

# Building Savings in 2011

AČSS 

Association of Czech  
Building Savings Banks





## Introduction

**Dear readers,** life brings paradoxical situations. In 2007, the basis of the world wide economic crisis arose on the mortgage market. In the Czech Republic, the crisis did not have a strong impact on building industry at first. The reason was also, beside other things, that for more than 15 years a financial system – building savings – successfully worked here, more or less

independent of the situation on the market. Similarly, the housing market remained at a decent level in Germany or Austria, which are countries with traditionally strong building savings. And following the same logic, it hit the bottom for example in the USA, Great Britain or Spain.

After three years of crisis, we can count the winners and losers. The Czech building savings is, from a certain point of view, in the second group, despite the reality of numbers. The state responded to crisis by preferring savings and chose the then well-functioning building savings as one of its targets. The government preferred savings especially on the spending side of the state budget to a total – definitely positive – balance of the building savings.

I do not want to and I will not criticise it because the housing support policy lies within the competence of the government, I am just reminding you. In the birthplace of the mortgage crisis – the United States of America, on the contrary, the property losses are running into trillions of dollars, losses of jobs into millions and costs of the rescue of the banking system into many hundreds of billions of dollars. No wonder then that Americans are now trying to find out if it is worth introducing a system of some form which would not allow such a severe impact on the population - the system of building savings! Surprise, surprise!

I will go so far as to claim that the course of actions of the state was very tough in the Czech Republic. The unfavourable development was not so visible in the years of crisis as in the years of the state intervention in the system.

I am not criticising the state support reduction, I am criticising the range of restrictions which have already been implemented, or are being prepared for implementation. In Germany, which is obviously our biggest business partner, they took a different direction – they used the system of building savings, functioning there for decades, and involved it with vigour in the pension reform.

I want to believe that the Czech government will also prefer usage of the building savings to its liquidation because the upcoming introduction of the universal licence to provide building savings by all banks will undoubtedly lead to its liquidation. I am talking not only about liquidation of building savings banks as specialized institutions providing this product, I am talking about the whole system of the traditional building savings! I want to believe that the proposals to broaden the purpose-orientation of the building savings to the effect of the so-called “life savings”, which have been discussed on the political scene currently, will be brought to a successful end.

The yearbook, based on objective figures issued by the Ministry of Finance, focuses on the years of crisis. You can also find current information on the web sites of the Association.

I hope this yearbook will give you some inspiration.

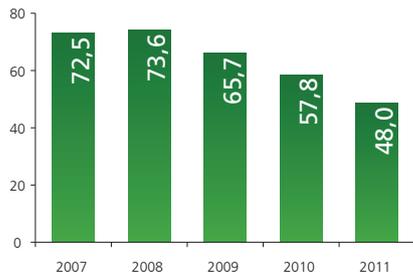
**Vojtěch Lukáš**, Chairman of AČSS

## Loans

The purpose of building savings is to provide money for housing for as many people as possible and under conditions which are stable and at the same time favourable compared with other products available on the market. The base of the system is loans which are designed solely to finance housing.

From this point of view, 92 785 loans in the amount of almost 48 billion CZK lent in 2011 is a significant contribution towards better housing of the Czech Republic residents. However, there was a year-on-year decrease of the volume of provided loans by 16.9 %.

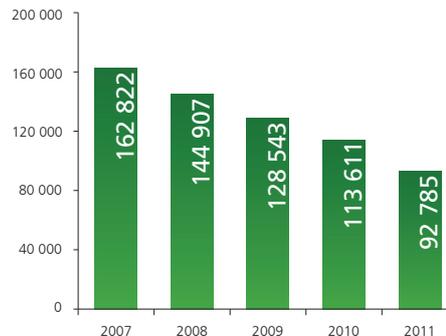
### Volume of loans provided (in CZK billion)



This decrease was caused not only by the uncertainty of the whole economy and clients of building savings due to constant changes, but also markedly stricter legislative conditions for providing consumer credits under which also come, according to law, housing loans not secured by a lien on real property, and also strong competition of other types of housing loans.

Behind the tens of billions of crowns provided by building savings banks to their clients in form of loans we must see especially the tens of thousands of people who improved their housing thanks to the loans, whether by modernization or purchase of new houses or flats. In 2011 there were 92 785 of them.

### Volume of loans provided



From the point of view of the average loan amount which was CZK 517 383, the preferences of clients have not virtually changed in comparison with 2010. The average amount of around half a million crowns also illustrates the fact that building savings banks lend higher amounts to finance new housing on the one hand and smaller loans in tens of thousands of crowns for small improvements of housing on the other.

The biggest proportion of loans from the total number of loans permanently goes towards refurbishment and modernization. Last year it was 45 %.

#### Purpose of loans provided by building savings banks in 2011 (numbers of loans)

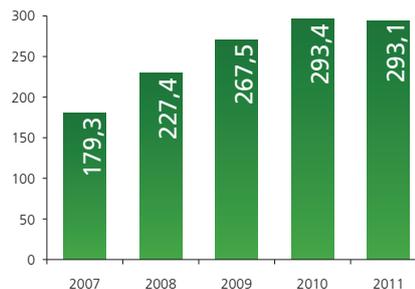
New flat and family houses	8 828	10 %
Purchase of a flat or a family house	24 888	27 %
Refurbishment and modernisation	41 373	45 %
Other	17 696	19 %

Loans provided by building savings banks are advantageous especially to finance refurbishment and modernisation of housing because while offering a highly competitive interest rate as compared to other credit options on the market, they lay an optimum administrative burden on the credit applicant. From this point of view, building savings acts as an irreplaceable pillar of modernisation and maintenance of the for decades underfinanced and neglected housing stock. There is no other loan on the market which would, while not secured by real property, provide a comparable interest and sufficiently long period for repayment.

## Credits stabilize the economic development

The total outstanding amount on client credit accounts has gone down for the first time in the history of building savings. Nothing can grow forever, of course, the change of trend was inevitable. Decrease of the total balance of loans to CZK 293.1 billion does not represent anything else than the current cessation of growth. Time will show if this will only be a short-term fluctuation or a real change of trend.

#### Credit account balance (in CZK billion)



The figures show, however, an important feature which the building savings involves. In a time when other markets of financing housing do not prosper so much, we can see that building savings keeps its performance. When surrounding and competitive markets are launched, on the contrary, the importance of stability of building savings is relatively weaker and the product does not interfere in the surrounding markets so much.

## Nobody can do loans without pledge better

The positive influence of the building savings on the quality of the housing stock is even more considerable in the category of loans without pledge of real property. Such loans do not reach staggering volumes but they are an irreplaceable tool in case of modernization of housing stock, especially when the consequences of its long-term neglect still persist and when the current requirement is reduction of energy intensity of housing. You will surely know it from your neighbourhood. Who does not live in a new house or flat, from time to time they have to change the windows, the roof, wheatherize it or reconstruct the wiring, bathroom and suchlike.

Prices for such maintenance or modernization are from tens of thousands to hundreds of thousands. Hardly anybody is willing, or even theoretically able, to pledge real property in such cases. They consider choosing building savings or a consumer credit.

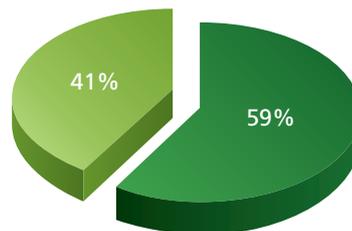
From the point of view of costs, loans provided by building savings banks and consumer credits are virtually non-comparable because the rates of usual consumer credits are minimally twice as high. Clients financing their housing needs by a loan generally prefer loans with low and fixed interest rates and stable and acceptable instalment amounts.

People also go to building savings banks for loans to purchase cooperative flats or renovate rented flats. As they cannot pledge such flats as security for the repayment of the loan, the loan provided by a building savings bank is for them the only accessible solution.

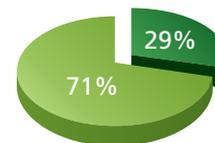
Mortgages, which do not and cannot by far cover the whole spectrum of investments into housing, thrived in 2011 also thanks to refinancing of older loans. The building savings is still the most often used product to finance housing in the Czech Republic.

If the people decided to use a loan for their housing needs in 2011, they borrowed money, according to statistics, in 59 % cases from building savings banks. Due to the fact that these are loans in rather small amounts, building savings accounts for 29 % of the volume.

### Comparison by number



### Comparison by volume



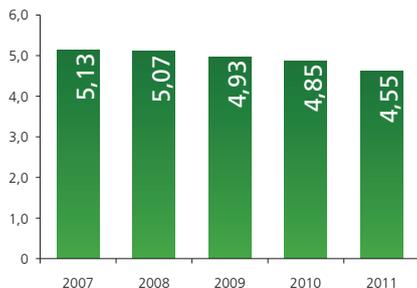
	Building Savings	Mortgages
Number	92 785 (59 %)	65 608 (41 %)
Volume (CZK billion)	48,0 (29 %)	117,0 (71 %)

## Sources for Providing Credit

Providing loans is conditioned by a sufficient inflow of sources into the system. To be able to guarantee the key parameter of the product – stable interest rate of the building savings loan from the moment of signing the savings contract – the system has to be separated from the unpredictable development of the financial market.

Building savings banks therefore acquire money from individual clients – small savers - and not by means of loans on the market. The participants of the building savings are motivated to save by means of several factors, such as high degree of certainty, possibility to accumulate and increase the value of capital with the prospect of getting a loan for housing needs and the existence of state support.

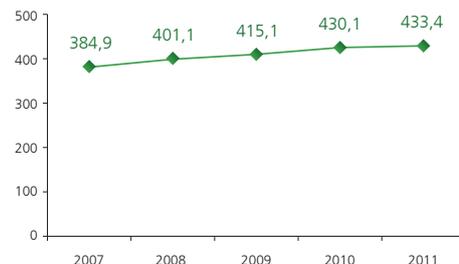
### ✓ Number of contracts in the savings phase (in millions)



Currently there are about 4.5 million contracts registered in the savings phase. The gradual decrease is not positive but it represents a normal reaction to the state support reduction both in 2004 and 2011 and the perpetual discussions about the changes of conditions of this long-term product.

The number of clients itself does not guarantee a resistant deposit fund from which the loans are provided. It is also necessary for the clients to save up enough money so that the volume of deposits can cover the whole amount which is borrowed by clients from the building savings banks. For further credit activities it is certainly essential that the deposits exceed the total receivables.

### ✓ Client deposit development (in CZK billion)



From this point of view, further applicants interested in a loan can be sure that also their future demand will be satisfied by building savings banks.

The volume of deposits is still slightly rising and it exceeds the volume of existing loans. There is therefore still space for further loans in the long-term. Short-term acquisition of money on the interbank market is certainly a possibility for providing credit. However, it cannot be the main and long-term source. It would not only refute the purpose of the existence of the building savings system, but it would in particular weaken the resistance of the product to undesirable influences of this market.

Results of the year 2011 were affected by unrest and uncertainty. The product, which should be based on certainty and stability, filled the newspaper pages with news about constant changes and unclear future. Building savings entered the year with a reduced state support and an extraordinary 50 % tax. In April The Constitutional Court decided on the immediate abolition of the 50 % tax. Autumn brought with it a scramble for the form of the new act. The state support reduction to CZK 2000 was finally confirmed.

Under these conditions, major successes can hardly be expected. The total number of concluded contracts is 410 461. Clients raised the target amount of further 274 990 contracts, usually due to the higher need for financing their housing.

In comparison with previous years, it is a significant decrease but the only meaningful comparison can be with the year 2004. This

**Development of the number of new contracts**  
(including increase)

Year	2007	2008	2009	2010	2011
Number*	862,0	1041,0	886,7	906,1	685,5

\*| in thousands

was the first year with the reduced state support, like the year 2011. In 2011 people concluded almost by 100 thousand contracts more than in 2004. Even after inclusion of contracts where the target amount was raised, the year 2011 won by several thousands of contracts. We can therefore conclude that increasingly larger proportion of applicants conclude a building savings contract with a view to a long-term financing of their needs.

**Credit/deposit ratio went down for the first time**

One of the indicators of the efficiency of the system is a ratio between the volume of credits and deposits. This coefficient shows what portion of deposited money building savings banks provided to clients in loans or in other words how much money building savings banks managed to redirect into the housing stock.

**Development of the credit/deposit ratio (in percent)**

Year	2007	2008	2009	2010	2011
Ratio	46,6	56,7	64,4	68,2	67,6
Growth	8,9	10,1	7,7	3,8	-0,6

The first all-time decrease which is from the mathematical point of view caused by the increase of the denominator, that is savings, indicates that the main reason was a lower demand for loans. We allude to the fact that building savings does not dominate the market in a period of cheap money but it comes into play especially in a time when the market conditions get worse. The stabilizing

function as another irreplaceable effect of building savings in economy has been confirmed by figures in the long term.

## Historic Value of Building Savings

In their 18-year history, building savings banks have provided 1.93 million special-purpose loans for housing in the total volume of 578.3 billion CZK. The most often purpose of the loans was financing renovations and modernization of housing, namely in about 51 % of cases.

By means of the loans, building savings has been contributing significantly to the reduction of energy intensity of buildings in the long term. Investments into savings, the meaning of which has been constantly growing, are desirable both for people and the state. There is a good reason for saying that the most effective energy is the one which does not have to be produced. The state assists in saving energy so that it has created a functioning system of building savings and made it accessible for broad population groups.

Clients have participated in creating a sufficient fund of sources of credit by concluding 13.84 million contracts. In 27 % of them they raised the target amount within the savings phase, usually in order to obtain a higher loan to finance their housing needs.

In the last ten years, 74 % of people who got a housing loan used a building savings bank. These relatively lower loans provided also without pledging the real property represented almost a 38 % share on the housing loans market.

## Summary of 2011

- As of January 1, state support was reduced to 10 % of the maximum of 20 000 CZK a year.
- Clients made use of 92 785 loans amounting to 48 billion CZK in total. The average amount per loan reached almost 517 thousand CZK.
- 45 % (i.e. 41 373) of the total amount were used to finance renovations and modernization of housing.
- There was a year-on-year decrease in the number of new contracts, but not as high as when the state support was last reduced in 2004.
- The credit/deposit ratio decreased for the first time - by 0.6 % points to 67.6 %.
- 59 % of people who used credit to finance their housing needs took a loan from a building savings bank.

## What will come next?

The key question which is related not only to building savings banks, experts and politicians but especially the general public is: What course will the building savings take in the future? The support has been reduced, there are suggestions for other adjustments of the system, the Ministry of Finance is preparing an amendment to the Building Savings Act.

The proposer suggests:

- proving the purpose-oriented use of not only the loans but also the state support,
- spreading the purpose-orientated use of the product into other areas,
- enabling universal banks to provide building savings but under quite different and looser conditions than the ones which building savings banks had to fulfil.

The suggestions are full of contradictions with partly positive but also very negative impact both on the state and the clients. However, the state will not save much money by any of these measures.

The purpose-oriented use is an old magic formula although it does not make sense and logically it must manifest itself by a lower number of clients entering into the system. At the same time it is true that if someone is going to prove the purpose-oriented use of 10-20 thousand CZK for housing within the period of six and more years, they will not have insurmountable problems with it. Do you perhaps know anybody who lives somewhere and does not use the two thousand a year on housing on average? Such an absurd

principle is brought by the endeavour to forbid the clients to use the support for non-housing purposes.

It should be remarked, however, that the so-called friendly client finances the loans to those who currently need more money for housing than they managed to save. When we consider the functionality of the system, **it is not important what an individual uses the money from building savings for but it is crucial how much money from the system is used to finance housing.**

It is necessary to view the measure as an ideological compromise which carries out the will of the proposer and at the same time it will enable the building savings to remain in operation. The aggrieved party here is the saving client, in the first place, and then also and much more the client who requires a bridging loan for which there will remain less and less money in the course of time.

The possible outflow of clients who would consider the conditions unacceptable would mean saving expenses of the state budget. At the same time, however, lending money will let up which will negatively influence building industry, labour market, revenue collection and finally it will increase the need of expenses for the state social benefits. The effect of created or saved jobs is of great importance to individuals, especially to small traders and employees in building industry or real estate trade.

One of economy branches with the highest multiplication effect is the building industry. From the point of view of the state budget, it is quite essential to ask whether the state will not, in the end, lose out due to the saved support on the income side more than it saves on the expenses. From activities which are financed by loans provided

by building savings banks flow considerable tax revenues to the state budget\*. These are several times higher than the expenses for the support. The building savings is thus greatly profitable for the state budget as a whole.

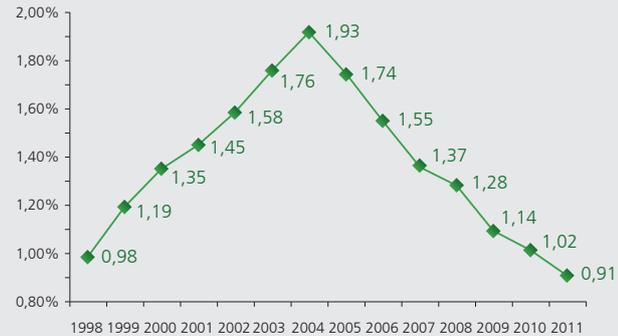
The expenditures on the state support themselves keep falling and this would be going on also without its reduction. The amendment from 2011 will not have an impact on the state expenditures on the support until 2012. From the number of clients and their deposits towards the end of 2011, it is possible to estimate approximately half the decrease.

**Amount of provided state support (in CZK billion)**

	2007	2008	2009	2010	2011
Provided state support	14,98	14,22	13,26	11,74	10,73
Increase / decrease (%)	-5,0	-5,0	-6,7	-11,4	-8,6

Building savings is not responsible for state budget deficits, this is evident from the figures. In the last five years, state expenditures on building savings decreased approximately by one third. If the whole state budget followed the same pattern, every finance minister would be surely satisfied. The extent of the burden on the state budget is decreasing and is currently below the level of 1998. In 2012, it will decrease approximately to the level of 0.45 %, which is less than in 1996 when building savings were practically getting off the ground and had about 1.5 million participants.

**Building savings support as a percentage of total state budget expenditure**



\* The statement is based on the study Development of building industry until 2012 (2010, Deloitte Česká republika, SPS, URS Praha), which states that 1 million CZK invested in building industry generates the need of 3.2 – 3.5 workers and every 100 million CZK put into building investments generates cca 55.5 million CZK of tax and other revenues in public budgets.

Tightly connected to proving the purpose-oriented use of the state support is also another measure which, on the contrary, accommodates the clients' requirements. The possibility to use building savings not only for housing but also for financing studies or pension saving is not at all bad. They already have savings for these purposes in countries with substantially longer history of building savings and the whole system works very well there. Reasoning that the intended use of the building savings is only for housing due to its name does not definitely hold water. In this case it is a historical matter - the system was set up as a collective saving with providing loans. People reached their aim earlier and nobody was disadvantaged. The commodity which was in hand here, more than one hundred years ago, was housing. That's where the name building savings originates from.

But it is possible to use the time-tested principle for any activity if there are enough people interested. A modern European state defines a whole range of activities which are acknowledged and financed. Many of them are one-time requirements of a large amount of money, for example for housing, studies, old age, illness and childbirth. Saving for such situations will surely pay, nobody doubts that. Building savings has, however, an indisputable advantage compared to pure state financing. People are much more involved which strengthens their own responsibility for their life situations.

Avowed opponents of combining *building* savings and non-building purposes can be persuaded by a simple change. Even now this product is used by many people for financing studies, securing for old age and for other life situations, in principle as *life* savings.

## Abolishing specialization= cancellation of building savings

The most controversial topic is extending the licence to provide building savings to common banks. Law amendment proposal counts on the principle that building savings banks will remain relatively strictly limited in handling money of the savers but the banks not. The aims of the investment limitations are, however, for resources of clients collected with support of the state to be safe and serve their main purpose. Building savings banks provide, first of all, housing loans. For the remaining free funds they can buy very safe securities such as government bonds or mortgage debentures. These are generally investments with low risk and low profit.

Banks, on the other hand, could make with clients' savings free, according to the proposed bill. They would certainly have to observe the contract terms, but what does it mean, after all? Banks will provide their clients with compulsory building savings loans and they will consider how to dispose of the other deposits on building savings to have the best benefit. They know that without investment limitations they have a whole range of more profitable possibilities where to put the money.

A building savings bank provides, generally speaking, building savings loans to which clients are entitled by law. Subsequently it decides how to use the remaining funds. It chooses between providing bridging loans and purchase of government bonds.

These days, when the annual bond yields are around 2 % and bridging loans yields between 5 and 6 %, the choice is clear.

Building savings banks are trying to maximize the offer of housing loans, both standard and bridging ones. The other (limited) options where to put the money are markedly less attractive.

A universal bank will, thanks to different conditions, proceed differently. It will also provide the “claimable” building savings loans and subsequently it will decide what to do with the money which was not lent. It can choose, however, from a whole range of product offers of the capital market. It can certainly provide bridging loans, buy government bonds, but it can also provide consumer and commercial credits or buy shares or other capital interests.

It is necessary to look at the yields which these instruments offer to banks. For example consumer credits are currently provided by banks at almost 14 %. So will the bank prefer providing bridging loans at 6 % like building savings banks or a consumer credit at 14 %? The difference in approach is determined by the limitation of investment activities.

Universal banks will therefore use building savings as a very favourable, government subsidized collection of deposits which will be “sure” for the period of minimum 6 years. They will use the resources to refinance other products, including the high-risk ones, as well as possible loans within the transnational financial group, and the like.

They will offer their clients to finance their housing needs by their traditional products – they will save money this way, besides other things, for the development of the specific software which is standardly necessary for administration of financing housing needs in the field of building savings. The actual consequence will be the fact that relatively cheap loans for renovations and modernization in lower volumes (as they are offered by existing building savings

banks) will be driven out of the market and will be replaced by expensive consumer credits.

Decline in providing bridging loans would have an essential impact on financing housing. Although the Czechs have learnt how to save money they are depositing much less than they in fact need. When they ask the building savings bank for a loan, they mostly have not saved enough to get a building savings loan. The only solution is the bridging loan. This statement is illustrated by figures more than sufficiently.

Only 15 % of clients deposit enough money to be entitled to a regular loan in time and finance their housing needs by means of the saved up money and loan. For others is the need to finance housing more urgent. They could speed up the claim to a regular loan only by higher deposits. Or the building savings banks can offer a bridging loan which is the case with remaining 85 % of clients. From the point of view of the volume, the situation is even more striking. Only 3.7 % of money borrowed by clients is provided in form of a building savings loan which is not preceded by a bridging loan!

Bridging loans are therefore a significant pillar of financing housing needs by means of building savings. Their suppression, which would be inevitably brought about by the new conditions proposed by the regulator, is a very bad news for the people.

The existence of the state support, which ensures in the case of building savings banks redirecting the clients’ savings into housing, loses its meaning in universal banks. There is no reason to subsidize common bank products which do not finance housing from the state budget.

Apart from that are loans provided by building savings banks irreplaceable in the category of loans not secured by real property. Perhaps that is the reason why we find in the justification of the new conditions also references to the fact that the system, which will be in universal banks, is going to cope with reduction, or abolition of the state support. Reducing the support in banks which do not provide housing loans as massively as building savings banks would, unfortunately, in fact make sense.

There are also other arguments which cannot be ignored. The statement which is based only on a feeling that building savings is offered by few providers does not hold water. In Austria where the system has been working for decades there are 4 building savings banks and in Slovakia there are 3 of them. In the Czech Republic, of course, anybody can obtain the licence under the same conditions as current building savings banks even today.

According to long-term experience of German building savings banks, maintaining the resistance and relative independence from the turbulent development of economy and the market is conditioned by creation of a robust client group in the extent of approximately 100 thousand clients. The question arises if the new providers will be able to build such a large and stable client group.

Building savings does not work virtually anywhere in the world within the framework of universal banks as it is proposed by its local opponents. An exception is the case of German land banks which have a building savings bank but with an absolutely separate company code and under the same conditions under which independent building savings banks operate.

Violation of economic competition is also evident here. A product with the same name is created by different institutions, in a different way and with completely different risks. One provider is limited in using the deposits, another is not. There is no need to explain the statement about obvious consumer deception. Clients are offered a product which is characterized by a different method of creation and risk but it should have the same name. What is more, it is a name which is already common on the market and is traditionally associated with a high standard.

Is this a healthy reform? It rather reminds of institutions hunt which somebody does not like only because they provide products which could not fulfil their original function without the existence of the state support. And this specific activity is the reason why they are singled out into a specialized sector and limited in their activities. Building savings banks are similar to insurance companies with respect to the principle of their operation. There is also a whole group of insurants who pay and the insurance benefit is repaid only to those who need it. Nobody doubts the fact that insurance companies are specialized and have life insurance and non-life insurance. Nobody also demurs at the fact that pension funds operate in an independent sector as well.

Of course, the basic rule that increase in competition forces players to a more intensive fight still applies. We must not forget, however, that there are more important rules, for example about functioning of the product itself and its ability to provide loans for housing for a large number of people at half the price of what is common on the financial market. Moreover, nobody would save money through the changes. On the contrary, demands on the state budget would increase.



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# Building Savings in 2011



*Virtually every Czech family has  
a **building savings contract.***

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