Housing Finance in Slovenia: The Key Role of the National Housing Fund

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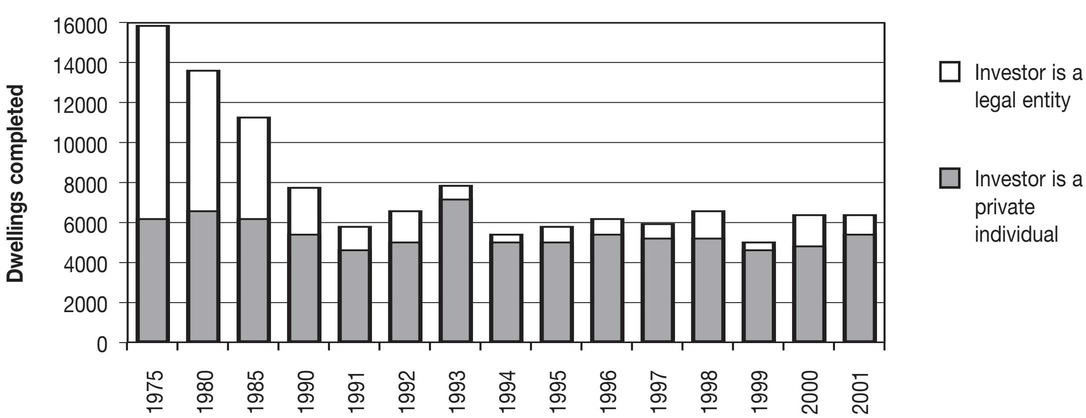
The transition to a market economy has brought dramatic changes to the system of housing finance in Slovenia. In the first half of the nineties there was a strong withdrawal of the state from the system of housing finance. In the absence of a well-defined housing policy and with a slowly developing system of mortgage financing, the Housing Fund of the Republic of Slovenia (hereon referred to as the National Housing Fund) emerged as the most proactive institution in Slovenian housing policy. In this article we shall deal with the development of housing finance in Slovenia with an emphasis on the role of the National Housing Fund.

THE SLOVENIAN HOUSING MARKET

Slovenia has a population of 1.964 million, with 684,847 households and 777,772 dwellings – of which only 665,111 are occupied (Census Data 2002). The introduction of a market economy in the housing sector meant the introduction of extensive reforms in housing policy. In the process of privatization of socially owned dwellings in the early nineties some 66,000 social housing units were sold and with this sale the rental tenure was reduced from 31 percent in 1991 to 11 percent in 1993 (Hribar, 1994; Znidarsic, Hribar, 1995). By 2002, the rental sector was reduced to 10 percent (7 percent of social rental tenure and 3 percent of private rental tenure). The proceeds from privatization were distributed as such: 10 percent to the Restitution Fund, 20 percent to the Housing Fund and 70 percent to previous owners of the social housing stock (firms and municipalities).

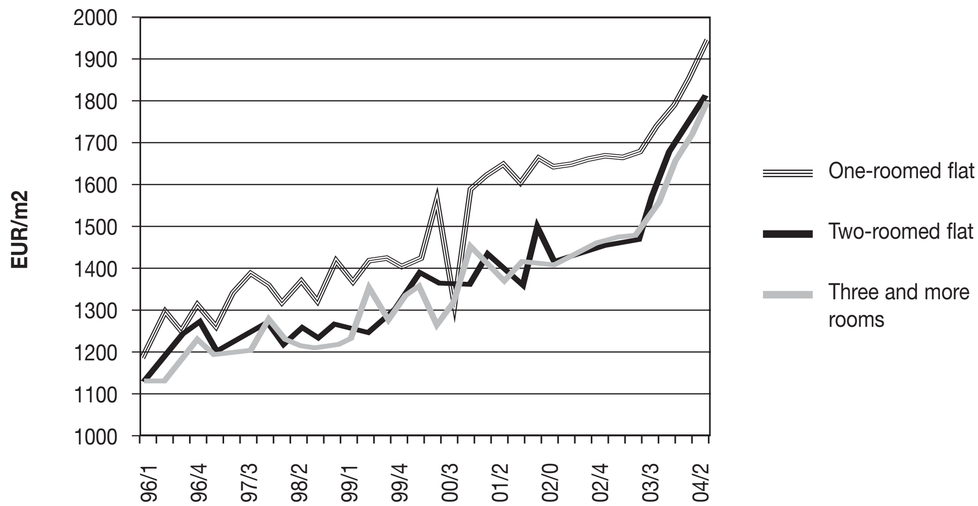
Reforms have also led to the disappearance of some mechanisms previously contributing to the maintenance of a relatively stable housing supply. New housing construction almost came to a halt after 1991 due to new regulations that abolished the system of public financing of new public housing in the form of financial contributions from the salaries of employees and enterprise profits. Lack of financing accompanied with high nominal interest rates in the banking sector, lack of

Figure 1: Dwellings completed in the 1975-2001 period



Source: Statistical Office of the Republic of Slovenia, 2003.

Figure 2: Housing Prices on the supply side of the market (asked prices) in 1995-2004



Source: Housing prices, Slonep, 2004.

building land due to restitution and long and complicated building procedures has affected construction activity most severely. However, the rate of housing built by individual families and households has more or less retained its pre-transitional level, since such housing has always been predominantly constructed on individual family initiatives (Sendi, 1999).

On the other hand, the demand for housing was stimulated by macroeconomic stabilization with decreasing inflation and interest rates, a growing number of households, loan disbursements by the National Housing Fund and development in the banking sector. This resulted in a strong increase in housing prices. Prices in the capital city Ljubljana (denominated in EUR) grew on average by 5 to 7 percent a year in the 1996-2003 period. The situation in the market could also be illustrated by the fact that every time a tender for favourable interest rate housing loans at the National Housing Fund was successfully completed, the inflow of money caused an evident increase in housing prices. In comparison to other transitional countries, Slovenia has one of the highest cost levels for newly constructed dwellings in Europe, relative to income. The median house-price-to-income ratio is 7.0, compared to 3.2 in Poland, 5.6 in the Czech Republic and 5.7 in Hungary (Pichler Milanovic Natasa, 2001).

NATIONAL HOUSING FUND BEFORE 2002

The Slovenian Housing Fund was founded by the government in 1991 on the basis of the Housing Act. Its initial sphere of activity was to support the construction, renovation and maintenance of housing by offering long-term housing loans on favourable terms to households and to non-profit housing organizations. With a capital of 60.9 billion tolars (EUR 264.5 million) in 2002, the Fund is one of the biggest financial institutions and the most important housing institution in Slovenia.

According to the Housing Act, the fund is entitled to receive 20 percent of the revenue from the sale of the socially rented dwelling. Although the State is legally obliged to financially support the National Housing Fund (NHF), the first transfer of funds from the central government budget was received as late as in 1995. From 1995 to 1999, the State annually strengthened the NHF capital base in the range between EUR 5 to 10 million. Since these funds were not sufficient for exercising all the activities, the management of the NHF decided to raise some additional funds by managing a portfolio of securities and to constantly place free current assets. In 1995, the NHF issued the first series of Housing Fund Securities. The main characteristic of this first issue was that the securities were bought by individuals who used them as a means of payment for their housing. The construction companies were supposed to receive the securities when selling the housing. The second and third series of securities followed in 1998 and 2001 with the funds entirely designated for disbursing loans to individuals.

With its lending activity in the nineties the Fund contributed to the demand as well as supply side of the housing market. On the demand side it used the funds to disburse low interest rate loans to households. In 1995, the interest rate in real terms for those loans was 3 percent, in comparison with the average banking interest rate of 12.8 percent. The last tenders were carried out in 2001 and 2002, with a real interest rate of

1.75 to 2.25 percent and a maturity of 10 to 20 years. The amount received depended upon the size of the household and income. Similar to banking practices, the loan could be insured by a mortgage, guarantors or insured by an insurance company. The loans were granted by public tenders that were usually heavily oversubscribed. Therefore, a proportional reduction of requested amounts was necessary. Until 2002, the NHF has managed to carry out 24 tenders for low interest rate loans to households in a total amount of almost EUR 300 million.

The National Housing Fund also tried to stimulate the supply of non-profit rental housing. After privatization, the Slovenian housing market suffered a severe shortage of affordable rental housing. The tenure structure reveals a high homeownership rate, with only 7 percent of households in the socially rented sector and 3 percent in privately rented accommodation, concentrated mostly in larger towns (Statistical Office of the Republic of Slovenia, 2003). However, due to the institutional arrangement of non-profit rental housing provision with low- and highly-regulated rents and the poor capital base of housing associations, the demand for NHF's loans by non-profit housing associations is relatively low. In the period from 1991 to 2002, the Fund carried out eight tenders and distributed EUR 55.6 million in loans. By the end of nineties, the loans carried a real interest rate of 1.95 to 2.25 percent, with a maturity of 25 years.

HOUSING LOANS OFFERED BY THE BANKING SECTOR

In the past, as well as at the present, there has been no specific banking institution in Slovenia that has specialized in housing finance, though most of them offer housing loans as one of their financial products. Mortgage lending, in the sense of house-purchase loans secured on the dwellings themselves, was introduced in Slovenia only in 1997. Prior to that, housing loans were secured by guarantors or insured by the insurance companies. Housing loans in Slovenia amounted to some EUR 950 million in 2001. Commercial and savings banks and the National Housing Fund, shared the market in a relation of approximately 2:1.

Unfortunately, mortgage loans at the end of the nineties played a smaller role in housing finance than they did in more developed financial systems. The banks mostly prefer insurance policies as collateral, since possession in the case of borrower default was a lengthy and difficult procedure (it still takes a minimum of two years). This results in high up-front costs with loan closing costs up to 5% of the loan amount. Loans secured on insurance are limited to ten years, because insurers do not issue insurance for longer periods.

The typical mortgage in Slovenia in the nineties was a ten-year repayment mortgage. The short mortgage term was the result of the relatively high nominal interest rate, which made long-term mortgages relatively unattractive. Most mortgages were offered with interest rates that were fixed above the level of inflation. The typical LTV ratio was quite conservative, at 50 percent, and the income criteria applied by lenders limited mortgage repayments to no more than 1/3 of the borrower's disposable income. Because of the country's high housing prices and the loan-to-income ratio, borrowers were rarely in a position to borrow even as much as 50 percent of the purchase price. The situation today is similar, except that the reduction in the rate of inflation and in interest rates has prolonged the average loan maturity to some 15 years and the LTV ratio is now 60 to 70 percent.

CHALLENGES FOR THE NEW MILLENNIUM

The housing situation – with low affordability of housing due to rising housing prices – called for changes in the housing policy at the end of the nineties. The challenges for the Housing Fund were how to assure further access to affordable lending and how to stimulate supply and assure affordable housing. In order to achieve this, two new instruments were introduced. In 1999 the National Housing Savings Scheme was introduced and in 2001 the National Housing Fund was transformed to a real estate fund, and this status enabled it to start its own investments in the provision of housing.

In March 1999 the Slovenian government adopted the National Housing Savings Scheme (NHSS) as a tool for promoting long-term saving, including premium granting, and with the purpose of increasing the supply of affordable long-term housing loans. The Scheme was modeled on the Austrian Bausparkassen system. It consists of 5- and 10-year savings contracts with a selected commercial bank. The interest rate for the 5-year contract is TOM[1] + 1.65% and TOM + 3% for the second type of contract. With the 5-year contract, every 12 months the government grants a "13th month amount premium", in an amount of 8.33 percent of annual savings. The 10-year contract entitles the saver to a premium of 10.42 percent of annual savings. After the period of contractual saving the savers participating in this scheme can obtain a favourable housing loan. The banks are obliged to provide savers with a loan which must be at least double the sum they have managed to save. With the 10-year contract the saver can obtain a 20-year loan with a pre-fixed interest rate of TOM+3.8 percent. The 5-year contract gives the saver the right to the 10-year loan and the interest rate is 2.45 percent per annum. For NHSS loans, banks are not allowed to charge additional costs for granting the loan and for its administration. The right to a housing loan is transferable not only to spouses or partners, but also to children and grandchildren. The loan proceeds must be spent on housing in a period of one year after the savings period is over. However, the use of proceeds from savings is not limited to housing.

Contracts on savings within the NHSS

[1] TOM is an interest rate used as a proxy for inflation. It is set by the Bank of Slovenia on the basis of average inflation in the past three months.

Table 1: National Housing Savings Scheme (NHSS) vs. bank loans

	Banks	NHF[2]
Interest rate	5.8%	2.45%
Funding	up to 1 year maturity	with NHSS 5-10 year deposits
Interest rate margin	approx. 2-3%	0.8%
Closing costs	Yes	No
Maturity	10-20	10-20
Loan insurance	same instruments	

began on 1 July 1999. with the limited amount of subsidy the number of available contracts was limited. The first issue of NSVS with almost 23,000 contracts was "sold out" in a week. By the end of 2003, 82,644 contracts had been concluded, the majority of them for a period of five years.

The NHSS instrument was introduced in order to force the banks towards a more competitive supply of housing finance. According to the survey, conducted in 1999 for the Ministry of Finance, foreign consultants pointed to several specifics of the Slovenian mortgage banking system. They noted that there was actually no true system of mortgage finance in Slovenia, since only a low proportion of housing loans was secured by mortgages. High real interest rates of around 6 percent in 1999 enabled banks to charge relatively high interest margins. The closing costs amounted to 3 to 5 percent of the loan amount. For the funding of housing loans, which typically have maturities between 10 and 20 years, Slovenian lenders rely primarily on savings deposits of up to 1-year maturity. With this structure of funding, interest rate risk for Slovenian lenders is relatively high.

At the time of introduction the NHSS was a very competitive product. While the effective interest rate (interest rate earned after the premium) was comparable to the interest rates of other banking products, the interest rate on loans was less than half of the interest rates charged by banks for their loans (see table 1). Therefore it came as no surprise that 22,800 people entered into the first scheme, and since the government maximized the yearly grants, the available amount of savings contracts at each subscription was reached within few weeks.

Due to its attractive features, a high amount of money started to pour into the NHSS. According to surveys conducted by the NHF over 80 percent of savers that entered the contracts in 1999 expressed the intention of taking out a loan after the saving period. This was expected to activate around 100 billion tolars (about EUR 420 million) in a period of one year, which is 10 to 20 times the amount of the loans disbursed by the NHF on the basis of an average tender. Therefore, there was a reasonable fear that this amount of money would lead to a housing market bubble in 2004 and probably result in a liquidity shock within banks. Consequently, the government was forced to take serious measures on the supply side of the market, otherwise all of the effect of subsidies would diminish and end in profits on the supply side of the market.

The government reacted with two sets of measures. On the one hand, it finally implemented long neglected reforms in spatial planning and real estate market regulation in order to speed up new construction. On the other hand, the government, as the owner of the National Housing Fund, transformed the institution to a real estate fund. With the introduction of NHSS, the Fund was also able to withdraw from lending activities to households. This enabled the NHF to free some of its capital for other purposes. This capital, and the status of the real estate fund, made it possible for the Fund to enter the housing market as an investor and finance new construction, in order to build up a new supply of housing with affordable prices.

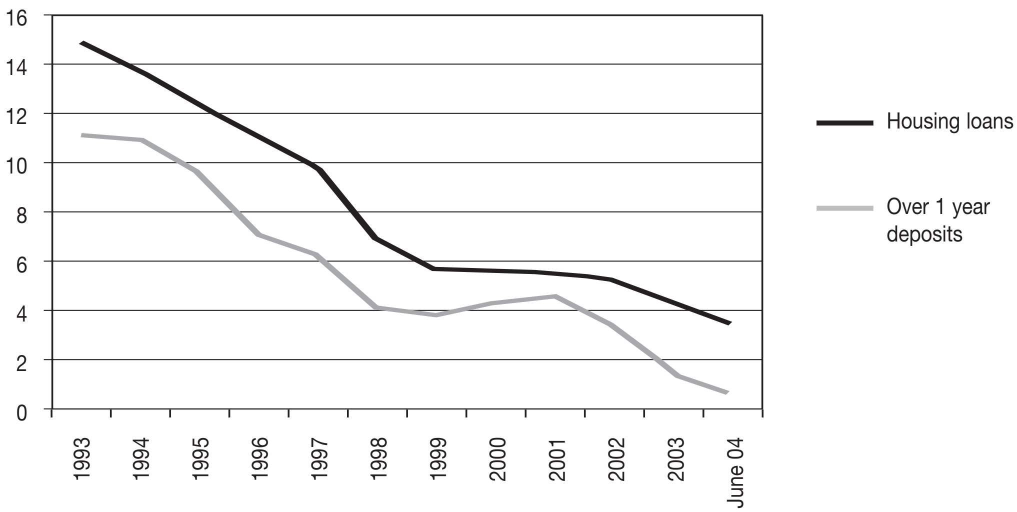
In 2001, the fund entered into 41 joint construction projects with 36 municipalities. This resulted in over 500 new non-profit rental units, while an additional 100 units were sold on the market. The second round of joint projects with municipalities that took place in 2004 is expected to result in an additional 650 rental units and 200 units for sale. By buying large quantities of newly constructed dwellings, the Fund also managed to attain favourable prices, and in 2003 sold 429 apartments in the high priced capital city and coastal area. The prices were in the range of EUR 1,100 to EUR 1,300 per square meter, some 20 percent below the prevalent market price. Through the acquisition of land, the Fund also financed new construction that resulted in 852 dwellings, with the same price range that came to the market in Ljubljana and the coastal area this year. The Housing Fund has also bought larger quantities of land and plans for an additional 5,000 apartments to enter the market by 2007.

On the other hand, the macroeconomic situation also meant that no major liquidity shock took place. Ongoing macroeconomic stabilization, the intention of entering European Monetary Union by 2007 and, above all, decreasing interest rate trends on worldwide financial markets, have resulted in the fact that by 2004 the housing loans offered by the banking sector[3] are competitive enough to keep reducing the number of savers that are actually exercising the right of low-interest-rate loans.

[2] Conditions for the prevalent 5-year contract.

[3] Especially loans offered by foreign banks that were Euro denominated and based on EURIBOR are very competitive at the moment due to the low EURIBOR.

Figure 3: Average banking interest rate on housing loans and 1-year deposits 1993-2004



Source: Bank of Slovenia Bulletin, 2004.

CONCLUSION

The first privatization that took place in Slovenia was the privatization of social housing in 1991. But after that the government put the housing issue on the backburner for almost a decade. In this period the Housing Fund emerged as the only real actor in the housing sector in Slovenia. Led by a strong individual it acted proactively most of the time. Until recently the Fund has had a dominant position in the provision of housing loans for individuals and non-profit housing associations. With the structurally inhibited supply this has resulted in a persistent increase in housing prices. The development of mortgage financing in Slovenia made it possible for the Fund to withdraw from lending to individuals and step over to the supply side. Today it operates as a provider of financial resources mainly for the non-profit sector and as an investor in housing – in order to boost housing construction.

This switch was very much facilitated by the introduction of the National Housing Savings Scheme. Upon its introduction the design of the Scheme seemed very shortsighted. The terms of the Scheme attracted many people to enter contracts and made a price bubble and liquidity crisis in 2004 seem like a highly probable scenario. However, it brought the necessary pressure to force the government to rethink its position of no-policy with only minor measures that by the rule boosted the demand side of the market and resulted in the growth in prices. A new legislative framework enabled better functioning of the land market[4], shorter bureaucratic procedures and further development of mortgage financing that was also beneficial to the construction industry. With favourable macroeconomic trends the outcome in terms of housing prices is probably not much different to what would have happened if the no-policy position was maintained.[5] But there is an important difference – infrastructure has improved and the Housing Fund has emerged as a strong player on the supply side of the market – therefore improving the outlook for future development.

The changed macroeconomic environment also changed the features of the Scheme. Once attractive due to its favourable interest rates on loans, it attracted people who wanted to spend the proceeds on housing. In 2004, the terms are no longer so advantageous on the borrowing side, while the savings interest rate has become extremely appealing for investors. Since the use of savings proceeds is not restricted to housing, the government could end up in the position that it no longer subsidizes housing but all sorts of other consumption. Therefore, no tender for the National Housing Savings Scheme took place this year.

The most probable future scenario is that the instrument will gradually fade away. By entering the European Monetary Union in 2007 the banking system will face even stronger competition and will probably become the prevalent provider of housing finance products. The government will quite likely restrict its position to allowing mortgage interest rate deduction or subsidize specific groups of potential

[4] However, one of most important instruments for efficient land policy – the introduction of the property taxation – is postponed until 2007.

[5] Figure 2 shows a high increase in asked prices in the last year. Still, according to real estate brokers, this also reflects increased expectations on the sellers' side, fuelled by the NHSS. As a rule those expectations are rarely realised.

homeowners; while for the Fund, one of the possible scenarios is that it will operate as an important player on the not-yet developed secondary mortgage market and in the provision of non-profit housing.

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