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## **THE HISTORY OF THE CZECH MORTGAGE BANKING**

### **1. The Origin of Mortgage Loan**

Mortgage as a source of the long-term financing has a long tradition. Already in the Middle Ages the governors pledged their castles, monasteries and towns in order to cover their financial needs. The modern roots of the mortgage loan as a special kind of loan and related mortgage bonds can be found in operations of Silesian associations in 70s of the 18th century. These regional societies associated owners of knightly farms in order to raise investing funds more easily. For this purpose, they provided mortgage loans to their members. Mortgage loans were financed by mortgage bonds issuance solidary guaranteed by these associations. Accordingly with Silesian associations, similar societies were established also in other German countries.

First mortgage bonds were issued in bearer form and the interests from them were paid off semiannually. The securing of the bond's yield by the mortgage related directly to the concrete real property. This was conditioned by keeping of the balance between the volume of mortgage bonds and the volume of mortgage loans. Thus the value of the installment for the mortgage bond's retirement had to correspond to the value of the mortgage loan's installment. Since some 1850 the bonds' securing by the mortgage related to the concrete real property was stepwise avoided. However, the basic balance between total volume of mortgage loans and total volume of mortgage bonds was kept. This arrangement influenced positively the flexibility and simplicity of the whole system. In spite of that, the regional associations couldn't, because of their regional constraints, satisfy the increasing demand for loans during the era of the industrial revolution and trade and agricultural development in the middle of 19<sup>th</sup> century. During this period many mortgage

banks in the form of corporation were established. The Belgian and French “Crédit foncier” belonged among those which came first. *Rakouskouherská banka* (at that time the central bank) dominated the mortgage market in Austria. Later in 1863 *Rakouský privilegovaný ústav pro úvěr pozemkový* was established in Vienna.

The following years are characterized by the dispersion of the financial power of mortgage banks especially because of the competition of newly established municipal banks. Municipal banks didn't primarily aim to achieve the profit as the mortgage banks did. Moreover, their debts were secured by the government. Savings banks which could provide mortgage loans since 1844 became other competitor. In comparison with mortgage banks which were deeply centralized, the main competitive advantage of the savings banks was the wide network of their bank subsidiaries. Except mortgage banks and savings banks, also loan offices provided mortgage loans especially for individual craftsmen and tradesmen. That is why mortgage banks were enforced to seek new activities and were transformed from specialized banks into the universal banks.

The municipal mortgage banks, as mentioned above, had a special position. They were founded in order to expand cheaper loans available in agriculture. Their aim wasn't profit achieving. In 1865 *Hypoteční banka království českého* was chartered as the first mortgage bank with municipal securing in the Czech territory. In 1890 *Zemská banka království českého* was chartered. Its establishment was a kind of paradox resulted from *Rakouskouherská banka*'s discriminating policy which was unfavourable to Czech industry's needs. This bank was focused on the granting of municipal, railway's and melioration's credits.

The municipal mortgage banks raised their funds for mortgage loans' refinancing firstly only from the issuance of mortgage bonds. These had the bearer form and the interests from them were paid off semianually. They became mature mostly on drawing the mortgage bonds. For example, *Hypoteční banka království českého* drew the mortgage bonds semianually – its articles of incorporation indicated the latest date of mortgage bonds' maturity, i.e. 38 years or 42,5 years according to the interest rate. This method of loan's refinancing brought to municipal mortgage banks (in comparison with commercial banks, savings banks and loan offices) some stable volume of long-term funds which allowed to conclude credit contracts with the fixed interest rate and as noncallable during the whole contract duration. Later the banks allowed the repayment of mortgage loan by mortgage bonds.

The mortgage banks played crucial role during boom times in 60s of 19th century. In spite of that a number of them didn't pass the crisis in 1873. The crisis was attended by an enormous outflow of funds from banks and also by the decline of trust of creditors in mortgage bonds. The bank's articles of incorporation didn't sufficiently guarantee the priority right in claims of mortgage bondholders on assets in the event of bankruptcy. Thus it happened, that claims of mortgage bonds' owners wasn't fully covered. In order to improve the situation, two Acts were

adopted. This legislation defined exactly such assets on which the bondholders had claim in the event of some crisis. The free disposal of these assets could be realized only under the approval of conservator delegated especially for this purpose. In the event of bankruptcy or execution over the bank's assets, the court established a custodian who was authorized to submit all claims of bondholders to bankruptcy court.

Table 1. Municipal Banks in Bohemia as of 31st December 1911 (in K m)

Municipal Bank	Authorized Bonds	Reserves Created from Net Profit	Mortgage Bonds	Municipal Bonds	Railway Bonds	Reclamation Bonds	Creditors	Total Liabilities	Securities in Store	Bills of Exchange
Zemská banka království českého v Praze	15,000	5,928	-	463,716	128,490	18,588	107,173	738,895	40,148	33,651
Hypoteční banka království českého v Praze	-	9,312	320,507	-	-	-	0,029	329,848	1,191	-
Hypoteční banka markrabství moravského v Brně	-	3,558	170,798	-	-	-	-	174,356	2,277	-
Zemědělská banka markrabství moravského v Brně	-	1,493	-	141,256	2,523	-	-	145,272	1,175	-
Rakousko-slezský pozemkový ústav v Opavě	-	1,500	33,446	-	-	-	-	34,946	1,704	-

Kommu- nální úvěrní ústav v Opavě	-	0,297	-	40,535	-	-	-	40,832	0,609	-
In total	15,000	22,088	524,751	645,507	131,013	18,588	107,202	1 464,149	47,904	33,651

Source: [3, p. 150].

## 2. Mortgage Banking after World War I

Shortly after World War I there were in total six municipal and mortgage banks (see Tab. 1). In the late 20s of 20th century there were these following four banks [6]:

1) *Zemská banka* (till 1920 *Zemská banka království Českého*) which provided mortgage loans only on a small scale. However, it played a crucial role at the development of the infrastructure in Czech and Slovak towns. After Bohemia and Moravia Protectorate constitution *Zemská banka* was forced to submit all its credits in Slovakia and in occupied border region. In 1941 the compulsory merger of *Zemská banka* with *Hypoteční banka česká* occurred; in 1943 also with *Ústřední banka českých spořitelén*. *Zemská banka* closed its activities in 1948, when it was consolidated together with other institutions into a new bank named *Investiční banka*. The activity of *Investiční banka* was focused on capital construction financing of national enterprises and cooperatives and on financing of operation of building and assembling organizations; however, these activities were transferred into *Státní banka československá* in 1958 and only securities administration and safekeeping remained on *Investiční banka*.

2) In 1922 *Hypoteční a zemědělská banka moravská* was established by merger of both Moravian banks. During 20s of 20th century it provided loans especially for electrification of Moravia. Also the financial support of building activity (especially the infrastructure development) and credit operations connected with the land reform were other activities of the bank. In 1941 within the framework of the banking concentration during the period of Bohemia and Moravia Protectorate, it was consolidated with the *Zemědělská banka moravská* into *Zemská banka pro Moravu*.

3) In 1927 *Slezský pozemkový a komunální úvěrní ústav* was established by merger of two Silesian banks which, accordingly as Moravian banks, had collective leadership and personnel. The bank provided especially mortgage loans for the purchase of agricultural land and house property.

4) *Hypoteční banka česká* (till 1921 named *Hypoteční banka království Českého*) had an exceptional position among mortgage banks, because its transactions were secured by the government. Moreover it used to be that investing

in its mortgage bonds was for widows and orphans which increased their value on the stock exchange. *Hypoteční banka česká* was focused on providing mortgage loans whose volume increased significantly during the second half of 20s of 20th century (from c. 320 m of CZK in 1923 up to c. 1,9 b of CZK at the end of 20s of 20th century). That was caused by enhanced building activity after 1925. However in post-war period, the bank was in difficulties with raising of money for financing loans by the mortgage bonds' issuance. That is why its activities had to be broaden after 1921. Except granting of long-term mortgage loans, its business activities were broaden also to raising of deposits on depositor's passbooks and current accounts, to the discount of bills of exchange etc. In 1941 the occupational authorities decided on the bank's close by the merger with *Zemská banka pro Čechy*.

Table 2: Progress of the Mortgage Loans Volume According to Individual Mortgage Banks in 1923-1937 (x000 CZK)

Bank	1923	1928	1933	1937
Hypoteční banka česká	322 860	1 078 028	1 897 783	1 945 367
Hypoteční a zemědělská banka moravská	319 706	389 517	908 384	885 433
Slezský pozemkový a komunální úvěrní ústav <sup>■</sup>	94 224	X	119 554	152 568

■ loans in total (mortgage loans, municipal loans, reclamation loans).

X – unknown data.

Source: [6, p. 292].

The mortgage banks were of great importance also during the crisis in 30s of 20th century when the number of mortgage loans raised and when the mortgage banks constituted a means of stability of the Czech economy. At that time the mortgage loans were more available than the other types of loans. Moreover, mortgage and municipal banks granted loans to the government in order to replenish the range of funds established for passing the economic crisis.

Since the Protectorate the economic growth of Czech lands was interrupted for nearly 10 years and the mortgage banking was in fact liquidated. In spite of these facts, the principles of mortgage loan had already shortly after World War II participated on the formation of the state support. The state could guarantee loans provided to the builder or, in some cases, grant subsidies for credit installments.

Still in 1962 *Státní spořitelna* provided loans basically secured by the assignment of claims on wage. Moreover, in some reasonable cases (e.g. building of family house) *Státní spořitelna* necessitated mortgage as a security on the debt.

The new Civil Code from 1964 meant total end of mortgage banking in Czech lands for nearly three decades, because mortgage served as a collateral of the credit only within the international trade.

### 3. Mortgage Banking after 1990 in the C.R.

After changes in 1989 mortgage banking was renewed formally in 1990 when the Act on Bonds (Act no. 530/1990) was adopted. The Act on Bonds defined mortgage bonds as bonds fully covered by a mortgage. The Act on Bonds also laid down that mortgage bonds could be issued only by a bank or a savings bank with permission of Ministry of Finance. Act no. 530/1990 limited the volume of mortgage bonds whose sale could finance mortgage loans to 60 percent of the value of the real estate serving as a mortgage. Due to inefficient capital market and legislation, the first mortgage loans were granted later in 1995 when the amendment of the Commercial Code (Act no. 513/1991), the Act on Bonds (Act no. 530/1990), the Bankruptcy Act (Act no. 99/1963), the Act on Banks (Act no. 21/1992) and the Civil Procedure Act were adopted.

The amendment of the Act on Bonds from 1995 brought a range of changes within the mortgage banking which are reflected in the following points:

- The substitution of the principle of mortgage as a security of mortgage bonds by a principle of claims from mortgage loans as a security of mortgage bonds which insists rather on the debtor's ability to service the debt than on the form of security.
- The definition of the mortgage loan as a purpose loan: „Mortgage loan is a such loan provided on an investment in a real estate within the territory of the Czech Republic or on its construction or on its acquisition which is guaranteed by that, also under construction, or by other real estate within the territory of the Czech Republic as a forfeit“.
- The maximum value of the real estate serving as a mortgage for the backing of the mortgage bonds was increased from 60 percent up to 70 percent of the value of the real estate.
- The responsibility connected with the licencing for mortgage bonds' issuance was shifted from the Ministry of Finance to the Czech National Bank.

The period of 90s of the 20th century can be characterized as a modest comeback of the mortgage banking. In spite of the state financial support granted on the basis of the commencement of the government's bylaw (no. 244/1995) at the turn of years 1995 and 1996, it was impossible to acquire a bank loan for the purchase of a flat or a house. The interest rates were very high and corresponded to the market rates at that time which in connection with the high rate of inflation, were often considerably in excess of 13% per annum.

A lot has changed since the end of 90s of the 20<sup>th</sup> century and especially since the beginning of 21<sup>st</sup> century. The mortgage boom was triggered primarily by the decline in mortgage interest rates. The decline in mortgage interest rates reflected the reaction of mortgage banks to the decline in repo rate announced by the Czech

National Bank. In the decreased interest in mortgage loans there was also reflected the competition especially after 2000. Moreover since 1998, the Income Tax Act (no. 586/1992 after the amendment from 1997) offers the possibility of tax relief on the interest on mortgage loans and loans from the building saving up to 300 000 CZK.

The last amendment of the Act on Bonds valid from 1st May 2004 brought other changes into the mortgage market. The Act on Bonds (no. 530/1990) for several times amended was repealed and replaced by the new one no. 190/2004. The changes within the mortgage banking consists especially in the definition of mortgage loan which is nowadays defined as "a loan, whose repayment is secured by a pledged real estate, also under construction" [9]. That means the waiver of mortgage loans` finality, the mortgage loan`s approximation to the consumer loan and the enlargement of mortgage banks` activities. New chances for the clients of mortgage banks have also been made. Until recently the mortgage loan did not allow to finance the purchase of the cooperative flat. The acquisition of cooperative flat reflects only the acquisition of the member share in housing association. It does not reflect the real investment into the real estate. Other changes are directly related to the Czech Republic`s EU accession. They enable for instance to secure the mortgage loan by the mortgage on the real property situated in the territory of other EU member state or enable to secure the mortgage bonds by government bonds or by other securities issued by EU member states, by their central banks or by the European Central Bank.

At the close of the paper we can conclude that, in spite of some difficulties especially at the beginning of 90s of the 20<sup>th</sup> century, the Czech mortgage market evolves successfully after a few decades of forced silence. Year after year the volume of new mortgages increases, the mortgage banks widen offer of their products and services (e.g. the combination of the mortgage loan with the building saving or with the life insurance). In spite of that the Czech mortgage market for now has not reached the level in developed countries of the EU which can be illustrated by the ratio of the volume of new mortgages to the GDP of the given country. In 2001 this ratio amounted almost up to 40 percent in the EU member states (in the states of the North Europe, it amounted to even more than 60 percent) and to less than 4 percent in the Czech Republic. But anyway, this situation within the Czech mortgage market can't be interpreted negatively. Because of the fact that the renewed mortgage market exists in the Czech Republic only 10 years (in contrast to countries of the Western Europe) and even it shows high growth rate, the present situation can be treated as a good base for the future.

## References

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 [8] Act on Bonds no. 530/1990.  
 [9] Act on Bonds no. 190/2004.

### Appendix 1: Czech Mortgage Market 1995-2003

Year	Mortgage Loans in Total			
	At the End of Year		Increment	
	Number pieces	Volume CZKm	Number pieces	Volume CZKm
1995	1 260	1 250	x	x
1996	6 188	9 088	4 928	7 838
1997	10 280	18 335	4 092	9 247
1998	15 268	29 322	4 988	10 987
1999	21 682	40 244	6 414	10 922
2000	31 910	58 424	10 228	18 180
2001	46 747	83 234	14 837	24 810
2002	68 292	113 545	21 545	30 310
2003	100 457	161 142	32 165	47 597

Source: Ministry for Regional Development.

### Appendix 2: Mortgage Banks in the C.R. (as of 31.12.2003)

Česká spořitelna

Českomoravská hypoteční banka

Československá obchodní banka

eBanka

GE Capital Bank

HVB Bank Czech Republic

Komerční banka

Raiffeisenbank

Wüstenrot hypoteční banka

Živnostenská banka



## HISTORIA BANKOWOŚCI HIPOTECZNEJ W REPUBLICE CZESKIEJ

### Streszczenie

Wykorzystywanie nieruchomości pod zastaw jako źródła długookresowego finansowania ma długą tradycję, sięgającą średniowiecza. Jednak pierwsza wzmianka o powstaniu kredytu hipotecznego jako specyficznego rodzaju transakcji finansowych oraz związanych z tym uregulowaniach hipotecznych listów zastawnych pochodzi dopiero z XVIII w. i dotyczy terenu Śląska, gdzie kredyt ten jest wymieniany jako domena regionalnych towarzystw. Pierwszym bankiem hipotecznym na terenie Czech był Bank Hipoteczny Królestwa Czeskiego, założony w 1865 r.

Banki hipoteczne stanowiły zawsze ważny element systemu bankowego i przyczyniały się do rozwoju gospodarki, jednak z chwilą powstania Protektoratu Czech i Moraw w 1939 r. sektor bankowości hipotecznej praktycznie zlikwidowano. Dopiero w latach dziewięćdziesiątych XX w. sektor ten odżył. Od tego czasu zainteresowanie kredytem hipotecznym – jako źródłem długookresowego finansowania przede wszystkim nieruchomości przeznaczonych na cele mieszkaniowe – ponownie wzrasta.