

Koloman Ivanicka (Slovak University of Technology)

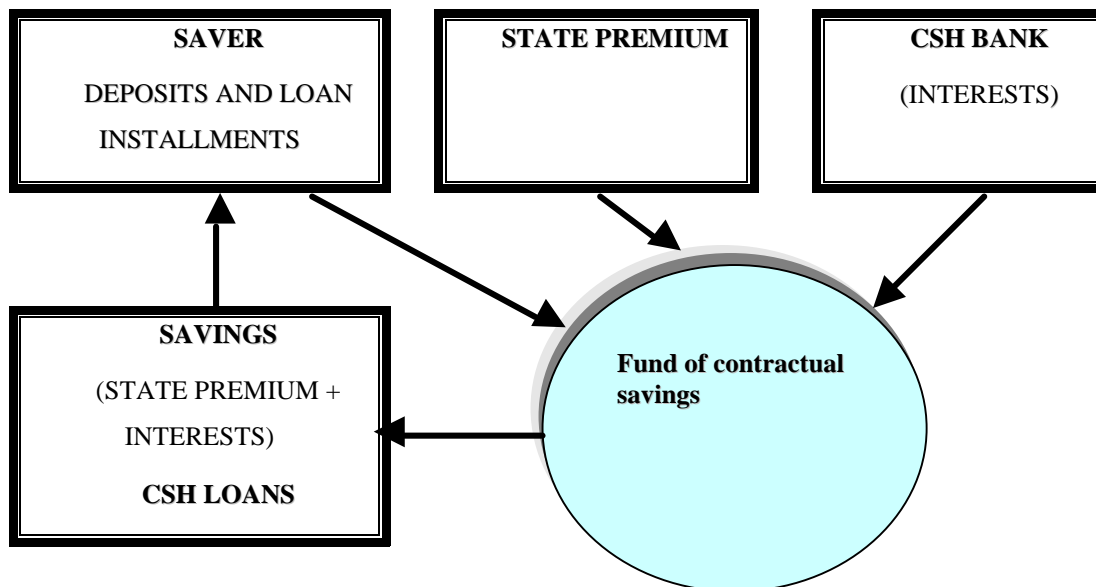
1. The analysis of the Contractual saving for Housing system in Slovakia

1.1. Contract saving scheme.

Contract savings for housing (CSH) system is essentially a contract between a household and financial institution concerning the granting of the loan, provided that the household meets the minimum savings commitment over the specified period of time at the prescribed rate. The accumulated savings can be the household's equity to the loan.

The system integrates the households into the banking system. That is, in the absence of sufficient sources of long term deposits for banks, CSH offer disciplined regular saving pattern from households. From the perspective of financial institution, the savings period provides monitoring of the creditworthiness of the contingent borrowers. Hence the CSH reduces information asymmetries that are prevalent in credit markets. Furthermore the accumulated savings minimize the maturity gap of short term borrowing and long-term financing within the financial institution. Since the deposits are kept for specified purpose, they are not easily called off and can form part of long-term loan funds of the bank.¹

The contract savings for housing (CSH) system (the German bauparkasse model) has been introduced in Slovakia in 1992 on the basis of German and Austrian know-how. In the typical scheme the CSH banks provide 3 % interest rate on savings and in addition the government provides the state premium. The value of this premium is calculated as the percentage from annual deposits, and its absolute value is limited by the existing legislation. The deposits of savers, state premium and interests on both items form the contractual savings fund from which the housing loans are provided (see the picture below).



¹ : (Llanto, G..M. Basilio, Q.L: Housing Policy: Developing a Market-based Housing Finance System, <http://www.pids.gov.ph>)

The amount of money available for housing loans is therefore the function of available money in the contractual savings fund. The CSH contract contains the target sum that client would like to achieve after several years of savings. The target sum is composed from his savings, governmental premia, and interests on both items and the loan. The size of loan depends on the size of multiplier. The value of the multiplier varies from 1 to 1,5. The size of loan will be found as the product of the sum of savings, premia and interest multiplied by the multiplier. The value of the multiplier is not very high, that makes the loans less attractive, but it enables to decrease the liquidity risk.

The target sum in the CSH system can be used for the construction of the new houses in private ownership, for the rehabilitation or enlargement of housing units. The market rate of interest is however much higher. In the savings contract the client decides the target sum that he wants to achieve after several years of savings.

The underwriting of higher loans from CSH system may involve the collateralization by the third party or by the value of the real estate. In the later case the total amount of the loan cannot exceed 70% of the value of the collateral – this is more advantageous than collateral for the mortgage credit where the value of loan cannot exceed 60% of collateral. If the value of credit is less than 600 000 crowns, no collateral is necessary, but one guarantor must sign the guarantee. If the sum does not exceed 300 000 crowns, the guarantor is not necessary. This information does not tell much about the housing affordability. For the comparison reason the new studio may be bought for almost 700 000 crowns, and the serious reconstruction of the flat in the multifamily concrete housing unit may cost from 250 000 SK to 500 000 SK

The total target sums are in most cases not big enough to buy the new housing units. The syndication of the several target sums is however possible (if several members of the family save the money). Yet the main problem is to obtain not only the CSH loan, but also mortgage loan. At present this is the problem, since it is hardly possible to use the same real estate as the collateral for both loans. There is one exception from this rule: It is possible to use the contractual savings and CSH loans together with the mortgage loan from the National Fund from Housing Development, that is the public organization supervised by the Ministry of construction and regional development, that provides the subsidies and housing loans mostly for low-income population. The closing the low-cost housing loan from the Fund is not however easy, since only the households with income per person less or equal the double of the life minimum are eligible. Such families however have hardly adequate savings in the CSH banks, and the low incomes may be the major obstacle for meeting the underwriting criteria of the Fund. Combination of the CSH sources with the regular private or semiprivate banks make serious problems.

1.2. Actors in the CSH banking

The first CSH Bank in Slovakia PSS (Prva stavebna sporitelna) was created during the fall 1992 through the joint effort of three banking institutions: Slovak Savings Bank Ltd. (Slovenska sporitelna, Ltd., now the 87% subsidiary of the Erste Bank, Germany) (35% of shares), Bausparkasse Schwäbisch Hall, AG (32,5% of shares), and Reiffeisen Bausparkassen Managementservice und Beteiligungsgesellschaft m.b.H, Wien, Austria (32,5% of shares). In 1993, the General Credit Bank of Slovakia and Wustenrot established another CSH bank: Stavebna sporitelna VUB Wustenrot (SSVW). Three stockholders own it: Vseobecna uverova banka - VUB (General Credit Bank), Wustenrot (Germany), and Wustenrot (Austria). Consequently, currently, the competitive market exists in this field.

The third CSH bank CSOB – stavebna sporitelna (100% affiliate of CSOB) has penetrated into the market only recently. It was founded on June 8, 2000 and it has begun to provide its services on December 1, 2000. In December 2000 CSOB – stavebna sporitelna has been able to close 26 000 of contracts with the target sum more than 6 890 Slovak crowns. In the year 2000 this bank has acquired 7,5% of the market according to the number of the closed contracts or 10.9% of the market according to the total target sum. This was the result of the introduction of the new housing contractual savings products.² Thus the penetration of the new banking agent was the new impulse for the creation of the more competitive environment on this market. Three Slovak housing CSH banks have closed in the first two months of 2001 41 801 new contracts, with the target sums 7 557 billions SK. The youngest CSOB Stavebna sporitelna (The owner of 100% of stock is CSOB – Ceskoslovenska obchodna banka) (Czechoslovak trade bank) has closed 41 801 new contracts (that number represents 11% of the market in the year 2000, or 12% of the market, if we take into account the total target sums in the closed contracts). At the end of February 2001 all three CSH banks have managed 854 720 contracts with the target sum 562 billions SK³

The strongest actor in the CSH market is PSS. Its growth during the last decade has been really remarkable, and PSS was considered to be the second best bank in Slovakia in the years 1998,1999, 2000. It is likely that it will keep its position even in this year.

When the contract savings scheme was introduced, it was estimated that the first loans would be provided in 1998. Because there is now the large number of people who save their money within the contract saving scheme, the banks are now able to provide the first loans in 1995. Recently Slovak State Saving Bank announced the new banking service - interim housing loan. The person, who will receive the interim loan, will be obliged to pay off only interests with the interest rate 14 % until he will receive the regular housing loan. Then the amortization scheme of the regular housing loan will follow the conditions of loans provided within contract saving scheme with low interest rates.

The above described situation illustrate the fact that once the new institutions are established, the foreign know-how can be utilized, and Government can provide the inevitable support, the new system may evolve surprisingly rapidly.

The CSH products of the CSH banks are to some extent different. The differences are mainly in the following areas:

- a) Conditions of receiving the CH loans (interest rate, time of repayment, etc.),
- b) details of the family contracts on CSH, long-term CSH savings for children with the lower monthly savings installments, details on different regimes of savings, such as target sums, details on the possibilities to obtain the CSH or interim credits, interest rate on credits,
- c) interest rates on deposits and state premia,
- d) insurance of repayment of the credit and interim credits by the contracts with life insurance company,

² CSOB Stavebna sporitelna a. s. nad ocaakavania. (CSOB CSH bank exceeded the expectations) Marec 2001. Eurostav, p. 78

³ . Viac možností (More possibilities) Finefekt príloha HN z 23 marca 2001 p. 2)

e) Different forms of compensations on deposits for those savers, who have completed the saving cycle agreed in the written contract and decide to continue to save the money regularly, the special compensations on children's savings etc.

f) Different forms and regime of collateralization on provided housing loans that depend on the value of target sum (by real-estate, third party, the trust based on the regularity of the savings, etc.)

g) Benefits resulting from the partnerships of the CSH bank with other banks.

The important factor of the friendliness of the CSH banks toward the customers is also the process of collateralization. This concerns for example the estimation of the value of the collateral. In Slovakia there are the official rules of the estimation of the value of the housing units. Such estimation is very technical. It takes into account the construction costs that were spent on building the housing units less the amortization. Such official approach does not take into account the position of the housing units in the town and its market value. It provides very unrealistic value of the housing units. This is the reason for which the CSH banks use the user-friendly approach to the value of the real estate and they have elaborated the multipliers of the housing values in the towns. In the best case the value of such multiplier achieve 3,5%. Thus is the licensed estimator uses the official approach toward the estimation of value of the housing units, and he finds out that the value is 200 000 SK. This estimation shall be multiplied by 3,5, and we shall thus obtain the value 750 000 SK.

Overall results of two most important savings banks can be observed on the following table.

The overall financial results of the most important players on the CSH market are shown on the following table

Table: Summary data on CSH contracts in PSS, and SSVW

| | 1992 **) | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | Total |
|--|-------------|------------|------------|------------|-------------|-------------|-------------|-------------|-------------|
| Annual number of closed contracts | 55 932 | 174 057 | 216 876 | 271 812 | 338 532 | 157 446 | 182 493 | 239 422 | 1636 570 |
| Total number of contracts | 55 932 | 229 989 | 446 865 | 718 677 | 1057 209 | 1214 655 | 1397 148 | 1636 570 | |
| Number of contracts in the savings phase | 55 762 | 227 729 | 425 005 | 636 845 | 902 544 | 893 078 | 844 483 | 788 681 | |
| Total value of target sums in mil. SK | 7 482 | 27 811 | 53 902 | 84 529 | 122 679 | 134 431 | 135 313 | 144 809 | |
| Value of savings in mil. of SK | 317 | 2 431 | 6 709 | 13 133 | 21 953 | 29 639 | 35 623 | 39 979 | |
| Value of remitted deposits in mil SK | 410 | 1 591 | 3 450 | 5 717 | 8 988 | 9 665 | 10 098 | 14 172 | 54 091 |
| Value of allocated state premium *) mil SK | 180 | 727 | 1 423 | 2 136 | 3 322 | 2 671 | 2 434 | 2 811 | 15 704 |
| Value of specifically used financial funds | 0 | 20 | 308 | 1 379 | 5 026 | 14 568 | 29 352 | 51 588 | 51 588 |

| | | | | | | | | | |
|--|---|---|---|---|-----|-------|---|-----|-------|
| from CSH system /in mil. SK/ cumulatively | | | | | | | | | |
| Bonds PKB, National Fund for Housing Development debentures, mortgage backed securities for VUB and SLSP banks in mil SK | 0 | 0 | 0 | 0 | 500 | 1 000 | 0 | 200 | 1 700 |

*) Value of allocated state premium represent the annual claim toward the national budget, that is the function of the total value of annual CSH deposits

***) The presented data are only from PSS, since SSVW started to provide its services from 1993

1.3. Competitive forms of funding of new housing construction.

The CSH loans are not the unique forms of housing funding. The Slovak citizens can obtain the housing loans also from the mortgage banks and National Fund of Housing Development.

The mortgage credits have been reintroduced relatively late, practically two years ago, after 50 years of their non-existence. At present there are several banks that provide these types of credits. VUB, Slovenska sporitelna, Istrobanka, Tatra banka a Hypoivereinsbank. The owner of license is also Bank Austria Creditanstalt, but it does not yet provide the mortgage credit. In spite of the generous interest subsidies from the government, the mortgage credit provision is developing slowly. The underwriting process is too long; fees high and the clients yet do not like to provide the real-estate collateral.

The Ministry of finance has assigned each of the last three years, including the current year 100 mil. SK of subsidies for repayment of the part of the interests on the mortgage credits. The subsidies are oriented on the natural persons. The percentage of the subsidy is approved each year in the project of the national budget, and according the banking loan, the percentage on already closed loan will stay valid during the all repayment period. At present the subsidy is 5%. It means that the borrower has to repay to bank installments with the 5% interest rate if the market interest rate makes 10%. Such generous subsidies may be in the future the important source of the budget deficit, since if the number of loans will grow rapidly, the need for subsidies will grow very rapidly. The approach is not therefore financially sound in the long run.

In the short run there are no difficulties with subsidies. In fact in the last two years the projected amount of subsidies from national budget targeted to they have not been used entirely. The people are not used to take such credits and the banks have not adequate experience in their provision plus there are some unsolved legislative issues, which complicate unnecessarily the underwriting processes.

If all the projected interest subsidies (100 mil SK) have been used, more then 4 billion. SK would be assigned for the new housing construction. For this sum of money 4 000 new housing units of medium standard for average size of families could be constructed. In reality it would be less, because the people who fulfil the underwriting criteria for receiving the mortgage credits would be interested to buy rather larger apartments or

more expensive family houses, and thus subsidies will have lesser impact on the number of the housing units constructed.

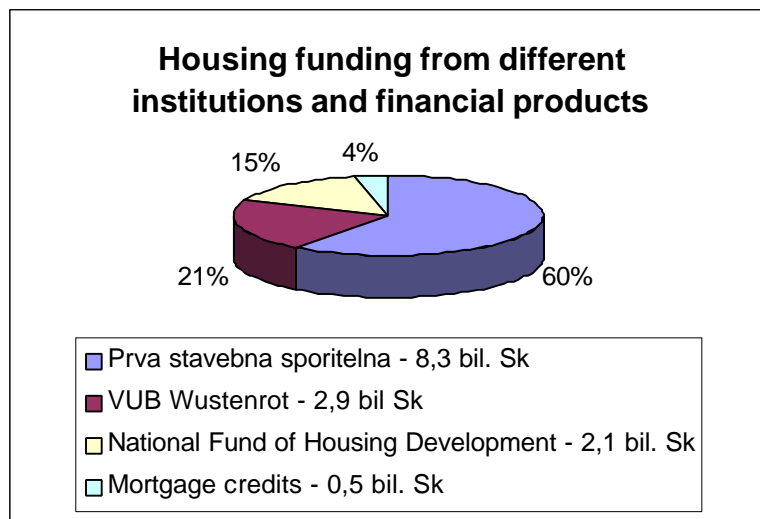
The loans from National Fund of Housing Development exist from 1996. This institution was created with the goal to make housing loans more affordable especially for the younger people. The Fund has started to provide subsidized low cost housing loans, as well as subsidies for the construction of new housing units. The financial funds provided could be used for a variety of purposes, such as the construction of apartments, hostels, housing for the handicapped, and maintenance of the existing housing stock. The contributions from the Fund have helped to elevate the new housing production after 1996:

However, the results achieved could have been higher if the functioning of the Fund was not burdened by excessive bureaucracy and the non-transparency of the distribution of funds for the construction of new housing units. In fact almost 40 % of its resources were used for the construction of luxury apartments 1998[i], which is in the contrast with the original intention of the Fund – to provide credits and subsidies from the Fund mostly to those who really need it. The perverse behavior of the Fund is maybe less surprising if we take into account the absence of firm guidelines for the utilization of the financing and its control. The large demand for the cheap credits from the Fund and the inadequate amount of funding coming mainly from state budget became the testing ground for corruption and other unhealthy practices. This was the reason why in 1999 the new rules of loan eligibility have been introduced to the functioning of Fund. The subsidized loans became accessible (through often not affordable) only for low or medium income population.

Maximum value of the housing loan from National Fund for Housing Development is 600 thousand SK; the interest rate is one half of interest rate of the Central Bank (now 4,4%)⁴. The person, who applies for the credit must provide the evidence that he is the proprietor of at 20% of the value of the future real estate, and that he and neither any member of his family has the income exceeding triple life minimum income fixed by government. The maturity of provided loan is 30 years.

The alternative forms of housing funding are at present providing less financial funds in comparison with the CSH banks. This can be observed on the following graph.

⁴ Bývanie na dlh (Housing on debt) Pravda, March 16, p. 3



1.4. The changes in the CSH legislation and its impact on the behavior of the savers

The CSH legislation has undergone several changes. In the first act on CSH the government agreed that it would pay to each saver the state premium calculated as 40% of the value of annual savings. Maximum value of the premium was 6,000 SK. Such a premium has enticed many savers to deposit their money in the CSH bank, and that resulted in the steep growth of the number of the contracts, fast growing overall sum of the governmental CSH premia. It was hardly sustainable system for the governmental budget, and limited public sources did not enable to keep the percentage of provided governmental premia at the same level in the long run.

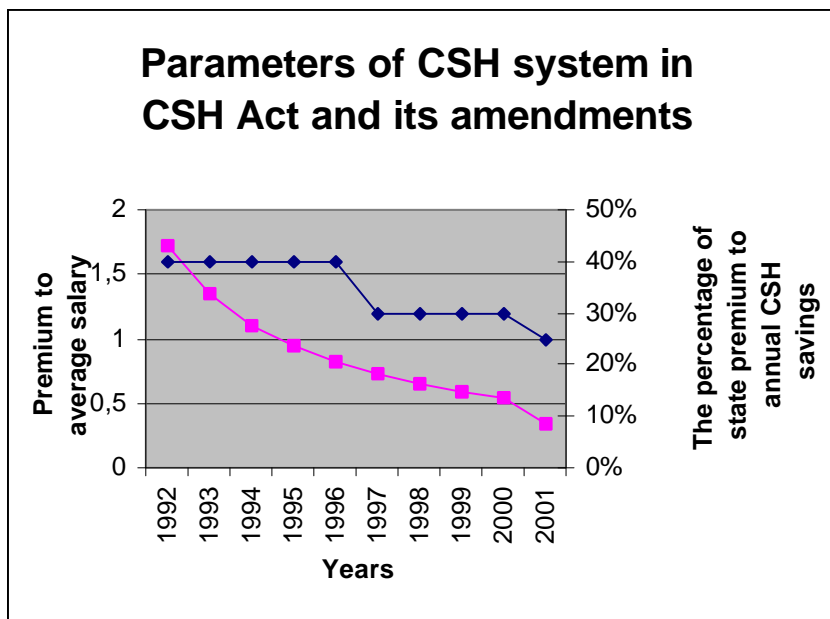
The legislation supported the existence of the “friendly savers” or “bon frères”, that is the persons who are willing to save the money in the CSH system, but they do not intend to draw the loan. Friendly savers are important part of the CSH, since CSH is closed system built on the basis of German know-how, and thus the total sum of the provided loans deepened on the total amount of deposits from CSH clients. As counter-value for such a behavior, the friendly savers are entitled to keep the CSH state premium and use it not necessarily for the building purposes, because their behavior support anyway the channeling the financial sources of the majority of the savers to the construction or reconstruction of the housing units. The first CSH act contained however also the serious legislative loophole. The friendly savers have been able to close contract at the end of year, deposit the necessary amount of savings, that has entitled them to receive the maximum state premium, and after the minimum waiting period, that is three month, to retrieve all his deposits from CSH bank including the state premium. Then they put their savings on some highly earnings savings accounts in another banks and at the end of the year opened the new CSH contracts. That was quite a bargain for the particular clients, but it has the negative impact on the image of the CSH system. This was not good, because the CSH system was just in the phase of the accumulation of savings, and it provided very limited amount of the loans for the housing purposes. In the absence of the serious tangible and the rapid growth of the construction costs, some decision makers were asking themselves whether the CSH system will be really able to provide adequate funding for the new housing construction, that was declining steadily since 1990. They were of course right, but such reasoning has also reflected the unrealistic expectations, that they put into the CSH system at the moment of its establishment. The

CSH system is able to provide lot of money to the housing sector, but the value of the target sums provided to the clients is not often adequately high to build the new housing units. Therefore the funding of the building construction must be supplemented from other sources, and it is hardly the fault of CSH banks if such alternative possibilities do not exist.

It is quite typical for the policy making that their decisions are often extreme. At first the undertaken measures go to far, and then comes the criticism and negative reaction that pushes the system in the opposite direction but also further then it is necessary. Thus often the both moves are the sources of the system dysfunction. Thus in 1996 the amendment of the CSH act was adopted. In the amendment the support for bon frères was liquidated. The contractual savers, who were not going to use the saved money for the housing purposes, and who have been saving the money for the minimum contractual period (for example for 6years) were not be able to keep the state premium anymore. Thus the “bon frères” where not willing to support the housing contractual savings by their presence and that has led to the augmentation of the liquidity risk. It had the impact on the rise of the interest rate after April 1998 on interim credits from 5% to 8%, and on immediate credit from 7,5% to 9,5%. At the same time the level of state premium was reduced to 30% on deposits with the unchanged maximum value of premium. The specialists have seriously criticized the liquidation of the bon frères system.

The support for the bon frères was reestablished after the change of government in 1999, but the under the more reasonable conditions that before 1996. The savers can keep the governmental premium, and use their money for any purpose on conditions that, they save the money in CSH system for at least 6 years. They may keep the premium also if they spend their savings for the housing purposes. In the second case they must accumulate the money in the CSH bank for at least two years.

The last amendment of the CSH act was made in the year 2000. The government has reduced state premium this year. The value of the premium was established on the level of 25% of contractual savings, and maximum amount of premium for the saver was reduced to 4 500 SK per annum. This cut-down is quite high especially when we take into account that when the contract saving scheme was introduced in 1992 in Slovakia the average salary was 3,000 crowns and the premium 6000 crowns, while today the average salary is 11400 SK crowns and premium 4,500 SK. The changes of the quantitative parameters of the CSH law in the last decade are summarized on the following graph.



This situation has certainly impact on the behavior of the clients of CSH banks. If they are not too affluent, they deposit as much money as they can; yet they may not be able to achieve the maximum value of the premium. 20% of clients are able to deposit more money yearly then is the threshold for receiving of the maximum premium. If the maximum premium would be still 6, 000 SK this part of savers would accumulate additional 4% of the overall annual savings deposits in CSH banks, that is additional 2 billion of SK. It does not make the sense for them to deposit more money however, since after they receive maximum premium, the real interest rate on their savings including the state premium is falling. Such behavior reduces the sum of the potentially provided credits.

The reduction of the state premium (either absolute value and the percentage) has enabled the ministry of finance to make the economy of 500 mil. of budgetary expenses. This will enable the government to allocate more money for other purposes including the subsidies of interest rates on mortgage credits for natural persons. Yet PSS think, that it was not a great bargain. PSS estimates that by providing more loans for the new housing construction and reconstruction, the widening activities of the building sector would bring to budget additional revenues coming from VAT and income taxes. The value of this revenues from additional 2 billion of crowns can make 400 mil. SK of additional revenues, and that almost covers the economy of the financial funds from the reduced state premia. The real additional revenues could then be higher, if the multiplicative effects from additional new housing construction and reconstruction would be taken into account. At the same time some new job places could be created and that would have an impact on the reduction of the overall amount of social allowances paid to unemployed people. The unemployment rate has already hit 20%, and there is already growing risk of the social unrest in the country. Thus the revenues from the collection of the additional taxes can according to analysts in PSS almost offset the growing expenses of the budget related to the growth of the total value of state premiums paid to clients.

Yet even such target sum is interesting for the natural persons, in spite of the fact that the inflation in the last years has been growing rapidly as the result of some systemic changes. The problem is that before the inter-banking rate where quite high, and thus the banks were trying desperately to find more clients by augmenting the

interest rate on savings. This is not longer true, and the after-tax interest rate on savings is much lower than the annual inflation. Thus the after-tax value of savings is degrading rapidly. One could invest its money into the mutual investment funds. The allocation of the money to such institutions is however more risky, and the degree of risk is further amplified by low level of the governmental regulation of the activities of non-banking financial institutions. That often means that these institutions promise the high returns on the allocated fund, but they are often becoming bankrupt because of the fraudulent activities. The government promised to enforce in near future the legislation that will force the non-banking institutions to behave in the more transparent ways. For many people in such a situation is the best option to save the money in the CSH system. The other forms of investing the money for instance into the life insurance or additional pension insurance are less used, because either the people are not well informed about the conditions of savings in such institutions and benefits from it, or they do not trust these organizations.

1.5. Corporate governance of the CSH banks in the context of corporate governance practice in Slovakia

Generally the corporate governance in the contract savings bank is quite well done. The contract savings banks were among the first Slovak banks with the participation of the foreign partners. This is the important moment since often the banking property is often in the hand of government in spite of the formally declared privatization. The corporate governance in the organizations with the majority ownership of government (de facto or de iure) has been quite problematic after the velvet revolution in 1989. Such a situation is not only the result of the fact that the government usually is less successful in taking care of the property than the private organization, but also of the specific historical development.

After velvet revolution the old and obsolete management structures of the Planning committee that have been partly responsible for the corporate governance of the state companies were abolished. The pro-democratic government were not able to create the efficient mechanisms for the corporate governance of the property that has not been yet privatized. Moreover the new ideologists were claiming that the public property was necessary to privatize very quickly in order to change typically inefficient socialist management. Thus the speed of the privatization regardless the incompleteness of the legislative conditions and non-existence of the solvent clients able to buy the property for the reasonable price, became the main criterion of the success of the transformation.

Instead of the strengthening of the position of the organizations in the public hands before the privatization, that would eventually enable to receive the better price for the companies privatized in the market, the public organizations were fast losing market and their state could be often described as the pre-privatization agony. Ineffective public corporate governance was not able to prevent wild privatization. The typical model of such privatization was the creation of the company with the limited liabilities by the managers of the state enterprise or the banks. Such a company has started to make business with the public enterprises on the very good payment condition and with the guaranteed market, access to know-how. The insider trading approaches has been the rule of such game. The private company has prospered while the publicly owned company was tunneled and had suffered several losses. Yet even in such situation the government allowed the managers of the non-prospering public firms to receive high salaries and bonuses that often exceeded several times the incomes of ministers.

Such a situation still continues in some cases at present. At the same time it was possible to channel some of the financial funds for the support of the electoral campaigns.

These problems are of course closely connected to the transformation of the whole banking sector. During the socialism the banks were not the banks from the western point of view. They had little experience with all kinds of risks connected with the closing the credit contracts. Also the legislative environment was quite different from the developed economies. In the past ten years lot of progress has been achieved, yet lot has to be done. The most important problems were first the bad debt from the socialism. The banks had funded the large factories and civil works, and after the destruction of the Eastern market, wild privatization, there was nobody to repay these debts. The lack of experience of the bankers and the inadequate management and control structure, and political pressures have caused that almost the same amount of the bad debts were produced by the sector in the years following the fall of the Berlin wall. Behind the “scene” one could suspect the lot of the corruption practices as well. The publicly owned banks were too dependent from the political parties at power. The banks often provided the credits to enterprises under the political pressure. The provided credits did not always respect the rules of prudent banking – hence the net result was the underwriting of lot of bad loans to customers.

The present government that is at the power has decided to move these debt into the newly created Consolidation bank, that tries to sell these liabilities to third parties. Total value of the liabilities makes 100 billion SK, or one half of the annual national budget. There is the risk, which the larger part of this sum will be repaid by the taxpayers. Now some banks have been already privatized by the foreign thrift institutions. We can now expect that the higher quality of the corporate governance, and the lower dependence from the political parties being at power will lead to the more prudent lending practices.

The last ten years of transition thus we can characterize as the serious chaos in the property rights and their enforcing. The position of Slovakia is in this case in no way unique – the similar problems were encountered in the neighboring Visegrad countries.

The position of the CSH banks was in this case much less vulnerable. The corporate governance structure have been functioning well from the very beginning, the financial flows were transparent enough, the government did not have negative influence on the banks where the majority was owned by the foreign stockholders saving bank. In such an institutional context the first CSV banks were from the very beginning the important isles of the healthy banking practices, and still they belong to the most trustworthy banks and well functioning institution in the not very transparent entrepreneurial practices in Slovakia. Such situation is however not too different in many other transforming Central and Eastern European countries.

Important question of the corporate governance is the dividend policy. The dividend policy is not regulated by the government as it is for instance typical for Hungary, where at the part of the profits has to be put into the company reserve, that serves for the future funding of the housing loans. Yet as we had the possibility to discuss this topic with PSS, the dividend policy is quite reasonable. In fact only ¼ of the retained profits are used for dividends, but another ¾ of retained profits goes for the building up of bank equity and that makes 400 million SK annually in PSS.

1.6. Partnerships of CSH banks with other actors in the housing sector

The important feature of the CSH banking activities are partnership relationships with other institutions. Although these relationships has started not long ago, and they have still a large potential for their development,

they may become the important contribution for achieving the higher quality of the housing financial services in the near future. They may help to create the better match between the supply of the banking products and the objective housing needs, and in such a way to augment the housing affordability. Moreover such arrangements may influence the overall management culture in the housing sector where the development of the partnerships especially between public and private sector is badly needed.

The examples are numerous. For example PSS cooperates closely with some vendors of the construction materials in Slovakia. These vendors have signed the agreements with the bank, that they will sell the building materials to the clients of PSS for the discount prices (less 10-15%). This is done also by SSVW. SSVW provides to each client W card, that enable the client to buy the building materials for the discount prices with up to 20 % reduction in 400 shops of the vendors of building materials in Slovakia.

The CSH banks would like also to buy the mortgage-backed securities, however Slovak banks hesitate to emit such securities in the important amounts. At present the situation on the capital market is not very good. There is the lack of good investment opportunities, the banks prefer to cover the provided mortgage credits by the short-term savings from the population, although the banking law recommends to use for these reasons the mortgage-backed securities. The preferential coverage of the mortgages buy the short-term deposits is at present economically more advantageous. In the last two years the interests on savings has declined substantially – and now they make 3-6%, while the inflation in the year 2 000 achieved almost 10%. The inter-banking interest rates has also declined to the unprecedented level (7,45-7,7⁵). The mortgage are at present provided approximately for 10,5 % interest rate, but the government subsidizes the interest rate for the clients – natural person by 5%, that means that the client pays to bank 5,5 % interest rate. Such banking policy seems to us, however, shortsighted.

The accumulation of the financial sources enabled to CSH bank to fund the housing needs also through other financial institutions. For example the CSH bank were able to buy the debentures of the Slovak savings banks, that were covered by the housing loans, and to buy the bonds from PKB (First communal bank). PKB bank funds the activities of municipalities including the housing construction.

Cooperation may have also the form of different housing partnerships, with the government and the local authorities. In the last year the MVRR has proposed the subsidies for the construction of the social rental housing units, that were not practically constructed in the last years after the velvet revolution, because the legislative and market environment was hostile to such a construction. The PSS thus proposed the participation in the funding of such units by the provision of the loans to municipalities. It already elaborated the pilot project. Yet the concrete realization will have to be postponed into future, because meanwhile the subsidization policy has been changed. Anyway such initiatives show that the CSH bank with their capital both financial and human can be a good partner or the developing well-conceived housing policy initiatives. The prepared decentralization of the public administration will positively influence the creation of such partnership, and that will potentially bring more money into the housing sector

The contract savings banks also seek the partners among the developers or building firms. Some of the developers has been able to create the preferential relation with the CSH banks. This makes the access to construction loans easier. In this case the CSH bank signs the contract with such partner and provides him the necessary loan. The legal person is not obligated to make the saving before obtaining the loan. When the

⁵ Burzové noviny (Stock exchange news), Hospodárske noviny. March 21, 2001

construction is finished, the future owners will reimburse to the construction firm the part of its price, and they will also receive the CSH loans (in order to receive it they must be the clients of the CSH bank for at least two years). The developer – construction firm will repay the part of its debt by cash and the rest of the debt will be offset by the new CSH loans that were provided to new owners with the parallel registrations of the liens in the cadastre. The debt of the construction firm will thus be fully amortized, and the lending risk of loan default distributed among the new owners. This is quite important since the long-term existence of many developers in the market is not the rule in the rapidly changing economic situation of the country undergoing the economic transformation.

In the last two years the new partner of CSH banks has emerged. It is Slovenska zarucna a rozvojova banka SZRB (Slovak guarantee and development bank). SZRB has the different programs. From the point of view of the housing sector there are interesting its initiatives toward small and medium entrepreneurs. The building developer of the small or medium size may receive the loan limited by 100 million crowns from CSH bank for the new housing construction. The loan must be used for the new housing construction or reconstruction/revitalization of the existing housing units. Then the developer may ask the SZRB to guarantee this loan (usually up to 65% of the provided principal). The developer-borrower has to pay the fee for the guarantee and prove the healthiness of his firm and present the realistic marketing plan. The guarantee is provided for the limited period (usually 36 months). Guarantee is finished in the moment when the housing units are sold, or the credits are transferred to the new owners. This mechanism provides additional incentives to finish the construction works as quickly as possible. The program cannot be used by big entrepreneurs, since the activities of SZRB are partly funded by the national budget, and therefore they are regulated by government, who has issued the bill on the governmental support of the small and medium enterprises, that already comply to the legislation of European Union. The fees paid for the guarantees on the loans do not cover all default risk. Part of the risks are covered from the governmental sources.

SZRB has also launched another guarantee program supporting the small and medium entrepreneurs that is related to some extent to housing. One of the goals of this program is to provide better access to credits to those entrepreneurs who want to fund the project targeted on the energy savings. Thermal insulation of the houses is one of the important ways of achieving the energy savings, and still pretty well neglected, and therefore the financial funds can be used also for these purposes. The mechanism of the guarantee provision are similar as in the preceding paragraph.

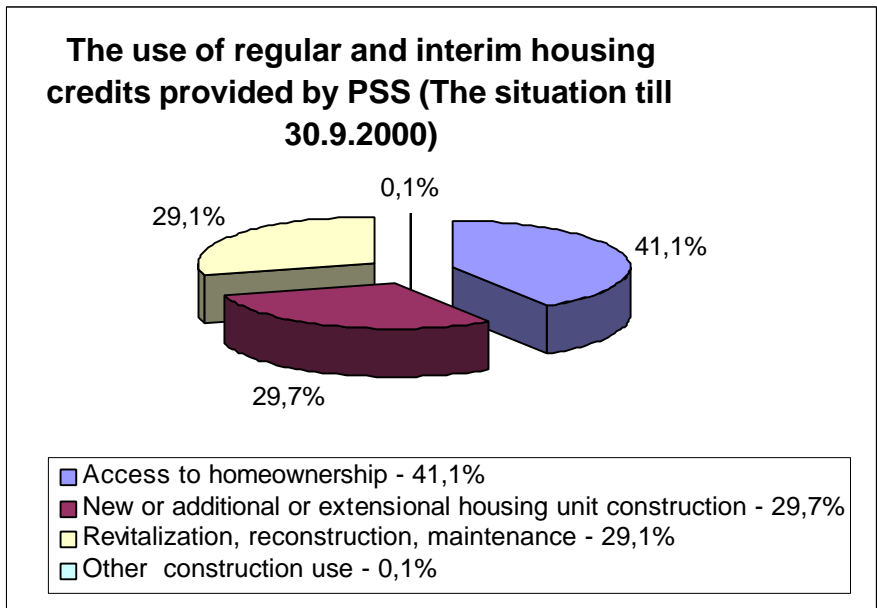
The efficiency of the CSH loans for the entrepreneurs with the guarantees of SZRB is yet difficult to evaluate, since some of them had started some one and half years ago. There are some signals that the cooperation between the CSH banks and SZRB is not too intensive. CSH banks are rather cautious in their activities within the partnership relations, and they do not want to be involved at present in the large-scale cooperation with other banking institution, especially when the new products are not well tested in the practice. Moreover the closing of such loans often needs the realization of the complex underwriting procedures, that are not easy to standardize. Some difficulties stem also from the imperfect legislative business framework, legislative loopholes, and frequent legislative changes that often affect the business environment negatively. The eventual larger scale cooperation with growing number of defaults may be have the relation to prevention of the liquidity problems of the CSH banks.

On the other hand the CSH banks are interested to show the better results in the area of the funding of housing construction, and that is why they are trying to extend the range of their banking products related to the satisfaction of the housing needs. The functioning of the CSH banks is not independent from the decision making of the Slovak government, but on the contrary it depends strongly on its policy. At the same time it is not insulated from the opinions of the population. Moreover the other banks are not always happy because of the exclusive position of CSH banks on the deposit market. The preferential rules of saving cause that the substantial deposits from the population are moved into CSH banks and fewer deposits are flowing to the savings banks. The point of view of the regulators from the Ministry of finance on the effectiveness of the CSH system is not always optimistic. On the informal meetings, they claimed to me that too much money in the form of the governmental premia has been invested to CSH system, and yet target sums provided from the system are rarely high enough to aid to fund the new housing construction. The objectivity of such opinions is not supported by seriously made independent analysis, yet they influence strongly the policy of government in the area of provision of the governmental premium, and the support of the alternative methods of the housing funding.

1.7. Impact of the contract savings scheme on the new housing construction and reconstruction, and on the economy as the whole.

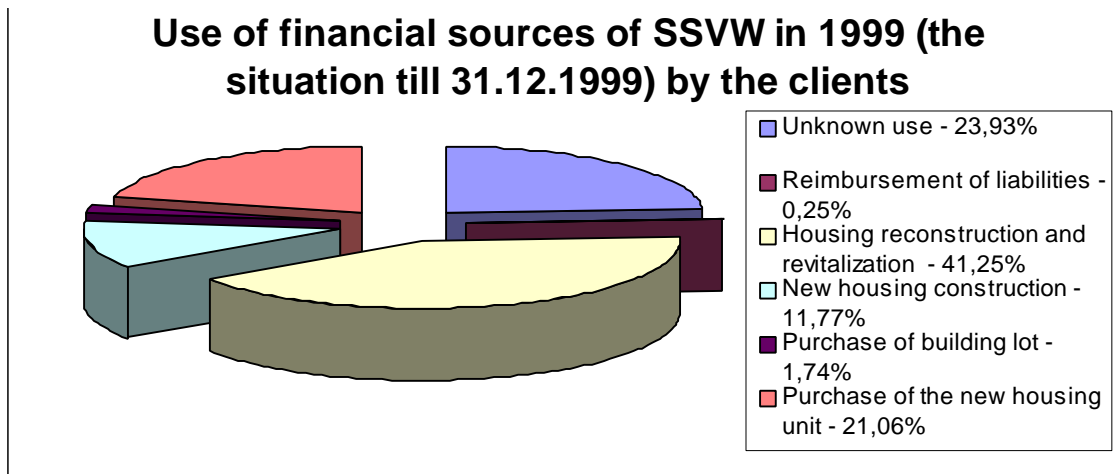
The CSH savings have several positive outcomes. First of all it is the enticement of the population to save regularly the money, that can be used for the building purposes or the reconstruction. In the area of the housing construction they can play more limited role since the target sums are usually large enough. However the funding of the maintenance and the reconstruction work are equally important especially when we take into the account the extend of deferred maintenance in the multifamily housing units. It is therefore interesting to follow the structure of the use CSH funds for the housing purposes. Two following graphs provide more insight into the understanding of this problem.

Moreover more funds flowing into the housing sector brings multiplicative effects into the other sector of the economy. This means more economic activities in other sectors and the creation of the job places. That also means that the large part of the national budget expenses allocated to the state premia can be offset by the growing incomes from levied taxes from higher level of economic activities. People are also enticed to invest their money into the satisfaction of their housing needs, and that means also the support for the domestic industries, since the large part of the building materials are produced in the country. That also means that people buy less exported goods and that may impact positively the balance of the foreign trade. As the result of more housing construction, the mobility of the population may grow, and that has the positive impact on the job markets. Unfortunately the new housing production has been severely reduced after 1990, in spite of the introduction of the new forms of the funding. The net result is that the mobility of the population inside the country has been reduced in comparison with the era of communism.



1.8. Problems of the contractual savings and their future perspectives.

The most important problem of the CSH banking is of course the liquidity. This is not really problem at the beginning, when many new savers are becoming the part of the system. When the system is more mature, the



influx of the new savers may not be high enough to ensure fast access to credit and that may influence the popularity of the system and its viability. Our CSH banks have not yet achieved this state of development, so it is difficult to say to which extent it will influence their functioning. One think is clear however – the frequent changes in the state legislation have hardly positive impact on the system.

In our opinion there are at present also the problem of the governmental supervision. The Ministry of finance that supervises the CSH system lacks the exact data on the functioning of the CSH banks. We were trying to receive the exact data from the different Ministries, but the data are really contradictory. That makes the serious analysis of the system difficult. Ministry of Finance is trying to get more detailed data on results of CSH system only recently although CSH system exist almost ten years. The banks oppose such tendencies from the

ministry. Moreover the system of the statistical monitoring of the SCV banks is not developed well. Then the results of the monitoring process are hardly comparable. For instance just today the exact definitions are being elaborated (For instance closed contract was understood by some banks the contract signed by client but not by bank, while in other cases the bank understood that the both signatures must be provided. The regulatory agency that is the Ministry of finance just controls randomly selected contract in order to find out if these comply to existing laws.

The other problem is the problem of the housing policy as the whole. Since the housing policy has many different aspects: economic, technical, legal, environmental, spatial, financial – many ministries are participating in the elaborating the legal acts related to building: Ministry of Environment, Ministry of Finance, Ministry of Construction and Regional Development, Ministry of Interior, and Ministry of Justice. The legislation is then often incomplete contradictory. That is the result of inadequate cooperation, excessive bureaucracy, and even the conflicting relationships. Then to some specific problems is not dedicated adequate attention.

Such problems may have the technical character. For instance one problem of the multifamily housing unit is the reconstruction of housing kernels (the kernels are usually constructed from the lower quality materials and they contain the sanitary installation – bathroom and toilette) in the concrete panel houses. The problem is that the reconstruction funded by CSH bank does not always take into account the different technical aspects such as the access to cross connected frames. Often the fund are targeted to less important aspects of the housing reconstruction, while the more important technical problems are not being removed, such as reparation of flat roofs, facades, stairways are neglected. It is the question whether the legislation should not treat in the preferential ways the treatment of the mentioned problems of the maintenance

The reconstruction of the common parts of the multiple family houses by the CSH loans is not in practice easy. After the privatization of the housing units the majority of the apartments in the panel multiple family houses is in the private hands. According to the law, the new condominium owners are obligated to create the association that would take care of the management of the property or to charge some management organization to take care of the management of the property. If the condominium owner wants to rehabilitate the building, they first have to find the consensus. If they save regularly the money in the CSH system they may ask for the loan. Then every individual owner will have to provide his housing unit as the collateral against the loan. Such loan is expensive to underwrite, because the lien against each individual property must be registered in the cadastre. That means that every individual involved in such a loan must pay the fees to notary and to cadastral office. The condominium association, if exist, cannot guarantee the loan, because it cannot own the property. At the same time the achievement of the consensus on the maintenance and reconstruction issues is in practice very difficult. The simplification of the credit provision is thus depending on the change of the legislation.

[i] Šcevoichová, M. (1998) *Až 40 percent příspěvků išlo na luxusné byty* (Almost 40 per cent of the allowances have been used for luxury apartments) *Národná obroda*, December 8, 1998