-papers, painting of ceiling etc. The law does not determine how often routine repairs shall be performed or specify circumstances under which the routine repair must be done, therefore a court decides upon those questions in case of disputes.

<sup>222</sup> Art. 6.493 para 1 of the CC.

<sup>223</sup> Art. 2150 of the Civil Law.

<sup>224</sup> Art. 42 of the Law on Residential Tenancy.

<sup>225</sup> Art. 42 of the Law on Residential Tenancy.

<sup>226</sup> Examining Article 40 of the Law on Residential Tenancy in connection with Article 2140 CC.

<sup>227</sup> However, in the legal literature it is also suggested that useful expenditures, i.e., expenditures which are connected with repairs (Article 42 of the Law on Residential Tenancy), are reimbursed in the cases, if the landlord was aware and consented to them. All other expenditures which are not necessary or useful, as well as have not been approved by the landlord are not reimbursed.

<sup>228</sup> Art. 334 para 2 of the LOA.

As to the **capital repairs**<sup>229</sup> common general principle that in order to secure that the tenant can use the rented dwelling for the period for which he/she contracted for, the landlord must perform capital repairs and maintenance of the dwelling is recognized by all three jurisdictions under review.<sup>230</sup> However, there is a difference in a degree of freedom of contract.

In LATVIA, landlord and the tenant *may agree* that the tenant performs the necessary capital repairs or fully or partially covers the costs thereof, and then the tenant has the right to an appropriate deduction of rental payments.<sup>231</sup> In LIHTUANIA, even though the lessor shall be obliged to make capital repair at his own expense, the parties are free to agree otherwise.<sup>232</sup> On the contrary, freedom of contract, at least in the framework of lease contract, is limited under ESTONIAN law, as the referred provision is mandatory, i.e. parties can not agree to the detriment of the lessee.<sup>233</sup> However, it is questionable, whether in all cases individual agreement that tenant performs routine or capital repair, would be contrary to tenant's interests as far as the tenant holds the right for compensation (and may set-off with the claim of rent payment). Summary of the regulation of repair can be found in **Table 9** below.

**Table 9 Regulation of repairs** (Who's responsibility? / At who's expense?).

	ESTONIA	LATVIA	LITHUANIA
Minor defects	Tenant/Tenant	Tenant/?	Tenant/Tenant
Natural wear and tear/routine repair	Landlord/Landlord Mandatory in favour of the tenant	Tenant/Landlord Dispositive	Tenant/Tenant Dispositive
The capital repairs	Landlord Mandatory in favour of the tenant	Landlord Dispositive	Landlord Dispositive

In ESTONIA, the general principle is that a **lessee may make improvements and alterations** to a leased thing only with the lessor's consent submitted in a format which can be reproduced in writing.<sup>234</sup> However, the lessor is not permitted to refuse consent if the improvements and alterations are necessary in order to use the dwelling or manage it reasonably.<sup>235</sup> If the lessor consents to improvements and alterations, he loses the right to demand that the original condition be restored, unless parties have agrees otherwise in a format which can be reproduced in writing.<sup>236</sup> In principle, upon

<sup>229</sup> Repairs of the constructional elements, engineering and communications systems of the residential house or residential space.

<sup>230</sup> LATVIA: Art. 2131 of the Civil Law; LITHUANIA: Article 6.483 of para 1 of the CC; ESTONIA: Art. 276 para 1 of the LOA.

<sup>231</sup> Art. 40 of the Law on Residential Tenancy.

<sup>232</sup> Art. 6.492 para 1 of the CC.

<sup>233</sup> Art. 275 of the LOA.

<sup>234</sup> Art. 285 para 1 of the LOA.

<sup>235</sup> Art. 285 para 1 of the LOA.

<sup>236</sup> Art. 285 para 2 of the LOA.

expiry of a lease contract, the lessee may remove an improvement or alteration made to a dwelling, if this is possible without damaging the property. However, the the lessee does not have such right if the lessor pays a reasonable compensation therefor, unless the lessee has a legitimate interest in removing the improvement or alteration.<sup>237</sup> If the landlord consents to improvements and alterations, he loses the right to demand that the original condition be restored (and respective expenses borne by tenant), unless he reserves such right in the giving of consent. Furthermore, if, upon expiry of a lease contract, it becomes evident that the value of the thing has increased considerably (i.e. dwelling can be leased for a higher rent or sold for higher price) due to the improvements or alterations made by the tenant with the consent of the lessor, the tenant may demand reasonable compensation therefor.<sup>238</sup> The limitation period of such claim is six months as of the return of the possession. Compensation for other expenses may be demanded pursuant to the provisions regarding *negotiorum gestio*.<sup>239</sup>

Similarly in LITHUANIA<sup>240</sup>, in the instances where the lessee with the permission of the lessor has made improvements of the leased thing, he shall have the right to compensation of the necessary expenses incurred by him for that purpose. In the event where the improvements made by the lessee without the permission of the lessor are separable without harm to the leased thing, and where the lessor does not agree to compensate for them, they may be taken out by the lessee. The value of improvements which are not separable without harm to the leased thing made by the lessee without the permission of the lessor shall not be subject to obligatory compensation.<sup>241</sup>

LATVIA – no special provision (?), see repair.

ESTONIA - a lessee has to tolerate **improvements and alterations made by the landlord** to a dwelling only if the work is done and its effects are not unfairly burdensome to the lessee.<sup>242</sup> Improvements and alterations could be carried out provided that lessor has informed lessee about the forthcoming changes at least two months before commencement of improvements and alterations.<sup>243</sup> A lessor shall notify the lessee of the nature, extent, time of commencement and expected duration of the measures planned for making the improvements and alterations, and of any potential increase in the rent which may arise therefrom. Such notice should be delivered in a format which can be reproduced in writing. If the improvements and alterations are significant and bring about an increase in the rent, the lessee may terminate a contract within fourteen days as of receipt of a notice by giving at least thirty days' advance notice. If a lessee terminates a contract, the making of improvements and alterations shall not commence before termination of the contract.<sup>244</sup> Upon making improvements

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<sup>237</sup> Art. 285 para 3 of the LOA.

<sup>238</sup> Art. 286 para 1. of the LOA.

<sup>239</sup> Art. 286 para 2 of the LOA.

<sup>240</sup> Art. 6.501 of the CC.

<sup>241</sup> Lithuanian Report, 142.

<sup>242</sup> Art. 284 para 1 of the LOA.

<sup>243</sup> Art. 284 para 2 of the LOA.

<sup>244</sup> Art. 284 paras 3 and 4 of the LOA.

and alterations, the lessor shall take the interests of the lessee into account. Even if the interests of the lessee are taken into account, the right of the lessee to reduce the rent or demand compensation for damage is not precluded or restricted. Reasonable expenses incurred by the lessee as a result of the improvements and alterations are also matters that can be reimbursed and paid in advance, upon request by the lessee.<sup>245</sup>

LITHUANIA – no special provision (?), see repair.

LATVIA – no special provisions (?), see repair.

**Possible rent increase after renovation.** See generally section 3.2.1. above (possibilities of rent increase).

ESTONIA: If the agreement has been made for an unspecified term, the rent can be raised (among other things, due to renovations) under § 299 of the LOA once every six months by giving 30 days of advance notice thereof. The lessee can contest the increase of the rent on the basis of § 303 of the LOA if the rent is excessive. An increase in rent is not excessive if the increase is necessary for the making of *reasonable improvements or alterations*, including improving the condition of a part of a leased room or building such that the room or building is in the usual condition for such rooms and buildings.<sup>246</sup> There is no special procedure. Upgrading the energy performance of the house is presumably a “reasonable improvement”, but it is critical to assess the period necessary to recover the expenses. It would be reasonable to assume that the landlord finances the repair works with a long-term loan and the increase in rent correlates with the repayment schedule. In any case, cost of constructive repair works should not be covered by the current tenant, which should instead be amortized over the period of some 10-20 years.<sup>247</sup> Renovation does not give the lessor the right to raise the rent in the event of a fixed-term lease agreement, unless the parties have agreed otherwise.

LITHUANIA: Rent increases to compensate inflation/ increase gains, rent increase after renovation or similar are legal, but according to the Article 6.583 para 6 of the CC the rent payment modification should be agreed beforehand cannot be more frequent than once a year.

LATVIA: The same rule is applicable in these situations, i.e., rent increase after renovation measures, e.g. upgrading the energy performance of the house, or similar will be lawful, if there is a respective clause. If not, the landlord may offer his tenant to amend the contract, this may happen according to a mutual agreement. It would be possible that the landlord can bring a court action, asking a court to settle a new rent payment amount, as well as determine the day from which the tenant is obliged to pay this new rent. The court will evaluate all circumstances and decide whether increase is justified, as well as to what amount rental payments may be increased. review.

As to the form of **rent subsidies for poor tenants**, please see 2.5 above.

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<sup>245</sup> Art. 284 para 5 of the LOA.

<sup>246</sup> Art. 301 para 3 of the LOA.

<sup>247</sup> Estonian Report, 139.

### 3.2.2. Stability

Effect of the lack of a written agreement in ESTONIA is that contract with a term exceeding 1 year is deemed to have been entered into for an unspecified term with limitation not to be terminated earlier than **1 year**<sup>248</sup>. LITHUANIA: a **fixed-term** contract of lease of a dwelling irrespective of who is the lessor should be concluded in written form. Under LATVIAN law, in absence of written contract the tenant should provide proof of the factual rental relations.

There is **no duty to register** lease contracts in either of three countries.<sup>249</sup>

Entry into Land Register in ESTONIA and Real Property Register and Cadastre in LITHUANIA plays role only in the context of transfer of ownership of the dwelling. See below, *emptio non tollit locatum*.

For „black market“, see 2.6 above.

In all three countries the parties are free to choose between fixed term or open-ended contracts. There are no minimum duration set by the regulation.

In case of contracts for unspecified term, the tenant should be prepared that, under ESTONIAN and LITHUANIAN law, the landlord may terminate (ordinary termination) by giving, respectively, at least three months' in advance notice. However, the longer term could be agreed. Under LATVIAN law, controversially, contract for unspecified term may, at the initiative of the landlord, be terminated only in the cases set by the Law on Residential Tenancy, i.e. in case of breach of contract from the part of the tenant. See **Table 7** for summary.

The institute of **tacit renewal** subject to different technicalities is known in all three countries. In LATVIA, the clause on prolongation (without the landlord's consent) has to be included into contract.<sup>250</sup> The prolongation clause can be drawn up in a different manner. The clause may state that the contract is prolonged upon unilateral request of the tenant or with the consent of the landlord; if the consent of the landlord is necessary, the landlord may refuse to prolong the rental contract without providing reasons for this answer. But even if no prolongation clause exists, Article 1488 of the Civil Law could be applicable, i.e., the tenant continues using the rented dwelling, covers all payments, but the landlord has not objected to it, has not demanded that the tenant vacates the dwelling, as well as accepts payments. In LITHUANIA<sup>251</sup>, upon expiration of the term of the contract of lease, the lessee shall have priority right to conclude a contract of lease of the dwelling for a new term providing that he duly performed the conditions of the

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<sup>248</sup> Source: BGB § 550.

<sup>249</sup> Latvian Report, 83; Lithuanian Report, 89; Estonian Report, p 95.

<sup>250</sup> Nevertheless the landlord has the right to refuse the prolongation, if at least one of the alternative circumstances exists: the tenant does (did) not fulfil the obligations specified in the rental contract (1); the landlord or the landlord's family members need the residential space for private use (2); the residential house is to be demolished or capital repairs have to be made (Article 6 Paragraph 2 of the Law on Tenancy) (3).

<sup>251</sup> The Art. 6.607 of the CC.

contract. The contract shall be renewed for the same term, and where the previous term of the contract exceeded twelve months, the contract shall be renewed for a term of twelve months unless the parties agree otherwise.<sup>252</sup> In ESTONIA, however we can talk about the tacit renewal as well as right to demand extension. Generally, a residential lease contract which is entered into for a term of at least two years becomes a lease contract entered into for an unspecified term after expiry of the term, unless any of the parties give notification at least two months before expiry of the term that the party does not wish to extend the contract.<sup>253</sup> Additionally, the tenant may demand that the landlord extend the lease contract for up to three years for the reason that termination of the contract would result in serious adverse consequences to the tenant or his or her family. If the landlord does not consent to the extension of the contract, the lessee may demand extension of the lease contract before a lease committee or in court. The tenant has this right even if the landlord has valid reasons for termination and the termination could not be considered to be contrary to good faith. It can be concluded, ...

In ESTONIA<sup>254</sup> a **right of pre-emption** is created on the basis of law or by contract. The only statutory right of pre-emption of the tenant is constituted by Art 121 para 10 of Republic of Estonia Principles of Ownership Reform Act.<sup>255</sup> Otherwise such a right of pre-emption is only an obligatory right subject to contract.<sup>256</sup> Neither is statutory pre-emption right acknowledged in LATVIA; however, parties may establish a contractual pre-emption right.

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<sup>252</sup> The lessor shall be obliged not later than three months in advance before the termination of the contract of lease to inform the lessee in writing about his proposal to conclude a new contract of lease on the same or different conditions or about his refusal to renew the contract where he does not intend to lease out the premises concerned at least for a period of one year. In the event of failure by the lessor to perform this duty, and if the lessee does not refuse to renew the contract, the contract of lease shall be deemed to be renewed for the same period and under the same conditions. In the instances where the lessor, after having refused to renew a contract of lease, leases the same dwelling within a period not exceeding one year to another person under the same conditions, the lessee shall have the right to demand acknowledgement of such contract null and void and claim compensation of damages caused by the refusal to renew the contract. This provision shall not apply in the event where the lessee refused to renew the contract under the conditions proposed by the lessor and did not apply to the court for the approval of the conditions of the contract.

<sup>253</sup> In other cases, more general rule applies: if, after expiry of the term of a lease contract, the lessee continues to use the property, the lease contract is deemed to have become a lease contract entered into for an unspecified term unless the lessor or lessee expresses some other intention to the other party within two weeks after the lessor learns that the lessee is continuing to occupy the property (Art. 310 para 1 of the LOA).

<sup>254</sup> Arts. 244-253 of the LOA. Estonian Report, 112.

<sup>255</sup> Tenants living in a returned residential building at the time of restitution have a joint right of pre-emption in the transfer of a returned residential building and of a corresponding registered immovable or a part thereof. The right of pre-emption does not apply upon transfer to a spouse, descendants, parents, sisters and brothers and their descendants. Right of pre-emption entered in the land register has the same legal force with regard to third persons as a preliminary notation securing a claim for the transfer of ownership.

<sup>256</sup> Basically, upon exercising of the right of pre-emption, the contract of sale between a person with a right of pre-emption and the seller is deemed to be entered into on the same conditions which the seller agreed with the buyer. A contract of sale entered into with a purchaser or obligations arising therefrom, do not become invalid upon the exercise of the right of pre-emption.

***Emptio non tollit locatum*** is generally recognized principle in tenancy law of Baltic States, but the practical consequences of the sale and measures of protecting landlord's interest are quite different, mainly because different role of the registration of the lease contracts.

Under ESTONIAN law, if a lessor transfers ownership of an immovable after receipt of the immovable into the possession of a lessee, or if the owner of a leased thing changes after transfer of the thing into the possession of the lessee in the event of the transfer of ownership upon compulsory execution or in bankruptcy proceedings, the rights and obligations of the lessor arising from the lease contract are transferred to the new owner.<sup>257</sup> The new owner has a special right to terminate the residential lease contract within three months if the transferee **urgently needs** the premises for himself.<sup>258</sup> According to the case law to date, 'urgent need' for oneself is difficult to prove, because, due to the lessee's possession, the transferee needed to take into account the fact that he may not be able to use the premises himself. However, the new owner does not have the special right to terminate the lease contract, if there is an entry of the lease contract in the Land Register. Tenant's request for entry of the lease contract can be enforced by judgment if refusal to permit registration is not justified.<sup>259</sup>

In LITHUANIA, there is no duty to register lease contracts, but the contract of lease of a dwelling may be invoked against third persons only in the event of it being registered in the Public Register.<sup>260</sup> It follows, that in the event of the right of ownership to a dwelling having passed from the lessor to another person, the contract of lease of a dwelling shall remain valid in respect of the new owner, providing the contract of lease of a dwelling was registered in the Public Register within the procedure established by laws.<sup>261</sup> Transfer of the right of ownership to the leased property from the lessor to another person is a ground for the termination of the contract of lease in case of a demand of the essee.<sup>262</sup> There are no specific statutory restrictions on notice after sale including public, or inheritance of the dwelling. In this case there are applicable statutory restrictions on notice settled in the CC.

Under LATVIAN law, the change of the landlord through inheritance, sale or in other cases, when the immovable is alienated in accordance with free will of its owner, does not affect the position of the tenant.<sup>263</sup> The lack of publicity of rental contracts, since there is no duty to register them in a public register, results into the problem that a new

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<sup>257</sup> Art. 291 of the LOA.

<sup>258</sup> Subsection 1 of Art. 323 of the LOA,

<sup>259</sup> Art. 324 para 2 of the LOA.

<sup>260</sup> Real Property Register and Cadastre. Lithuanian report, p 82. Art. 6.579 para 4 of the CC.

<sup>261</sup> Art. 6.585 of the CC.

<sup>262</sup> Art. 6.494 para 3 of the CC.

<sup>263</sup> Art. 8 of the Law on the Residential Tenancy.

owner is not always aware of the rental contracts concluded by the previous owner.<sup>264</sup> There are specific provisions regarding public auctions when the court bailiff sells the property because of debts, as in this case the alienation takes place against the will of the owner (landlord).<sup>265</sup>

**Table 10 *Emptio non tollit locatum.***

	ESTONIA	LATVIA	LITHUANIA
Registration requirements	<b>NO</b> , but possible notation in the Land Register.	<b>NO</b>	<b>NO</b> , but possible registration in the Public Register
Contract binding for the new owner	<b>YES</b> , but only if tenant has acquired a possession	<b>YES</b> • Draft law 2013 – based on Land Book	<b>YES</b> , but only if contract registered in the Public Register
New owner has special right to terminate	<b>YES</b> • in case of ‘urgent personal need’; • within 3 months’ period. ... unless entered into Land Register.	<b>NO</b>	<b>NO</b>
Tenant has special right to terminate	<b>NO</b>	<b>NO</b>	<b>YES</b>

There are additional “**social defences**” available in the eviction procedure in all three countries.

In ESTONIA, the tenant may apply for postponement of enforcement action in two ways: first, a bailiff may postpone an enforcement action on the basis of an application of the claimant or a corresponding court decision, or when there has been a substitution in the person conducting the enforcement proceedings. Secondly, on the basis of an application of a debtor, a court may suspend enforcement proceedings or extend or defer enforcement if continuation of the proceedings is unfair to the debtor. In such case, the interests of the claimant and other circumstances shall be taken into account, including the family and economic situation of the debtor.

Article 36.1 of the Law on Residential Tenancy of LATVIA establishes which groups of tenants are entitled to receive social aid from a local municipality in cases of private

<sup>264</sup> On July 7, 2014 the Constitutional Court of Latvia passed the judgment deciding that the rule in question has a legitimate aim (safeguarding tenants’ rights to unhindered use of residential premises) and complies with the principle of proportionality and is thus valid and conforms with the Constitution. <http://www.satv.tiesa.gov.lv/?lang=2&top=1&rid=1187> However, new draft law prepared by the Ministry of Economics at the end of 2013 foresees that all rental contracts shall be registered in the Land Book in order to ensure that the rental contract concluded by the previous owner is binding for a new acquirer of the property. Article 26 of the new tenancy law.

<sup>265</sup> Article 601 of the Civil Procedure Law, Latvian Report, 111.

renting. If eligible persons are evicted because of debts for rental payments or payments for basic services and a judgment is entered into force, the eviction is postponed till the local government provides the eligible tenant with other residential space. However, the landlord – private person - may claim costs connected with postponement of eviction which the tenant has to cover. At the same time, if the tenant does not carry out the activities provided for by law in order to receive assistance of a local government or delays the provision of assistance without a justified reason, the judgement shall be executed.<sup>266</sup>

When the tenant is not eligible to receive the social help in accordance with law, still he may ask to postpone execution (eviction) in accordance with Article 206 of the Civil Procedure Law, in this case the tenant have to submit an application of eviction postponement, sometimes the prosecutor, institution of the State or a local municipality may apply for this instead of the tenant.<sup>267</sup> The court which has rendered a judgment in a matter is entitled, taking into account the financial situation of the parties, children's rights or other circumstances, to take a decision to postpone the execution of the judgment, the tenant may apply for postponement after the court bailiff has started compulsory execution of the eviction judgement<sup>268</sup>.

Also in LITHUANIA, upon justified reason, the court, the prosecutor who has given sanction to evict, as well as higher-ranking prosecutor upon the application of persons concerned or the bailiff's application has the right to postpone the eviction.<sup>269</sup>

### 3.2.3. Flexibility

**Unilateral termination by tenant** within reasonable delay is guaranteed in case of fundamental non-performance by the landlord or in case the tenant cannot use the dwelling because of its condition. However, if the reason for unilateral termination is not attributable to the landlord but belongs to tenant's sphere of risk, the solutions vary.

Under LITHUANIAN law, the tenant of time-limited lease contract has the right to bring an **action to a court** for dissolution of a contract of lease before time in case of breach by the landlord or there exist other grounds provided for by the contract of lease.<sup>270</sup> Previous tenant in proposing the new tenant can avoid the claim on no-received lessor's income if the previous tenant interrupted the time limited dwelling's rent contract before the time without any legal grounds.<sup>271</sup> In case of open-ended lease contracts, the lessee of a dwelling has the right to dissolve the contract of lease by warning the lessor in writing **1 month** in advance. In the event of failure by the lessee to comply with this requirement, the lessor shall have the right to compensation of damages caused.<sup>272</sup>

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<sup>266</sup> Article 36.3 of the Law on Residential Tenancy.

<sup>267</sup> Civilprocesa likuma komentāri. I daļa (1.-28.nodaļa). Sagatavojis autoru kolektīvs. Prof. K. Torgāna zinātniskajā redakcijā. Rīga: Tiesu namu aģentūra, 2011, 450-451.

<sup>268</sup> Ibid.

<sup>269</sup> Lithuanian Report, 164.

<sup>270</sup> Art. 6.498 of the CC.

<sup>271</sup> Lithuanian Report, 152.

<sup>272</sup> Art. 6.609 of the CC.

Under ESTONIAN law<sup>273</sup>, tenant may terminate a lease contract entered into for an unspecified term by giving at least **3 months'** advance notice (Arts. 311 and 312 para 1 of the LOA) (*ordinary notice*), unless parties have agreed shorter period of notice. In case of a lease agreement of specified term, only *extraordinarily termination* (without advance notice) with good (compelling) reason is possible<sup>274</sup>. Extraordinary termination is permitted mainly under the circumstances specified in Arts. 314–319 of the LOA, i.e. compelling reasons for extraordinary termination may foremost relate to the fundamental non-performance by the landlord, basically if the tenant cannot use the premises for a reason dependent on the landlord, after having granted the lessor a reasonable term to render the dwelling usable. A reason is “good” if, upon occurrence thereof, a party seeking termination cannot, given all the circumstances and considering the interests of both parties, be reasonably expected to continue performing the contract.<sup>275</sup> Thus, it should be waged if interest of the party wishing to terminate the contract is more significant and would be more severely damaged if the contractual relationship continued. The reason is “compelling” if it is unexpected to the parties. If those conditions are fulfilled, the lessee has no duty to cover any damages to the lessor. However, in case the lessee needs larger dwelling space or has to move due to personal or professional reasons, those reasons may well be valid for extraordinary termination (yet disputable), but as self-induced termination of a lease agreement is also considered a breach of the agreement the lessor is entitled to demand compensation for damage caused by the breach. Differently from Estonian law, LATVIAN law does not distinguish ordinary and extra-ordinary notice of the tenant or make differentiation of termination of time-limited or open-ended rental contracts. In LATVIA, the tenant’s rights for unilateral termination, or actually its consequences is highly disputable subject. Article 27 of the Law on Residential Tenancy stipulates that unless the contracting parties have agreed otherwise and all adult family members of a tenant consent thereto, the tenant of a residential space has the right to terminate a rental contract at any time, notifying the renter thereof in **writing 1 month** in advance. The obligation to pay

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<sup>273</sup> Art. 313 para 1 of the LOA.

<sup>274</sup> Art. 312 para 1 of the LOA.

<sup>275</sup> Ibid.

outstanding rental and other payments or compensate losses, if the tenant terminates the contract before the end of the agreed term, is not established.<sup>276</sup>

**Table 11 Unilateral termination by the tenant (except for breach of contract by the landlord).**

	ESTONIA	LATVIA	LIHTUANIA
Contracts for unspecified term	YES Maximum of <b>3 months'</b> notice (mandatory in favour of the tenant)	YES 1 month (dispositive)	YES 1 month' notice
Contracts for specified term	<b>YES</b> , but only <b>extraordinary termination with good (compelling) reason</b> taking into account all the circumstances and considering the interests of both parties. Application disputable!		Right to bring an <b>action to a court...</b> there exist other grounds <b>provided for by the contract</b> of lease.
Damage claim by the landlord?	<b>YES</b> , as self-induced termination is considered a breach of the contract.	<b>ONLY</b> if so agreed initially. Highly disputed – does CC as <i>lex generalis</i> apply?	<b>YES</b> , if terminated <b>without any legal grounds</b> (Previous tenant in proposing the new tenant can avoid the claim on no-received lessor's income.)

**Subletting** is generally allowed subject to the consent of the landlord. Law in LITHUANIA<sup>277</sup> and in LATVIA<sup>278</sup> additionally prescribes, that tenant has the right to contract for sub-lease only with the consent of the adult family members living together with the tenant. ESTONIAN law<sup>279</sup> provides for more details as to the procedure and

<sup>276</sup> Considering the newest jurisprudence of the Supreme Court in the similar questions, the tenant is obliged to make rental payments and payments for utilities only for the time period when the rental contract was valid, unless the contract does not contain further contractual terms on the legal consequences of the termination. If the rental contract does not comprise the obligation to cover losses in cases of pre-term termination, the answer if losses may be claimed is disputable. Regarding damage or loss compensation the following two points of view have been expressed. One author thinks that the tenant is obliged to pay rent payments for actual use of the rent dwelling. Another author indicates that the tenant has to pay rent payments for the whole period of time on which parties have agreed. Nevertheless, the second opinion does not specify if it relates to residential tenancy which is regulated by the Law on Residential Tenancy. Namely, since the Law on Residential Tenancy does not regulate the issues following from termination notice of the tenant in detail, Article 2144 of the Civil Law could apply. That article differentiates legal consequences in cases of the tenant's unilateral termination according to the fact, whether a termination ground was justified or unjustified. Ground for termination is justified if the tenant cannot use the premises for a reason dependent on the landlord or use is not possible because of possible harm to health. Other reasons may well be classified as unjustified.

<sup>277</sup> Art. 6.595 of the CC, written consent is required.

<sup>278</sup> Art.17 (1) of the Law on Residential Tenancy.

<sup>279</sup> Art. 288 of the LOA.

consequences of the landlords consent. First, the lessor does not have to give consent without knowing the details of the contract of the sublease. The lessor may refuse to grant consent for the sublease of the thing only if the lessor has a good reason, especially if:

- (1) the tenant does not disclose the conditions of the sublease to the landlord,
- (2) the sublease would cause significant loss to the landlord,
- (3) the sublease would be unreasonably burdensome on the leased premises,
- (4) the landlord has good reason therefor arising from the identity of the sublessee.

Furthermore, if the sublease of a thing may be expected only in conjunction with a reasonable increase in the rent, consent may be subject to the condition that the lessee agrees to the increase in the rent.<sup>280</sup>

However, if a landlord refuses to grant consent for the sublease without good reason, lessee may terminate the contract in accordance with the terms provided for ordinary termination of lease contract for indefinite term (i.e. by giving at least three months' notice, but he has no other recourse. At the same time, subletting without the consent of the lessor may give ground for extraordinary termination of the lease contract by the lessor, but only if, as a result, the lessor or neighbours are so affected that the lessor cannot be expected to continue the lease contract.<sup>281</sup>

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<sup>280</sup> Art. 288 para 4 of the LOA.

<sup>281</sup> Art. 315 para 4 of the LOA.

## 4. COMPARISON OF TENURES WITH A PUBLIC TASK

### 4.1. Generalities

**Public rental tenure** in the Baltics comprises of all state or municipally owned dwellings let for leases. **Social housing is a targeted residual system** whereby only the most vulnerable social groups are beneficiaries.

In ESTONIA social housing is understood as local government providing dwellings for persons or families who are unable or incapable of securing housing for themselves or their families and to create, if necessary, the opportunity to lease social housing on the basis of Article 14 of the Social Welfare Act. The procedure for the provision and use of social housing as well as the terms of the actual tenancy agreement are established by the each rural municipal council or city council. Legal framework of the lease contract is the same as for the contracts in market terms, but certain tenant-protective provisions of residential lease contract do not apply and all regulation is dispositive also in favour of the municipality.<sup>282</sup> Other public (municipal or state) housing (i.e. social housing in large terms), dependent on the housing policy of the municipality may benefit e.g. young families, key workers of the municipality, etc. For example, the capital city of Tallinn is the only LA in Estonia that applied two new public housing programs created in the post-1990 era. Moreover, there is a plan, at least in the case of Tallinn, to extend eligibility also to other below-average income groups in future. Thus there is an important turn in the neoliberal housing policy that had existed in Estonia: there was an effort to encompass a broader range of population groups in the allocation of social housing.<sup>283</sup> As there is no uniform regulation as to the conditions set for the eligibility of tenants and terms of social lease contracts each municipality elaborates its own terms.

In LATVIA, at the moment, assistance in solving apartment matters is the sole competence of local municipalities, before the assistance was also provided by the State. The Law on Assistance in Solving Apartment Matters<sup>284</sup> establishes who is eligible to receive assistance in solving residential apartment matters and determines the procedures by which a local municipality rents out apartments. Social rental contracts are concluded by a local municipality on the basis of an administrative act<sup>285</sup>. Law on Social Apartments and Social Houses of June 12, 1997<sup>286</sup> contains specific provisions about the subject matter, terms, rent amount and termination of such contracts. Nevertheless, the Law on Residential Tenancy and the Civil Law are subsidiary applicable in all social rent cases insofar as Law on Social Apartments does not regulate such relations.

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<sup>282</sup> Art. 272 para 4 (4) of the LOA.

<sup>283</sup> Kährnik & Kõre (2013), 170.

<sup>284</sup> 06.12.2001. Likums "Par palīdzību dzīvokļa jautājumu risināšanā" < <http://likumi.lv/doc.php?id=56812> > (last visited 2 September 2013).

<sup>285</sup> A decision taken by a local municipality about the conclusion of a social rental contract is supposed an administrative act.

<sup>286</sup> 12.06.1997. Likums "Par sociālajiem dzīvokļiem un sociālajām dzīvojamām mājām". < <http://likumi.lv/doc.php?id=44160> > (last visited 2 September 2013).

In LITHUANIA, rental tenures with a public task are called social housing (non commercial, municipality owns living premises that are rented based on the governmental order of determining the rent fee). They are allocated to a low income persons and families. In Lithuania there is no other form of support (like rental housing in private housing market for people with low income). The social housing in Lithuania is considered as the part of the social support and the social integration, which is provided by the Municipalities, so Municipal tenancies are equivalent to social tenancies, i.e. they are the synonyms in the Lithuanian rental regulation. The rent of social housing is regulated by the Law on the Lithuanian state support for housing purchase or lease and apartment buildings renovation (modernization) and by the Municipalities executive authorities acts.

#### **4.2. Evaluative criteria for public/social/private subsidized landlords**

In the Baltics, the allocation and management of the social housing is in sole competence of the municipalities. A social rent contract is a part of private law, although the conclusion of the social rent contract is based on an administrative act, which is already public law.

Funding problems can be illustrated by the example from ESTONIA: Since 2003, KredEx has been implementing the national policy of building municipally owned housing. A total of 102.8 million EEK from the state budget and the ownership reform reserve fund was earmarked for expanding municipally owned housing stock in 2003-2007. By the end of 2008 the local governments had used these funds for building 371 municipally owned dwellings for tenants in houses returned to their legitimate owners and other social housing target group, and 41 new municipal dwellings for the target group of new labor arriving in the country. Estonian National Housing Development Plan for the years 2008-2013 also prescribed support for increasing municipally owned housing stock, but this measure has not been implemented since 2008 due to lack of political will and/or financial means.

According to the recent practice, other types of ownership/financing schemes are also used to develop public housing. For example, the municipality of Tallinn has implemented special residential housing programs set up as PPP projects, whereby the municipality supported the construction of the buildings by providing right of superficies to the land and taking completed buildings into use under the conditions of long-term (20-30 years) operative leases.<sup>287</sup>

As typical contractual arrangements, and regulatory interventions into rental contracts example of LITHUANIAN regulation may be presented<sup>288</sup>:

- if the social housing contract is interrupted because the family or individual breached its conditions, the family or individual have right to conclude the new one social housing contract only after 5 year from the contract interruption's day;

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<sup>287</sup> Estonian Report, 20.

<sup>288</sup> Similar provisions may be found in social housing contract prepared by ESTONIAN municipalities.

- parties of the contract may include conditions on the tenant's relocation to housing with smaller area. When the family and the person acquire ownership of housing, social housing contract is terminated in accordance with the contract conditions;
- social housing tenant is required every three years, under the Law on Resident's property/assets declaration, to submit declaration of assets and income received for the last 12 months. If the social housing tenant's (or his family member's) assets or income received in exceed the maximum levels set by the Government, the lease is terminated. Data on declared assets and income received during the month from the date specified in this paragraph must be provided to the Municipality's executive authority;
- the fee for cold and hot water, electricity, gas, thermal energy and utilities (trash removal, elevators, common areas and exterior cleaning, etc.) is taken separately from the social housing rent;
- for temporarily departure of the tenant, family member or a former member of the family, the right of social housing is left for six months on condition that they will pay the rent and charges for utility services. In cases, indicated in the right of social housing could be left for all period of departure.

ESTONIA: In case of contracts for social housing, municipalities have to take into account the Government's Regulation on Requirements to the Dwellings.<sup>289</sup> Accordingly, dwelling provided for social housing should meet the following regulations. The purpose of the requirements of the dwelling is to guarantee safety and a healthy environment to the residents.<sup>290</sup>

### 4.3. Evaluative criteria for the tenant

#### 4.3.1. Access

Common problem in Baltic States is that there are not enough dwellings to provide social housing for all families in need, especially in bigger cities.

E.g. in LITHIANIA, in 2012, 6283 persons were waiting for a social housing.

In general, applicants of social housing are registered in priority lists of different categories. For example, in Tallinn, the following households have priority for social

<sup>289</sup> Government Regulation of 7 Feb. 1999 Adopting Standards for Dwellings (*Eluruumidele esitatavate nõuete kinnitamine*). - RT I 1999, 9, 38.

<sup>290</sup> According to the regulation, dwelling is defined as a residence house, apartment or other separated room, that meets requirements for living quarters. Dwelling should be in the condition allowing persons to stay there round the clock. Dwellings must have a separate entrance door. Minimum floor area is 8 m<sup>2</sup>. Each room should have at least one window, which provides the opportunity to ventilate the premises and ensures adequate natural lighting. The window and the floor area ratio should not be less than 1:8. Dwelling should have natural or mechanical ventilation. The air temperature in the dwelling must be optimal to create a warm cozy feeling for the residents. In case of people's prolonged stay in the room, the indoor air temperature should not be below 18 ° C. Optimal indoor air humidity is 40-60 percent. A dwelling must be equipped with a closet or in the absence of it there should be possibility to use the toilet in the immediate area. Access to cold water of suitable quality for drinking) should be guaranteed in the same building or in the immediate area. Socially justified housing size is 18 m<sup>2</sup> living area for each family member, and an additional 15 m<sup>2</sup> for family.

housing: families whose dwellings have been destroyed in an accident, catastrophe, or by demolition; orphans; disabled persons or persons with special needs; and former tenants in restituted housing. In other cases, eligibility of each applicant is assessed individually using multiple evaluation criteria, such as the applicants' current housing situation and his/her socioeconomic status. In LATVIA following social groups would be listed as candidates for social housing: persons in need, persons suffered from a natural disaster, disabled persons, inhabitants of the denationalized or privatised houses etc. are entitled to get assistance in solving of apartment matters.

#### **4.3.2. Affordability**

In case of social rent, the municipality in LATVIA may determine an amount of rent which does not include profit and reduce payments for maintenance; besides, the respective municipality is entitled to cover payments for utilities in part.<sup>291</sup> The Law on Social Apartments and Social Houses does not contain specific rules or procedure on rent payment increase, therefore it is performed according to the Law on Residential Tenancy which is reviewed above, if necessary. In addition, the aims of social renting has to be observed.

Under the Article 6.583 of the CC of LITHUANIA payment of lease for the state and municipality dwellings shall be calculated in accordance with the procedure established by the Government. The municipality can increase the rent payment only in such case if the Government's Resolution was changed and according to the new procedure of the rent payment calculation the rent payment is increased.

In ESTONIA, majority of social housing contracts are contracts for a specified term and provide only for the cost of utilities.

In LATVIA local municipality may offer social housing dwelling without cold water and/or sewerage.<sup>292</sup>

Usually municipalities impose the maintenance and routine repair obligations to social housing tenant.

For subsidies for poor tenants, see 2.5 above. In ESTONIA, for example, upon necessity, tenants of municipal dwellings are equally eligible for subsistence benefits. Public tenants are subsidized by free use of dwelling (tenants paying only the cost of utilities) or very low rent. Over 90 per cent of local authorities subsidize rent to cover the costs of the housing.

#### **4.3.3. Stability**

Under ESTONIAN law, tenant of the social housing may stay till the end of contract term as long as he respects the contract.<sup>293</sup> Usual term is 1-2 years.

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<sup>291</sup> Article 11.1 of the Law on Residential Tenancy, Article 12 of the Law on Social Apartments and Social Houses.

<sup>292</sup> Latvian Report, 83.

<sup>293</sup> E.g. standard social lease contract of Tallinn, section 21.1; standard social lease contract of Tartu, section 9.4.

In case of LITHIANA, there are also contracts of indeterminate term and contracts for a fixed term. Contracts for a fixed term usually are valid until the person receives the dwelling rent for indeterminate term and concludes indeterminate contract. However, the tenant must every three years to declare his income and if his income exceeds the limits settled by the Government of the Republic of Lithuania the dwelling lease contract must be interrupted.

In LATVIA, the rental agreement with public tasks is usually concluded for six months<sup>294</sup>, i.e., is time-limited. After the six-months term of a social rental contract is expired, competent institutions must reevaluate, whether circumstances of a particular tenant or family have been changed and whether the tenant or family may continue renting a social apartment<sup>295</sup>. If the answer is positive, the rental agreement is prolonged for more six months.<sup>296</sup>

There is no statutory pre-emption rights of the tenant in public housing, because the tenant right to lease the dwelling depends only on the fact if he has or sustains the criteria settled in the specific law.<sup>297</sup>

#### 4.3.4. Flexibility

LATVIA: The right of the tenant to terminate the term contract in cases where the matter concerns social renting is not provided. The Law on Social Houses and Social Apartments stipulates that, if a tenant is no longer entitled to receive assistance in solving apartment matters, the social rental agreement has to be terminated, unless, upon the request of the tenant, the respective local municipality agrees to conclude a new “normal” rental agreement.<sup>298</sup>

In ESTONIA, social housing term contracts may be terminated by the lessee giving 1 month advance notice.<sup>299</sup>

In LATVIA<sup>300</sup> as well as practically in ESTONIA<sup>301</sup> in case of social housing lease contract **subletting is not allowed**. Neither would, in general, subletting be an option

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<sup>294</sup> Art. 11 of the Law on Social Apartments and Social Houses.

<sup>295</sup> Art. 11 of the Law on Social Apartments and Social Houses.

<sup>296</sup> Art.14 para 4 of the Law on Social Apartments and Social Houses.

<sup>297</sup> In case of Lithuania: the Law on the Lithuanian state support for housing purchase or lease and apartment buildings renovation (modernization) of the Republic of Lithuania.

<sup>298</sup> Art. 14 para 4 of the Law on Social Houses and Social Apartments. Latvian Report, 155

<sup>299</sup> E.g. standard social lease contract of Tallinn, section 19.2; standard social lease contract of Tartu, section 9.2.

<sup>300</sup> Since social rent is a part of public law, the lack of a provision about subletting indicates that it is not allowed. Furthermore, the opposite conclusion that subletting might take place would not comply with the aims of social renting. It is recognized by the jurisprudence of administrative courts that assistance in apartment matters is only provided, if a person or family does not have a place to live and cannot find a residential space themselves because of justified objective reasons. If a person were entitled to sub-rent a social residential space, it would mean that it has found another place for living. Moreover, the option to sublet a social dwelling would mean that a local municipality could not rent a living dwelling to other persons. Considering that social houses and apartment are not numerous, subletting would endanger the provision of assistance in apartment matters by local municipalities. Latvian Report, 119-120.

for the public tenant in LITHUANIA. However, in LITHUANIA, if the dwelling is retained in case of temporary departure or reserved with the consent of the municipality in the event of departure of the lessee and all of his family members, the lessee shall have the right to permit the dwelling to be used by other persons under a contract of sub-lease.<sup>302</sup> Upon the return of the person who was temporarily absent, the sub-lessee must immediately vacate the dwelling, and the persons who fail to vacate the dwelling concerned shall be evicted without prior notice and without another dwelling being provided.

## 5. CONCLUSION

Informality of the rental relations is common problem in Baltic States. This leads to distrust and uncertainty of the conditions of the relationship, inability to prove rent payments by the tenant. As the common reason for not concluding written contract is the aim to avoid taxes, informal relationship may also lead to the tenant's blackmailing to disclose all information to the Tax Authorities. Tax issues are most topical in ESTONIA as majority of landlords are non-professionals who could not deduct any investment or maintenance cost of the dwelling from the rental income and have to pay (currently) 21 % income tax on the total amount received as rent. This is the major reason, why many private landlords tend to avoid written contracts.

Unfortunately in case of LATVIA, the level of legal certainty is relatively low as the legal provisions of the Law on Residential Tenancy do not always conform to provisions of the Civil Law. As a result it is very difficult to determine the mutual relations and applicability of articles of the Civil Law, when the Law on Residential Tenancy does not regulate a particular issue in part.<sup>303</sup>

ESTONIAN law is too restrictive, i.e. the parties may not agree on terms and conditions that work to the detriment of the tenant, unless specifically provided by law. There are further limitations to the parties' freedom of contract, for example, agreements which require the tenant to pay a contractual penalty upon violation of a contract are void. On the other hand, given package of the regulations does not allow flexibility in the tenancy relationship and, as such, does not fully support the development of the market for residential dwellings. For example, solution that the parties can not agree that the long-term tenant takes care of the routine repairs, is not reasonable.

**..... TO BE CONTINUED**

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<sup>301</sup> E.g.; standard social lease contract of Tallinn, section 15, standard social lease contract of Tartu, section 7.2.

<sup>302</sup> Articles 6.592 and 6.594 of the CC.

<sup>303</sup> Under Article 1 of the Law on Residential Tenancy the Civil Law and other legal enactments are applicable to the legal relations of rent in so far as the Law on Residential Tenancy does not regulate such relations. Nevertheless, court practise limits application of different legal provision of the Civil Law without well-grounded reasoning, it causes uncertainty because the parties cannot prepare their agreement so that it complies with law. The matter concerns the issue which are not established by the Law on Residential Tenancy in an explicit way. Latvian Report, 175.

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