

## Current Situation on Building Savings Market the Czech Local Scene

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**Abstract:** The present study is focused on building savings schemes, representing the second most popular product for private housing financing in the Czech Republic. In the Czech Republic, building savings schemes can be used as a certain kind of investing free funds and as possible subsequent solution for using building savings credit for private housing purposes. This type of product is provided by specialized banks, i.e., building societies. The objective of the present research is to analyse the development and current situation on the building savings market. It concentrates on the evolution of basic building savings indicators but also on the shares of all five building societies operating on the Czech market on the given indicators. Although, the mortgage credit rates have dropped significantly in recent year and clients rather tend to use this method of financing their housing, building savings schemes still have a significant position on the Czech market. Mainly secondary sources from official providers have been used for this study.

**Key words:** Building savings, development, housing credit, investment, market

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### INTRODUCTION

Consumers mainly consider the profitability and risk level of their investment. Building saving is considered a very safe product owing to governmental regulation of the deposit flow and due to state subsidies. However, low risk level also involves a relatively low profitability. This combination is especially popular among conservative investors who wish to maintain the same rate of return every year or every month. How people spend their money depends on their current amount of funds available which may also be influenced by other economic indicators. In 2014 the Czech economy got its way out of recession and currently experiences recovery. This can be seen for instance from indicators such as unemployment rate, GDP or inflation rate. The labour market has seen an increase in average gross salary by nearly CZK 1,000 but also a drop of unemployment rate which reached only 4.8% in the 3rd quarter of 2015. Real GDP broke the 4% level and rose up to 4.1%. In 2015 the average annual inflation rate achieved only 0.3%, representing the lowest value for the recent 10 year.

At present we are facing a constantly growing tendency of almost all people wishing to live in their private-owned flats or houses. Young people prefer rather

bigger towns for studies and subsequent research where they create especially but not only housing conditions for setting up their families. Contrariwise, older generation may prefer a calmer way of life and thus tend to move into their own houses in calmer areas. Although, the real estate prices are on a constant rise, interest rates keep decreasing. This makes them better attainable also for risky debtor groups (lower income, unstable repayment, etc). Hypoindex reports: "Price growth is mainly affected by increased demand for flats." In the 3rd quarter of 2015 the average price of a flat was CZK 58,156 per square meter and next year it is expected to exceed, under the same conditions, even CZK 60,000 per square meter. According to so-called HB Index (Hypoteeni banka's real estate price index), in 2015 the greatest interim price increase (as compared to 2014) was encountered in flat prices (6.3%), followed by land prices (4.4%) and the lowest increase was marked in detached house prices (merely 2.2%). The said three categories have changed their positions various times since 2010 when the HB Index was introduced. Whereas detached houses and flats showed price drops and price rises between quarters, land prices have been constantly rising since 2010. The prices rose by almost 25% between 2010 and 2015. However, building up a new house or buying an older

house or flat requires a high amount of money, easily achieving the level of several million Czech crowns, representing amounts that a normal citizen does not dispose of immediately. Therefore, the above-stated mortgage credits or building saving credits or bridging loans are utilized. Decisive factors for consumers are the following: interest rate level, instant of time (when they will need the money or how long they plan to pay back) and what credit repayments they can regularly make.

**Literature review:** The fundamental legal regulation for providing building savings schemes, operating building savings societies and for defining product parameters is Act No. 96/1993 Coll., on Building Savings Schemes and State Support for Building Savings Schemes and on the Amendment of Czech National Council Act No. 586/1992 Coll., on Income Taxes as amended by Czech National Council Act No. 35/1993 Coll., as amended. Act No. 21/1992 Coll., on Banks is another act regulating the operation of building savings societies, especially in areas non-regulated by the Building Savings Schemes Act because the legal regulation is identical both for banks and for building savings societies.

Soukal and Musterova (2015), dedicated themselves to the new legal regulation of the Civil Code and modelled the situation in a selected building saving society. Dusek and Jansky (2012), provided an evaluation of state subsidies of building savings schemes, focussing on the impact on savings and income inequality. Luke and Kielar (2014) also focused on the building savings market. Davis (2013) was interested in the situation of housing and finance in the United Kingdom. Aalbers (2011), utilizing research in mortgages from the US, Italy and the Netherlands (Elsinga *et al.*, 2015) done the comparison of financial implications of affordable home ownership products: four Dutch products in international perspective, Further statistics are available for instance on the website of European Federation of Building Societies.

**MATERIALS AND METHODS**

The objective of the present research is to analyse the evolution and current situation on the building savings market from 2005-2014. Selected graphs indicate 2014 as the final period because by the time this research was being composed the building savings societies' annual reports for 2015 were not yet available. However, where certain upto-date data was available for 2015 they are specified in the text. While composing this study, especially secondary sources from the various home savings societies but also official statistics by the

Ministry of Finance were used. Information was also obtained from expert press, conferences, seminars and other sources. The obtained data were further sorted, processed in custom tables, clearly set-out diagrams and further analysed to provide a basic overview of the relevant problem area.

**RESULTS AND DISCUSSION**

Interest rates offered by most banks for mortgages or by savings societies for regular or bridging loans are currently comparable. Therefore, savings societies try to attract clients by other benefits such as possible irregular extra payments, deferral or complete remission of a repayment (one or more). In 2008-2010, interest rates of building saving credits were up to 0.5% more convenient than mortgage credits. Since 2011, mortgage credits have provided more convenient rates and their values tend to drop faster as compared to building savings credit interest rates (Fig. 1). Also in 2015 the decreasing trend continued. Average housing credit rates were oscillating around 2.51%, for building savings credits around 4.16% and the lowest interest rates were still those provided by mortgage credits at 2.22%. Totally 1, 257 and 116 mortgage credits and 971, 176 building savings credits in total (regular and bridging loans) were provided in the same year.

At the current situation on the interest rate market, people may use mortgages to repay building savings credits or mortgages with less convenient interest rates. This affects the rising trend of number of mortgage credits and their volumes. In 2015, 104 thousand new clients were attracted to borrow totally 190 billion CZK. Also, the fact that the number of newly concluded contracts keeps decreasing proves that building saving used to be more popular in the past (Fig. 2). In 2008 the number of newly concluded contracts reached its local peak at the value of 702, 463. Contrariwise in 2015 the number of such

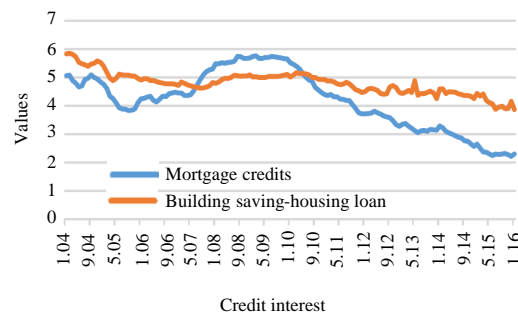


Fig. 1: Housing credit interest rate tendency, own research based on

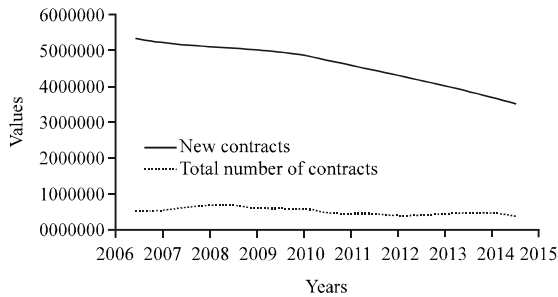


Fig. 2: Evolution of number of building savings agreements, own research based on

new contracts was nearly only half that figure at 373, 096 which represents the lowest value for the last 10 year. This is due, among other things to the fact that also some commercial banks already offer convenient savings options. This is especially the case of so-called low-cost banks such as Equa Bank, Air Bank or Zuno. They mainly get to the market by massive advertising promoting not only their savings products. In 2015, clients were being attracted by valorisation of up to 1.5% p.a. and especially by opening and keeping savings account free of charge. Worth mentioning is also the record-breaking number of new concluded building savings contracts back in 2003 when 2, 097 and 338 new contracts were concluded and the total number of active contracts with building savings societies amounted to 6,300 and 831. However, the following year marked a dramatic drop by 85%, especially because an amendment to Act No. 96/1993 Coll., on Building Savings Schemes and State Support for Building Savings Schemes entered into force. This amendment introduced a new method of calculating state support. In the period under consideration (2005-2014), almost 1.8 million participants terminated their agreements with building savings societies. As of December 31, 2014, their deposits amounted to nearly CZK 414 billion, 1 year later it was already almost 30 billion less. However, this decreasing number of new clients was partially made up for by the constantly increasing average deposit per agreement. At the beginning of the period under consideration, i.e., in 2005 the average deposit per agreement was CZK 59,023; in 2014 this figure rose nearly by CZK 50,000 to reach CZK 108, 114.

The relation between the number of building savings agreements and the number of credits provided can be viewed from two perspectives. As for bridging loans the comparison is clear. A bridging loan agreement is concluded in the same year as the building savings agreement. However, as for regular building savings

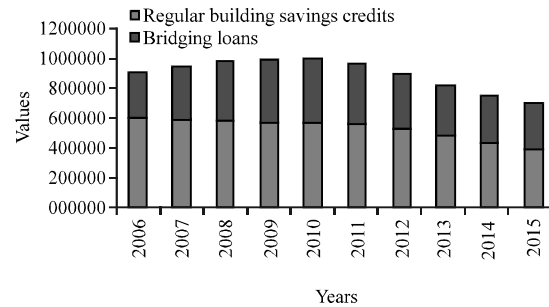


Fig. 3: Evolution of number of credits between 2005 and 2014, own research based on

credits the point of comparison must be shifted at least 24 month backwards. This is due to the fact that the conditions of providing this credit require previous regular saving period of at least 2 year. This period may also be longer-depending on client's needs.

Regular credits have seen a decreasing tendency since 2007 (Fig. 3) while in 2006 regular credits reached their historical maximum at 587, 501 credits provided. However, in 2015 their number dropped by 206, 628 to only 380, 873. On the contrary, bridging loans keep increasing their share on the total number of credits. In 2009 and 2010 they achieved 420 thousand agreements. In 2015 the share of provided bridging agreements amounted to 45% out of the total number of 695, 439 credits. This increase is affected by tariff offers provided by building savings societies, allowing combinations of various benefits and discounts such as reduced interest rate when additional products are contracted, keeping the credit account free of charge or credit application proceeding free of charge. The total amount provided in the form of credits in 2014 reached CZK 250 billion. Logically, bridging loans represent a bigger share in the overall volume of funds provided-around 80%; this is because clients "start from zero".

Tens of thousands of credits are provided for mere refurbishing, modernizing or repairs of housing estates. Most frequently, clients borrow around half a million Crowns (in average CZK 540,000). They are mainly attracted by the fact that for such relatively minor credits they do not have to secure their loan with the actual real estate. Frequently, there is even no security obligation required at all. The maturity period of such minor credits on the banking market with an interest rate comparable to the offer of building savings societies is usually around 5 year. Building savings societies allow an extension of this period. This is how households can

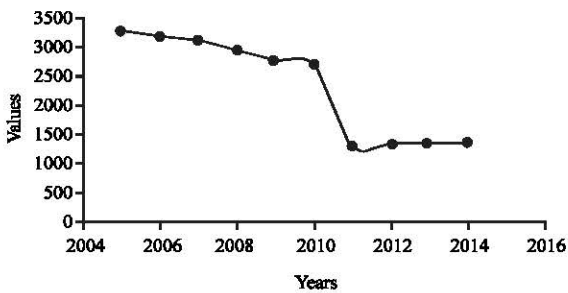


Fig. 4: Annual amount of state support, own research based on 14

reduce their monthly repayments. In the short term the volume of credits may exceed the volume of deposits. From the long-term perspective there must be more deposits than credits provided. Credit items must be higher so that the building savings society has funds for providing credits. Should this principle be breached the building savings societies could not provide such benefits as so far. In such case they would act like other banking institutions. In 2015 the proportion of total credits to saved amounts represented 63.2%.

The government also supports the attractiveness of building savings schemes. Not all participants meet all the conditions for obtaining state support, amounting to maximally CZK 2,000. The average annual amount of state support also decreases continuously due to changes in the legislation (Fig. 4), Between 2011 and 2014, this support was slightly above CZK 1,300 while until 2007 it was constantly above CZK 3,000. A huge drop was encountered especially due to a reduction of the state support to only 10% of the amount saved.

The 2011 amendment of the Building Savings Schemes Act cancelled, among other things also the tax exemption of credit revenues from building savings schemes. Clients of building savings societies were thus going to lose up to a half of their state support in that year. However, the 50% tax had been adopted in a manner breaching the constitution wherefore it was abolished at the end of the same year by the Constitutional Court. It was also considered retroactive because support provided for 2010 was supposed to be taxed in that way. Nevertheless, the interest taxation was not abolished completely-every year client's obtained interests are subject to 15% taxation. A similar trend as in the average amount of state support per agreement also applies to the total real paid out amount of state support. State support for the precedent year is always paid out only in the following year. Therefore, there was a dramatic difference in the amount paid out in 2012 and not in 2011. Building savings schemes therefore inflicted expenditures

amounting to CZK 5.29 billion in 2012 which was only a half of the amount paid out in 2011 (CZK 10.729 billion). The historical peak value was achieved as early as at the beginning of the period under consideration, i.e., in 2005, when the government supported building savings schemes by the amount of CZK 16.086 billion. All building savings schemes were supported in the recent 4 year (2012-2015) by a total amount of around CZK 5 billion.

**Association of Czech building savings banks and Czech building savings banks:** Association of Czech Building Savings Banks was founded in 2000. Its fundamental purpose is to support and protect building savings banks on the Czech market. These should be stable and give consumers confidence in the entire system. Even before the foundation of the association, representatives of the various building savings societies informally agreed to pursue their common interests in the area of housing financing. From its foundation on the Association consisted of six members but in 2008 2 of them (Raiffeisen and Hypo) merged. Therefore, there are currently only 5 association members: Eeskomoravska Stavebni Spooitelna, A.S., Stavebni Spooitelna Eeske Spooitelny, A.S., Modra Pyramida Stavebni Spooitelna, A.S., Raiffeisen Stavebni Spooitelna A.S. and Wustenrot stavebni Spooitelna A.S.

These institutions are at the same time members of the European Association of Building Savings Societies, Czech Banking Association and International Union for Housing Finance, a global organization uniting all institutions involved in housing financing. The Association itself has its presiding committee, president, vice-presidents and expert committees. But up until 2005, the various building savings banks alternated in the presidency. Model was then recognized as unsuitable and therefore substituted by unique presiding committee. The building savings market in the Czech Republic is closely linked with four legal codes (Davis, 2013; Luke, 2016; Luke and Kielar, 2014). Compared to banking institutions, building savings societies reach lower profits, mainly due to the fact that they only provide one single product and that their investment possibilities are subject to legal regulation. Their revenues mainly come from building savings credit interests and fees. Costs, on the other hand, include paid-out deposit interests. The most successful and the biggest player on the Czech market was Eeskomoravska stavebni spooitelna that achieves the highest volume of revenue interests in 2014. It also reaches the highest net interest revenue amounting to CZK 2, 273 and 512 thousand. Comparing net interest revenue and fees for these 2 services makes obvious that Modra pyramida charges the lowest fees. The highest

service fees, on the other hand are charged by Raiffeisen. But this comparative evaluation may be slightly misleading.

Fincentrum runs an annual public inquiry called bank of the year, evaluating all banking institutions including building savings societies. Wustenrot-stavebni spooitelna has won in this inquiry for a fifth time in a row. In 2015, Eeskomoravska stavebni spooitelna gained second position and stavebni spooitelna Eeske spooitelny landed on the third place. This category is evaluated by around 70 financial experts. Their task is to select the most attractive offer of services and products of the relevant building savings society and then make up a ranking list of them.

### CONCLUSION

Building savings schemes have been present on the Czech market for >20 year and have managed to establish a firm position on the financial market since then. The first building savings schemes were based on the principle of collective funding and subsequent drawing on one's own and other participant's funds. The fundamental idea has been maintained until nowadays. Even though building saving is considered a conservative product it is still being utilized by millions of citizens not only in the Czech Republic but also in Europe and worldwide. The last few year however, indicate a decrease in client's interest in the Czech Republic. This decline may be attributed to changes in legislation concerning the provision of state support or interest taxation.

Some participants only use building saving schemes to valorize their deposits, some use it for borrowing funds and some combine both phases of the building savings scheme. Saving products currently present on the market provide similar interest rates as those offered by building savings societies. Saving accounts charge very little or no fees at all and they can be utilized immediately they are highly liquid. Contrariwise, building savings societies charge fees not only for keeping an account but also a high "entrance" fee. If they lowered their fees they would most probably gain new clients. The greatest benefit of building savings schemes is the possibility to obtain state support. A competitive product in the credit phase is a mortgage credit. This is very convenient when building a new house or buying a house or a flat. A client is expected to secure the loan by the actual new acquired real estate and may be provided with a higher sum at a lower interest rate.

Refurbishing or modernization does not require such high amounts of money (around up to CZK 500,000) and building savings societies provide acceptable interest rates even without security. Mortgage credits are currently dropping to their minimum historical values. Building savings credits cannot compete with these rates. If credit interest rates were lowered it would also cause a decrease of deposit interest rates. This would result in a decrease of saving clients and saving societies would be short of available funds to lend to clients interested in credits. At the same time they would be lacking funds to pay out clients terminating their agreements prematurely. In future, building savings schemes might become more convenient as compared to other saving products or mortgages.

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