

## CHAPTER 9. HOUSING FINANCE IN CROATIA

by  
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### Introduction

The Republic of Croatia is a sovereign, independent republic, established as a parliamentary democracy since 1991. Its governing structure is based on a principle of the distribution of power among the legislative authority (the Croatian parliament), executive authority (Government of the Republic of Croatia) and judiciary (municipal courts, country courts, commercial courts, the High Commercial Court, the Administrative Court and the Supreme Court). The power is decentralized by virtue of the constitutional right to local and regional self-administration. The country's territorial organization includes 20 counties and the City of Zagreb (capital) with a total of 123 towns and 425 municipalities.

As a new independent country Croatia is going through a complex process of transition toward a market economy. The main objective is the establishment of a welfare state and to achieve it, it is necessary to improve the efficiency on the macroeconomic as well as the microeconomic level as much as possible, and to raise the living standard and reduce inequality among citizens.

The living standard, housing financing models, their supervision and the policies related to this issue are presented further on in this paper.

**Table 1. Land Indicators**

Land area (km <sup>2</sup> )	56,542	Residential land (km <sup>2</sup> , % of the total):	7.65%
Coastal sea (km <sup>2</sup> )	31,067		
Islands:	1,185	Inhabited Islands:	47
Capital:	Zagreb	National currency:	Kuna (HRK)

Source: Central Bureau of Statistic

Croatia is among the countries with the longest tradition of urban planning, and physical planning is described as a field of construction that has been regulated for more than 30 years. The organization and development of towns has been influenced predominantly by the Mediterranean and Central European culture. All major settlements have to have urban development plans. The future development of settlements and construction-designated areas is part of the country's physical planning strategy and programmes. Croatia, like the EU members, is a signatory of the European Landscape Convention and has passed legislation ratifying it.<sup>1</sup>

The urban organization displays some irregularities: small towns are predominant, regional centres lag behind the capital while some regions have no large urban centres at all. Since a few years back, a number of physical plans of towns have been abrogated for various reasons. Such a situation has

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helped spawn unplanned and illegal construction in towns and tourist settlements that is considered a criminal act under the latest legislative amendments, which also preclude the possibility of providing such illegally erected structures with the basic public utilities. The decisiveness of the new Government to bring order is reflected in the amendments to several laws that regulate this field and also in demands for the relevant authorities to draw up physical plans, in comprehensive inspection checks and numerous campaigns to remove illegally built structures all over the country (in 2004, the competent ministry has had 200 such structures demolished and plans to have another 50 demolished by the end of the year, while the owners themselves demolished a number of other such buildings). In order to amend and improve the current situation, the Government established a State Physical Planning Council, which is in charge of reviewing and coordinating physical plans of local self-administration units, counties etc. The general urbanization level (ratio of town residents to the total population) stands at 51.09% and is expected to rise further. In line with the trend, the urbanization level is expected to reach 75-80% by 2015. The average population density is relatively low at 78.39 residents per sq km. The fact that towns represent the main hubs of employment is among the reasons that 16% of the total population lives in the metropolis. Out of the total housing units in 2003, 67.03% were in towns and 15.6% of the total population were day migrants (or commuters).

**Table 2. Population Indicators**

		1999	2000	2001	2002	2003
Population	(thousand people)	4,554	4,381	4,437	4,443	4,442
	(% change)	-0.04	0.01	0	0	-
	Population density (inhabitants/km <sup>2</sup> )	80.5	77.5	78.4	78.5	78.5
Labor force	(thousand people)	1,730	1,894	1,767	1,792	1,793

Source: Central Bureau of Statistic

Note: Labor force: working age population according to ILO (International Labor Organization) standard

Croatia's demographic picture based on the facts collected in the 2001 census can be described as less than satisfactory, senior citizens prevail in the population and the number of deaths exceeds the number of births (the population is shrinking).<sup>2</sup>

**Table 3. Macro Economy**

		1999	2000	2001	2002	2003	6/30/2004
GDP (at current prices)	(million USD)	19,906	18,427	19,863	22,436	28,335	-
Real GDP growth	(% change)	-0.9	2.9	4.4	5.2	4.3	-
GDP per capita	(USD)	4,371	4,206	4,477	5,050	6,377	-
Unemployment rate	(% of labor force)	20.4	22.6	23.1	21.5	19.1	18.6
Inflation rate	(in % end of year)	4.2	6.2	4.9	1.7	1.8	1.9
Gross savings rate	(% of GDP)	37.4	48.4	63.1	77.6	82.9	-
Monthly average net wages	(in USD)	427	429	429	537	661	693
Exchange rate	(HRK : USD)	7.6477	8.1553	8.356	7.1457	6.1185	6.0579

Source: Central Bureau of Statistic and Croatian National Bank

The Croatian economy recorded solid growth in 2003 (slightly weaker than a year earlier) which, along with the external debt (reaching 51.6% of GDP) and balance of payments and fiscal deficits, was the main characteristic of the macroeconomic situation. Construction was the activity with the strongest growth, primarily thanks to intense investment in the road infrastructure (motorways) that was stressed as a top priority of the Government's economic programme. The industrial output index rose 4.2% compared to 2002 (having risen 5.4% in 2002 over a year earlier). Tourist seasons of the past few years have brought an increase in the number of tourists (by 7% in 2003 and 6% in 2002) and foreign exchange receipts (the Croatian National Bank (CNB) estimates their increase at 67% in

2003), and such developments are expected to continue in the future. The 2003 consumer price index recorded an increase by 1.8%, with goods prices rising 1.6% and services prices 2.5%. Among the monetary developments it is interesting to point out that the CNB enforced certain measures in 2003 aimed at curbing the credit expansion (after a 33.6% credit expansion in 2002), so 2003 credits grew 11.3% (with the financial activities of non-banking institutions, e.g. leasing etc. growing at the same time). Also, there has been an evident increase in the credit exposure to households (household credits rose 43% in 2002, and 27.7% in 2003). The unemployment rate has fallen slightly, while the average net wages have risen. The manufacturing industry (electrical machinery and appliances) accounts for 94.5% of the total merchandise exports, with the European Union countries being the main foreign trade partners (with more than a 50% share).

**Table 4. Overview of Croatia's Credit Ratings**

	Long term rating Foreign currency	Long term rating National currency
Moody's Investor Service	Baa3 /stable "outlook"	Baa1
Standard & Poor's	BBB-/stable "outlook"	BBB+
Fitch Ratings	BBB-/positive "outlook"	BBB+
R & I	BBB	-

Source: Ministry of Finance

This April, Croatia was received positively by the European Commission. It became an official EU candidate in June, and the negotiations on accession to EU should start in March 2005.

### **1. Housing Supply and Demand**

The data available on the number of housing units, households and population might lead to a conclusion that there is no lack of housing. However, even a rough analysis shows an evident overpopulation of a number of dwellings (as several households sometimes inhabit the same dwelling) as well as a considerable shortage of housing in large centres/towns, low housing standard (the average housing area was just 27.6 sq m per person in 2001, etc.)<sup>3</sup> and strong demand for social housing, while a number of dwellings are in need of renovation (e.g. 7.2% of inhabited dwellings lack sewage, 6.3% have no water supply and some 14% have no WC or bathroom). All this considering, the demand for the purchase and renovation of housing is expected to grow in the future, and so is the demand for home financing.

**Table 5. Housing Stocks**

		1961	1971	1981	1991	2001
Dwellings	(thousand units)	-	1,219	1,480	1,772	1,877
	Growth rate (%)	-	-	21.4	19.7	5.9
Dwellings for permanent residence	(thousand units)	-	1,189	1,381	1,576	1,661
	Growth rate (%)	-	-	16.2	14.1	5.4
Households by Censuses	(thousand)	1,168	1,289	1,424	1,544	1,477
	Growth rate (%)	13.2*	10.4	10.5	8.4	-4.3
	Average number of persons per household	3.6	3.4	3.2	3.1	3.0
Inhabited dwellings with:	(One household; thousand)	-	1,072	1,261	1,405	1,366
	(Two household; thousand)	-	66	56	45	40
	(Three or more household; thousand)	-	15.2	8.4	3.3	2.7

\* calculated to the previous census in 1953

Source: Central Bureau of Statistic

**Table 6. Housing Stocks by Construction Year**

HOUSING CONSTRUCTION YEAR		UNKNOWN	~ 1970	1971-1990	1991-2003	TOTAL
Housing stocks by construction year (thousand units)		49	674	574	119	1,416
Composition ratio	(%)	3.5	47.6	40.5	8.4	100

Source: Central Bureau of Statistic

Notes: Composition ratio shows the ratio of respective housing stocks to the total stocks in year 2003 (=100).

**Table 7. New Construction**

		1999	2000	2001	2002	2003	6/30/2004
Completed buildings	Total (units)	1,762	1,341	1,795	2,229	n/a	n/a
	Residential buildings (units)	1,389	955	1,439	1,872	n/a	n/a
	Office buildings (units)	50	46	41	45	n/a	n/a
Completed dwellings	Total (units)	12,552	17,487	12,862	n/a	n/a	n/a
	Dwellings for permanent residence (units)	12,175	15,988	12,580	n/a	n/a	n/a
Housing trading volume (thousand units)		782	1,036	1,028	957	1,436	1,028

Source: Central Bureau of Statistic

Notes: 1. Completed buildings means the construction built by legal entities employing 5 or more persons that are main constructors  
2. Housing trading volume means the number of traded housing stocks.

The current demand for rented housing is estimated at 6,900 social and 4,000 non-profit units, and the waiting time for these is quite long. War damage during the recent aggression on Croatia contributed to an erosion of the housing standard as 135,000 dwellings were destroyed between 1991 and 1994, worsening the living conditions of numerous displaced persons and refugees. A total of 12,580 units were completed in 2001, down 21% compared with 2000, while the number of dwellings built since 1996 is largely a result of the renovation of housing destroyed or damaged during the war. The number of dwellings built each year still lags behind the pre-war period (in the 1980s, 20-30,000 units were being built annually). Resolving housing problems of the Homeland War victims and the reconstruction of destroyed dwellings was set as a priority of the housing crisis resolution. All the structures damaged in the war should be rebuilt by 2006 as part of a programme entitled "A Roof for Each House". The rented housing market is poorly organized and the exact number of tenants is difficult to determine as a large number of people who let housing do not report this officially in order to avoid paying tax. Around 37,000 households in Zagreb alone (or 13.5%) have the status of lessees (tenants), paying a monthly rent of 5-7 EUR per sq m<sup>4</sup>. Furthermore, large cities have a considerable

number of dwellings with several rooms inhabited by the elderly, so this points to insufficient and inadequate programmes of care for senior citizens.

**Table 8. Demolished Dwellings**

	1999	2000	2001	2002	2003
Demolished dwellings (units)	450	784	575	687	-

Source: Central Bureau of Statistic

The first signs of stabilization in the region following the Homeland War brought about a considerable increase in housing prices. The average price per sq m of housing in 2003 was between 10,241 kuna (in Zagreb area) and 7,033 kuna (in other towns), while the average monthly net wage totalled 3,940 kuna. A comparison of these amounts shows that an average citizen needed 1.8 – 2.6 monthly net wages for the purchase of a square metre of housing, i.e. financing the purchase of one's own flat or house from the regular income is impossible.

**Table 9. House Prices and Financing Indicators**

		1999	2000	2001	2002	2003	6/30/2004
Housing price	(domestic currency, average)	9,004	8,688	8,306	8,366	8,569	8,453
	(% change)	-	-3.5	-4.4	0.7	2.4	-1.4
Housing price index		-	-	-	-	-	base date: -
Long-term credit rate (fixed market rate)	Indexed loans to EURO (%)	-	-	-	-	7.5	7.5
Long-term credit rate (adjustable market rate)	Indexed loans to EURO (%)	10	9-9.5	9-9.5	7.5-9	6.9-8.9	6.8-8.5

Source: Central Bureau of Statistic and Internet

- Notes: 1. Mortgage rate is a base rate of most popular fixed rate loan product with longest maturity, provided by the major mortgage lender.  
2. Long-term credit rate is a base rate of longest-term loan provided by major commercial bank.

The latest figures released indicate an increase in the prices of housing in Zagreb and on the Adriatic as a lot of foreign buyers have appeared alongside local buyers, so a number of analysts predict that the prices will increase further. Despite the price increase, the number of housing units sold over the past year has risen significantly. According to the information available to the Author of this paper, almost 70% of these units were small flats (maisonette or bed-sit type, one-room flats), their prices rose most and 80% of them were financed by housing loans.

In the absence of one's own funding, housing may be bought and financed by borrowing on the financial market. However, a large number of average Croatian citizens cannot meet the current criteria of commercial banks – the single market creditors providing long-term housing loans immediately.

## 2. Housing Finance Market and System

Organized housing financing in Croatia is the business of commercial banks and housing savings banks. Commercial banks often participate in home financing together with housing savings banks, and their products are included in various housing models (e.g. the government-subsidized POS model).

The ratio of approved housing loans to the Gross Domestic Product in Croatia was 9.85% at the end of 2003, or relatively low compared to the European Union average.<sup>5</sup>

**Table 10. Distribution of Granted Home Loans by Financing Model**

		1999	2000	2001	2002	2003	6/30/2004
TOTAL HOME LOANS	(in mil. USD)	976.70	1,012.64	1,132.31	1,742.96	2,792.20	3,086.38
	(change in %)	-	3.68	11.82	53.93	60.20	10.54
	(%)	100.00	100.00	100.00	100.00	100.00	100.00
Market share - Banks	(%)	100.00	99.99	99.88	99.27	98.90	98.55
Market share - Housing Savings Banks	(%)	0.00	0.01	0.12	0.73	1.10	1.45
GDP	(in mil. USD)	19,906	18,427	19,863	22,436	28,335	-
Home loans / GDP	(%)	4.91	5.50	5.70	7.77	9.85	-

Source: Croatian National Bank

Basic data on housing financing products of the main creditors are shown in the table below.

**Table 11. Mortgage Products**

Major products	Method of payment	Loan interest rates	Maturities	Borrowers	LTV	Others
1. Home loan of Commercial bank	Monthly installments (amortization)	6.45-8.50% (adjustable)	mostly 15-20 years (possible up to 35 years)	Higher&middle - income households	up to 100%	Maximum payment/income ratio = 1 : 3; average loan amount 40,000-50,000 EUR; indexed to the EURO; deposits are requested (10-20%); co-borrowers (1 or 2) and guarantors (1 to 3) are requested; real estate as collateral (1:1.3); loan fees 0.5-1.5% of the loan
2. Home loan of Housing Savings Banks	Monthly installments (amortization)	4.44-6.0% (fixed)	up to 20 years	Households	up to 100%	Controlled use of funds; co-borrowers (1 or 2) and guarantors (1 to 3) are requested; real estate as collateral (1:1,5); deposit is requested (30-50%); indexed to the EURO; loan fee 1%

### 2.1. Housing financing by commercial banks

Along with the process of establishing its independence the Republic of Croatia also embarked on a reform aimed at building an efficient, market-based financial system, transparent by international standards. The first step in that direction was the adoption of the Bank and Savings Bank Act in October 1993<sup>6</sup> that enabled the establishment of banks and savings banks. Until then banks' operations were regulated by a law taken over from former Yugoslavia, under which a market-oriented banking system reform of limited scope was initiated in 1989. The October 1993 Bank and Savings Bank Act remained in force with minor amendments (passed in 1996) until 1998, when it was replaced by a Banking Act<sup>7</sup>. In 2002, a new Banking Law<sup>8</sup> was passed. The early banking regulations were drafted

after those in Germany, while also taking into account quality solutions found in other countries. However, the inherited and current state of affairs at the time did not enable a complete "copying" of foreign models. The proposed legislation could not be such as to cause major "breakdowns" within the banking system, but at the time its provisions were supposed to influence banks to develop their business in line with the market rules.<sup>9</sup> After the Bank and Savings Bank Act was adopted in October 1993, universal-type commercial banks began to be founded and they nowadays represent the most developed type of local deposit financial institutions. The development of commercial banks has gone through various stages, and Croatia also had two banking crises.

Most recently, the banking system has been characterized by a consolidation (numerous bank mergers and mergers of banks and savings banks), and an increasing representation of foreign-owned banks in the total banking sector assets.<sup>10</sup>

Under the current, July 2002 Banking Law, the banks' main service is the receiving of money deposits and the granting of loans and other placements from the deposit funds on their own behalf and for their own account, and the issuance of other payment instruments in the form of electronic money. Apart from banking services, banks may also provide other services with a prior consent of the Croatian National Bank. A minimum share capital of banks is set at 40 million kuna (6.6 million USD), and they may only be established as joint-stock companies. The same law regulates in detail the terms under which banks may be founded and operate, as well as their supervision by the Croatian National Bank, the circumstances under which their licence may be revoked etc. Savings deposits of up to 100,000 kuna (16,507 USD) held by commercial banks have a 100-percent coverage on the principle of mandatory deposit insurance of the State Agency for Deposit Insurance and Bank Rehabilitation.

There were 41 active commercial banks in Croatia at the end of 2003, and 33 of them had credits to households related to the housing loans granted to them.<sup>11</sup> Banks that do not engage in housing financing (8 of them) are smaller banks with individual assets of less than 700 million kuna, while their combined assets represent 1.04% of the total banking sector assets. At the end of 2003, the share of housing loans approved by commercial banks in their total assets amounted to 8.10%.

Total consolidated commercial banks' assets at the end of 2003 reached 195.3 billion kuna and stood 17.9% higher compared to 2002, or 77.6% higher compared to 2000.

With respect to the subject of this paper it is interesting to note that in 2003, receivables from households rose by 27.7% compared to 2002, or by 136.1% compared to 2000. Total credits to households included housing loans.

The Croatian banking system is characterized by a significant presence of large commercial banks. The two largest commercial banks by asset size (Zagrebačka Banka d.d. and Privredna Banka Zagreb d.d.) account for 42.7% of the total banking sector assets, while 8 largest banks account for 82.9% of the banking sector total. The same 8 largest banks by assets size granted 88.65% of the overall housing loans reported at the end of 2003.

There is no organized trade in housing loans in Croatia, and banks engage in housing financing as portfolio lenders. Commercial bank encounter numerous problems related to housing loans, the most significant of which are an information asymmetry, i.e. insufficient information on retail clients (a credit register was established in 2003), and difficulties related to the valuation and use of collateral (property assessors, in bankers' opinion, are not focused enough on the market value; collection by seizure and sale of mortgaged property is difficult to implement and very often takes a long time).

**Table 12. Banks' Accounts, in million kuna**

	1993	1997	2000	2002	2003
<b>ASSETS</b>					
1. Reserves with the CNB	861	5,046	10,589	20,373	26,784
2. Foreign assets	6,212	16,186	19,710	25,978	35,383
3. Claims on central government and funds	19,972	15,239	19,055	21,918	21,544
4. Claims on other domestic sectors	20,262	48,592	60,364	96,218	110,374
4.1. Claims on local government and funds	11	309	1,175	1,422	1,563
4.2. Claims on enterprises	18,348	35,487	35,891	51,723	53,810
4.3. Claims on households	1,902	12,796	23,298	43,073	55,001
5. Claims on other banking institutions	10	–	69	219	432
6. Claim on other financial institutions	16	247	162	915	762
Total (1+2+3+4+5+6)	47,332	85,309	109,949	165,622	195,278
<b>LIABILITIES</b>					
1. Demand deposits	1,759	8,424	11,386	21,166	23,315
2. Savings and time deposits	1,466	5,599	7,651	13,001	18,371
3. Foreign currency deposits	5,412	31,278	46,902	72,055	76,035
4. Bonds and money market instruments	48	134	478	216	598
5. Foreign liabilities	12,066	13,807	17,810	35,023	49,932
6. Central government and funds, deposits	1,438	6,875	6,730	6,095	5,283
7. Credit from central bank	275	34	329	18	969
8. Restricted and blocked deposits	14,262	5,852	2,550	1,680	1,709
o/w: Households, blocked f/c deposits	13,857	4,574	1,695	319	168
9. Capital accounts	11,203	17,027	24,953	26,323	27,389
10. Other items (net)	–597	–3,720	–8,839	–9,956	–8,324
Total (1+2+3+4+5+6+7+8+9+10)	47,332	85,309	109,949	165,622	195,278

Source: Croatian National Bank

**Table 13. Structure of Bank's Loans by Institutional Sectors**

	1999	2000	2001	2002	2003	6/30/2004
Government units	6.41	8.01	6.59	7.26	7.76	7.89
Financial institutions	2.42	2.12	2.25	2.34	2.78	2.13
Public enterprises	3.73	4.60	4.43	4.09	3.67	3.91
Other enterprises	48.86	43.58	43.48	40.94	37.36	36.64
Non-profit institutions	0.44	0.57	0.25	0.33	0.31	0.30
Households	37.10	40.57	42.48	44.51	47.76	48.86
Non-residents	1.05	0.54	0.52	0.53	0.36	0.27
Total credits (%; mil. USD)	100.00	100.00	100.00	100.00	100.00	100.00
	6,095	6,280	7,884	12,916	17,995	18,712

Source: Croatian National Bank



It is evident from the share of housing loans in the total household credits that the absolute amount of these loans as well as their relative share in the portfolio of commercial banks is growing. The reasons for such developments lie in the following: stable growth of long-term savings deposits, fall of the interest rates charged by banks on housing loans, rise of living standards, loan security (loan service by retail clients has proven the best), improvements in property rights and judicial practice (e.g. fiduciary rights) etc.

**Table 14. Overview of current Banks' Home Loan Terms**

BANK:	Interest rate		Effective Interest Rate – EKS (%)	Repayment period (years)
	%	Type		
Zagrebačka Banka d.d., Zagreb	6.80 – 7.50	adjustable	6.84-7.86	up to 30
	7.49	fixed	7.54	up to 25
Privredna Banka Zagreb d.d., Zagreb	6.98 – 7.48	adjustable	7.82-8.84	up to 30
Raiffeisenbank Austria d.d., Zagreb	7.50 – 8.50	adjustable	9.22-9.50	up to 25
Erste & Steiermärkische Bank d.d., Zagreb	(4.99*) 6.45 – 6.95	adjustable	(5.64*) 7.38-7.28	up to 30

\* Interest rate for loans indexed on Swiss franc. All the others are on loans indexed on EURO

Source: Internet, researched on August 08, 2004

Housing loans are currently offered on the local financial market at a nominal interest rate of between 6.45 and 8.50% (i.e. effective interest rate of 6.84 to 9.50%<sup>12</sup>) annually, and various credit worthiness criteria are applied. The main criteria for obtaining a housing loan are a borrower's income (salary size) and the quality of the company he/she works for (the stability of its business is assessed). Depending on these criteria additional requirements may also be made (a borrower's own participation; co-borrowers and/or guarantors with appropriate income; certain type and amount of collateral – most often a housing unit worth at least as much as the loan amount to be approved<sup>13</sup>, life insurance policy of the borrower tied over to the bank etc.).

Recently, some banks have issued housing loans indexed to the Swiss franc, thereby promoting lower interest rates and others have granted loans under a repayment-free model, with nothing but the interest repayable over the loan period while the respective share of matured principal is paid into an investment fund. Such products represent an innovation on the local housing loan market and their supply is limited.

Refinancing housing loans from more favourable resources has had negligible scope in Croatia so far, although housing loan contracts include the clauses that regulate this issue, mostly providing for the payment of a certain fee. However, such a state of affairs is definitely influenced by the widespread practice of Croatian banks which, prior to approving housing loans, require that borrowers open current accounts with them for the payment of their whole salary (or other regular income) and do not approve housing loans before a certain period has elapsed (usually three months). Therefore, the choice of a bank to apply to for a housing loan does not depend exclusively on loan terms. Nevertheless, there has been some liberalization of loan terms in that respect as well lately, and it is sure to continue in the future.

Banks use their own networks of branches and outlets (these totalled 1,022 at the end of 2003) as the main distribution channel for housing loans, while the Internet is used first and foremost to inform clients on loan terms and documents that are necessary. Banks have yet to develop external credit brokers as a distribution channel for loans. Some banks have opted to operate through such arrangements and we may expect this distribution channel to see further improvements in the future.

The characteristics of housing loans granted by commercial banks in Croatia are very similar, so we may speak about a certain standard of primary housing financing set by the banking industry which is applied throughout the country. For now, there have been no housing loans with the credit characteristics adjusted to particular groups of retail clients (so-called hybrid housing loans etc.) although there is scope for developing such products (e.g. for people who let private villas in the residential parts of towns and as well as numerous rooms and tourist apartments along the Adriatic coast etc.).

In view of a multiple effect of banking products that finance private housing projects (as a component of the total cost, project feasibility factor etc.) it is necessary to point out, as part of the subject matter of this paper, that such products with their characteristics (loan period, required documents, collateral etc.) are very often not adjusted to the needs of entrepreneurs. This ultimately translates into less favourable terms for buyers as it also raises housing prices.

To finance housing loans, Croatian banks do not yet issue mortgage bonds (European model) or mortgage-backed securities (Anglo-Saxon model), nor do they raise funding for this particular purpose in any other manner. The main sources of their housing funding are deposits and their own capital, with the EBRD special-purpose deposits and long-term syndicated loans used by some banks also worth mentioning.

**Table 15. Funding Instruments**

OUTLINE OF THE SYSTEM & CHARACTERISTICS	MAJOR ISSUERS	MAJOR INVESTORS (customers)
Mortgage Bonds	-	-
Contractual Savings Schemes - HSB	Housing Savings Banks	Households
Mortgage-Backed Securities	-	-
Others	Selective deposits	EBRD
	Syndicated loans	-

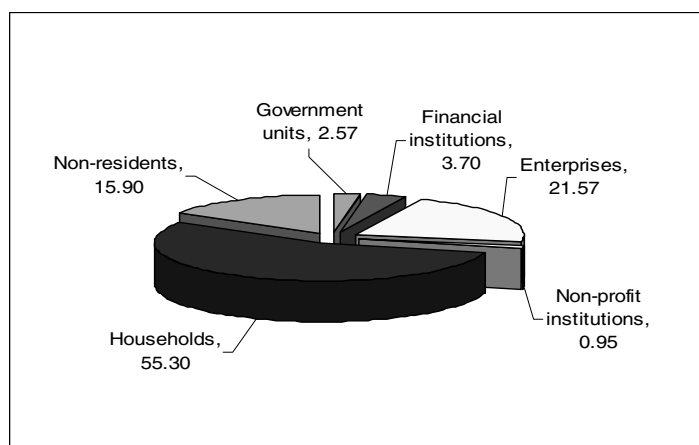
**Table 16. Issuance Volume / Savings Volume**

		1999	2000	2001	2002	2003	6/30/2004
Mortgage Bonds	(million USD)	-	-	-	-	-	-
	(number of transaction)	-	-	-	-	-	-
Contractual Savings Schemes - HSB	(million USD)	11.5	53.7	136.1	281.7	533.7	574.1
	(number of transaction)	-	-	-	-	-	-
Mortgage-Backed Securities	(million USD)	-	-	-	-	-	-
	(number of transaction)	-	-	-	-	-	-
Others	(million USD)	-	-	-	-	-	-
	(number of transaction)	-	-	-	-	-	-

Source: Croatian National Bank

Most savings at commercial banks are denominated in foreign currencies (foreign currency deposits account for 30% of the total liabilities in the consolidated balance sheet of commercial banks) and are mostly household deposits. Toward the end of 2003, household deposits made up 55.3% of the total deposits.

**Figure 1. Distribution of Deposits by Sectors (in %)**



When raising housing loans, retail clients are required to make a deposit of 10-20% (of the total loan amount) and some banks enable the deposit and loan processing fee to be subtracted from the disbursed loan amount. The deposit is most often tied over the loan period and bears no or very negligible interest. Recently, it has been possible to raise a deposit-free housing loan under partially changed loan terms, as banks may require a life insurance policy of the borrower, a larger number of guarantors and/or larger mortgage amount.

## **2.2. Contract Savings Model – Housing Savings Banks**

Croatia, as a number of other countries at the beginning of the transition process, introduced a model to develop housing financing by engaging private citizens' own funds for the purpose of resolving their housing problems. It is a contract model of special-purpose savings with housing savings banks, similar to those in Germany and Austria (Ger. *Bausparkassen*).<sup>14</sup>

To regulate and help develop the contract special-purpose housing savings and financing model, the Housing Saving and Government Incentive to the Housing Saving Act was passed and came into force on 1st January, 1998. It enabled the establishment of financial institutions that specialize in housing financing – housing savings banks. Soon after this Act came into force, housing savings banks began to be founded, expecting a good acceptance in the market and solid business results. Three housing savings banks were founded in the first year after the Act came into force, and one was founded later.

The housing savings banks with the Croatian National Bank licence operating on 30th June, 2004 are:

PBZ STAMBENA ŠTEDIONICA d.d.<sup>15</sup>

PRVA STAMBENA ŠTEDIONICA d.d.

RAIFFEISEN STAMBENA ŠTEDIONICA d.d.

WÜSTENROT STAMBENA ŠTEDIONICA d.d.

The Housing Saving and Government Incentive to the Housing Saving Act defined the terms under which housing savings banks may be established as well as their operations, the housing savings and housing loan terms, the terms, criteria and procedure of using state incentives for housing and penal

provisions. Art. 20 Par. 2 Cl. 2 of the Act stipulates that a maximum agreed interest rate to be charged by a housing savings bank on a housing loan may not exceed the interest rate it pays on housing savings deposits by more than 3 percentage points.

Any Croatian citizen, as well as municipalities and towns (provided that they use these funds for the housing construction in order to provide housing to poorer persons) may become depositors and beneficiaries of housing loans by concluding a housing savings contract with one of the existing housing savings banks in the market.

Depending on the length of the saving period, that cannot be shorter than two years, housing savings banks offer various possibilities of saving (e.g. quick, normal and slow; prime, basic and golden etc.) that they call types or tariffs. Payment of housing savings deposits may be agreed on a monthly, quarterly, annual or one-time basis. Complying with the agreed manner of payment by depositors is important because any payment delay or default directly extends the period of saving necessary for raising a loan of the planned amount. Paid-in deposits are guaranteed by the housing savings bank, and they are also subject to mandatory insurance by the State Agency for Deposit Insurance and Bank Rehabilitation.

The stimulation of housing savings by Croatian citizens is visible from direct incentives, i.e. budgetary funds allocated to all the housing savings banks in the amount equal to 25% of one's own payments into housing savings deposits over a previous calendar year. The basis to which 25% in state incentives is added is legally limited to 5,000 kuna (825 USD) at most, so a maximum amount of incentives a single housing depositor may get is 1,250 kuna (206 USD). In view of the interest and state incentives on one's own paid-in deposit, housing savings are exceptionally attractive at the level of individual deposits of 5,000 kuna (825 USD) per person.

Housing savings banks in Croatia operate in accordance with the Banking Law and other regulations of monetary and public authorities that govern the business of banks and savings banks, and their operations are supervised by the Croatian National Bank, the Ministry of Finance and the State Auditor's Office.

An analysis of the operations of housing savings banks in Croatia since they were established reveals two distinct periods: the first did not allow for housing savings contracts with a protective monetary clause (which is often referred to as the "currency clause" in public), and the second period since 8<sup>th</sup> July, 1999, when agreeing the clause was enabled, making it the main reason for a marked increase in the amount of savings deposited with housing savings banks in the following years. By the end of June, 2004, housing savings banks had concluded more than 560,000 housing savings contracts with private citizens.

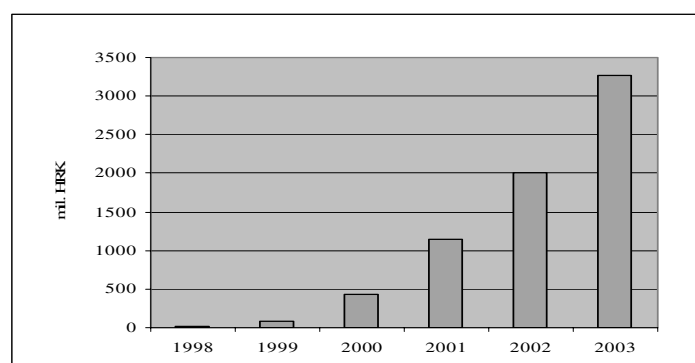
**Table 17. Housing Savings Banks' Accounts, in million kuna**

ASSETS	1998	1999	2000	2001	2002	2003
1. Reserves with the CNB	2,4	8,6	7,6	15,5	19,1	0,0
2. Claims on central government and funds	49,7	81,4	497,6	1.208,8	1.983,9	3.033,5
3. Claims on other domestic sectors	–	5,3	1,1	11,6	93,3	187,9
o/w: Claims on households	–	–	0,6	11,6	91,3	187,9
4. Claims on banks	54,2	57,0	7,6	18,1	37,2	247,2
5. Claims on other banking institutions	–	–	–	–	–	–
Total (1+2+3+4)	106,3	152,3	513,8	1.254,0	2.133,6	3.468,6
LIABILITIES						
1. Time deposits	8,7	87,6	437,8	1.137,5	2.012,9	3.265,2
2. Bond and money market instruments	0,4	-	10,0	10,0	-	11,1
3. Capital accounts	108,3	117,4	112,5	124,0	141,1	159,7
4. Other items (net)	-11,0	-52,7	-46,5	-17,5	-20,4	32,6
Total (1+2+3+4)	106,3	152,3	513,8	1.254,0	2.133,6	3.468,6

Source: Croatian National Bank

The saving stage begins by concluding a housing savings contract and it lasts until all the criteria on the required amount and saving period have been fulfilled. Afterwards, housing depositors who wish to raise a housing loan enter a loan stage. However, any housing depositors who do not wish to raise housing loans may continue to save and withdraw the funds they paid in, increased by the accrued interest, state incentives, bonus etc.

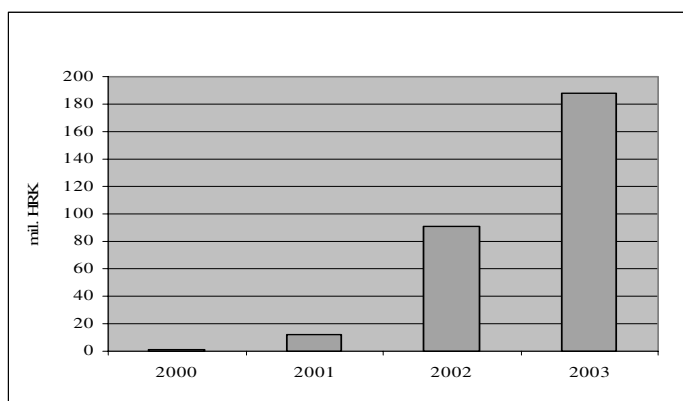
**Figure 2. Total Deposits Collected by Housing Savings Banks**



In order to win new depositors, housing savings banks have used the following distribution channels: 1) a network of their external salesmen – organized on various multi-level principles, with all the members motivated to sell by the commission paid on the basis of contracts they conclude with depositors, 2) their own and private licensed sales offices, 3) cooperation with and use of the distribution channels of banks (e.g. their counters and outlets), 4) the Internet etc.

Since the approval of an application for a housing loan is subject to a minimum of two years of purpose savings, housing savings banks only began granting housing loans in 2000, while greater credit activity as far as the number and total amount of approved loans is expected in the future.

**Figure 3. Granted Home Loans by Housing Savings Banks, in million kuna**



**Table 18. Overview of Current Housing Savings Banks Home Loan Terms**

HSB:	Interest rates		Repayment period (years)
	Savings	Home loans	
PBZ Stambena Štedionica d.d.	1.50 – 3.33**	4.44 – 5.88**	up to 20
Prva Stambena Štedionica d.d.	3	6	up to 13
Raiffeisen Stambena Štedionica d.d.	3 – 3.5*	6	up to 16 years and 5 months
Wüstenrot Stambena Štedionica d.d.	2 – 3***	5 – 6***	up to 15 years and 8 months

\* Higher interest rate (+0.5 %) would be given to the depositors who do not request a home loan after 5 years of saving

\*\* Different level of interest rates is offered depending on the period and type of contract

\*\*\* Higher interest rates are calculated for contracts in the national currency

Source: Internet, researched on 11th August 2004

Izvor: Internet, pretraživano 11. kolovoza 2004.

After a housing depositor meets the basic saving criteria (a set period and amount) and applies for a housing loan, the housing savings bank will grant the loan provided that it has assessed the depositor's credit worthiness and the loan purpose positively. Depositors face an almost equal path of gathering various documents for the purpose of proving their credit worthiness to that they would be facing had they applied for a loan at a local commercial bank.<sup>16</sup>

**Figure 4. Overview of Deposits and Home Loans in the Housing Savings Banks Model**

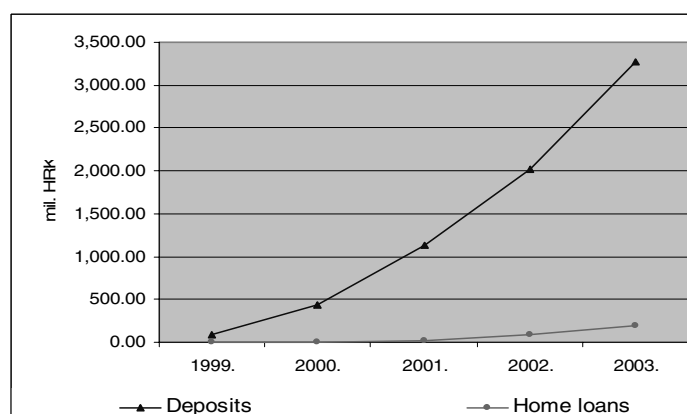


Figure 4 illustrates a rift between the housing savings accumulated by housing savings banks and the amount of housing loans they granted in the period under observation, with their respective trend. Since a significant portion of loans has not yet “come up” for granting, in the circumstances of strong demand for housing loans housing savings banks have been placing the funds for other purposes defined by the law.<sup>17</sup> Under the Housing Saving and Government Incentive to the Housing Saving Act, housing savings banks are not allowed to engage in direct interim financing of housing depositors, but they have all developed a form of cooperation with commercial banks that enables them to offer a product with appropriate characteristics in the local market. Nevertheless, such a form of interim financing has imposed additional costs, while also hampering the development of this product and a whole area of housing savings banks’ business policy. Therefore, instead of financing housing loans their credit potential will be channelled into financing the government and its institutions through bond investment.

### ***2.3. Socially-Supported Government Housing Construction Programme***

A socially-supported government housing construction programme (known as “POS”) is the latest market incentive housing model, implemented in Croatia since 11<sup>th</sup> December, 2001, when the Socially-Supported Housing Construction Act was passed. This model is designed to resolve/improve the housing needs and conditions of households by engaging public funds (those of the government, towns and municipalities) and combining them with the funding of commercial banks and households. It is implemented through the construction of housing units organized so as to optimize the use of public and other funding for the coverage of costs, ensure its repayment and enable the financing of housing purchases on instalment schemes, under more favourable than market conditions as far as the interest rates and years of repayment are concerned. The socially-supported housing construction model envisages the construction of flats provided that their maximum sales price does not exceed 910 euros per sq metre of the net usable area.

Local self-administration units determine the housing needs and interest for the purchase of flats in their respective areas, and are under obligation to provide adequate building site with utilities and other communal infrastructure for this purpose. Those units also set the terms, criteria and procedure for determining the order of priority for the purchase of flats under this model.

If the flats under the POS programme are purchased on an instalment scheme, the buyers have to provide 15 percent of the estimated value of the flat as their own share, 45 percent is financed by a bank loan, while the Ministry of Environmental Protection, Physical Planning and Construction and self-administration units finance the remaining 40% of the value of flats. Each person buying a flat on an instalment scheme has to meet the credit worthiness criteria set by the state Agency for Real Estate Affairs (APN) or a commercial bank providing the loan funds, and the flat being bought is used as collateral to guarantee the repayment of the entire debt including interest. After each such purchase the commercial bank loan is to be repaid first, followed by the remaining part owed to the Ministry and self-administration unit. The annual interest rate charged on the bank portion of the loan is 7.85% and is linked to the six-month EURIBOR, while the interest on the Ministry and self-administration unit’s funding (40% of the flat’s value) is not payable for the first 16 years and only a so-called compound interest at a 2% rate is calculated. Over the next 15 years, the loan is to be repaid at a 5% annual interest, and the total repayment time on an instalment scheme may not exceed 31 year starting from the time a purchase agreement is concluded. The monthly annuity is set as an even amount over the entire loan period, but it may not be smaller than 0.25% of the total purchase price of the flat.

The social dimension of the described model is reflected in the provisions that provide an advantage in the purchase of flats to the households without adequate housing. Under adequate housing we

understand flats of 35 sq m in size (with appropriate infrastructure) for a one-member family, plus an additional 10 sq m for each additional member of the household.

By July 2004, a total of 1,521 flats under the POS programme had been completed and delivered to their users, while another 1,834 flats are in various stages of construction. According to the data that has been published, 5,696 flat are currently being planned and the interest in further housing construction has been recorded. The new Croatian government, elected in November 2003, announced further improvements to this model of housing financing.

### 3. Regulatory Structure

The Banking Law and the CNB regulations form the basis of the regulatory system of housing financing. Since housing financing is an activity that housing savings banks also engage in, it is important to say that they are regulated by a special law that sets a minimum capital requirement of 20 million kuna (3.3 million USD) for their establishment. Housing savings bank operations also have to be in accordance with the Banking Law and the accompanying regulations (much like those of commercial banks).

**Table 19. Regulator and Supervisor**

	Name of organization	Establishment	Main functions
Primary mortgage market (Lending and credit market)	1. Croatian National Bank	Independent from former Federal National Bank since 1989. Latest law in 2001	Central bank; Supervision Authority for Banks, Housing Savings Banks and Payment System; Banking regulation
	2. Ministry of Finance	-	State Treasury, Supervision, Regulator
	3. Money-Laundering Prevention Office	1997	Anti Money-Laundering Authority - Supervisor for payment transactions
	4. Deposit Insurance and Bank Rehabilitation Agency	1994	Deposits insurance (up to 16,507 USD) and bank rehabilitation
Secondary mortgage market (Funding market)	-	-	-

The business of commercial banks and housing savings banks is supervised by the CNB, along with the Ministry of Finance etc. (e.g. housing saving banks are also supervised by the State Auditor's Office).

**Table 20. Main Regulations**

	Title of laws / regulations	Enforced date	Main purposes
Primary mortgage market	1. The Banking Law	New one from 2002	Regulates the establishment and operations of Banks and Housing Savings Banks as well as the discontinuation of supervision over bank operation.
	2. Housing Saving and Government Incentive to the Housing Saving Act (HSB Act)	1998	Regulates the establishment and operations of Housing Savings Banks
Secondary mortgage market	-	-	-

Croatian courts have a huge backlog of unresolved cases (estimated at more than one million, 25% of which refer to the issues of collection), and that very often makes court proceedings long and arduous. The record of ownership and mortgage of real estate is kept by land registration units (with municipal



courts) that also have a large number of unresolved cases. Making a record of ownership changes takes long (often more than a year); therefore certain properties cannot be put on the market. Still, registering liens upon the order of financial institutions etc. takes precedence so such applications are dealt with more quickly (often within 2 weeks). Property may be pledged by virtue of a mortgage or a fiduciary deed, and the only difference between them is that a fiduciary transfer envisages the property being tied over to the creditor until the debt is repaid and collection by such a creditor in the event of any problems may be easier and relatively quicker (since no court proceeding is necessary to obtain a distress order, as is the case with the other type of pledge). When the value of the pledged property is assessed, it is often estimated to be lower than the real value in order to obtain additional collateral from the borrower and thereby increase chances of collection in the event of forced execution. Also, borrowers are sometimes required, at the time the loans are granted, to agree to a pre-set price that will be asked for the pledged property at a first auction (in the event of loan default), and that later enables an easier sale in order to collect the amount due. In the event that the pledged property is put on sale so as to close a credit position, the costs of execution proceedings are to be settled first, then the interest and finally the principal owed. The debtors in default are liable for penalty interest payment.<sup>18</sup> The process of collection on the basis of pledged property lasts between 3 and 5 years on average. The possibility of pledging movable property to guarantee the repayment of one's financial obligations is regulated by law, but for now there is no single register of pledged property so such pledge notices are published in the official gazette *Narodne Novine*.

The key national legal regulations that govern housing financing issues are the following: Civil Law, Land Registration Law, Law on Ownership and Other Material Rights, Deed of Assignment Act, Bankruptcy Law, General Tax Law, Income Tax Law, Execution Act, Penalty Interest Rate Act, Draft (Bill of Exchange) Act, Trial Proceedings Act, Notary Public Service Act, Foreign Currency Act and various CNB decisions or directives (e.g. those regulating a single way of expressing the effective credit and deposit interest rate, or a classification of bank credits and potential liabilities etc.).

#### **4. Housing Policy**

After World War Two, housing problems were for the most part resolved in two ways: 1) through the construction of family houses funded and built by the owners themselves (so-called self-help) and the purchase of flats from construction companies or housing cooperatives owned by private citizens, and 2) through a distribution of community housing by companies, institutions and other organizations.<sup>19</sup> After former Yugoslavia broke apart, Croatia passed new legislation that regulated housing, thereby initiating a housing reform which is still under way. Consequently, major changes with regard to the housing ownership status occurred between 1990 and 1994 and, in the course of those five years, 57% of the former community (state-owned) flats became private property of households (299,136 community flats, representing 76% of the total, were privatized by the end of 1997)<sup>20</sup>. The privatization of those flats led to numerous doubts and questions concerning their price justifiability (i.e. the issue of whether the prices were realistic) and justification of other terms under which the flats were sold, while there also arose some problems related to the maintenance of housing blocks and their management. The housing reform resulted in the fact that living in one's own flat became a dominant housing status of most households. The so-called «wild» and illegal construction presented an even larger problem related to the land register management and planned housing construction. Hence, the potential for the development of a real estate market trade or mortgage financing of housing construction was limited. Concrete progress in the development of a housing finance system has only emerged since 1997, when the State-Supported Long-Term Housing Financing Fund Act, the Housing Saving and Government Incentive to the Housing Saving Act and a Socially-Supported Government Housing Construction Programme were adopted.

Passing the said legislation marked the beginning of an active housing policy in Croatia that is expected to yield concrete results in several years. So far, commercial banks' credit support to housing financing has intensified and the housing savings project has proven increasingly attractive as the number of newly concluded savings contracts and the accumulated savings continue to grow. The latest government programme, the Programme of Social Incentives to the Housing Construction, has awoken great interest among the population while the state-supported long-term housing financing fund has meanwhile ceased to operate.

**Table 21. Government Policy for Own-Housing**

Name of the measure	Outline of the measure and recent results	Name of laws	Name of regulator
1. POS model	Dwellings are made available to citizens under favorable price and financing terms. Administrative way of setting the priority for buyers.	POS Act	Ministry of Environmental Protection, Physical Planning and Construction
2. No transaction tax	No transaction tax is charged when a first home is bought	Income Tax Law	Ministry of Finance
3. State premium (direct subsidy)	State premium (direct subsidy) is paid into the Housing Savings Banks system	HSB Act	Ministry of Finance
4. Deductions from the income tax base	Interest paid on home loans (as well as investments into home renovations) are tax deductible from the personal income tax base (up to 1,981 USD).	Income Tax Law	Ministry of Finance

An earlier model (Government-Supported Long-Term Housing Financing Fund), which did not take off in practice, envisaged subsidizing the interest payable on housing loans.<sup>21</sup> However, it is interesting to note that some employers subsidize the interest paid by their employees on home loans, and in turn employees are required to stay with the same employer for a certain number of years. The current government subsidies for housing are reflected in the premium paid annually to depositors under the contract model of housing saving, and the funding allocated under the POS model.

Since 2003, the interest paid on housing loans in the amount of up to 12,000 kuna (1,981 USD) has been recognized as tax deductible in the annual tax returns filed by individual Croatian tax payers. The cost of housing refurbishment/reconstruction of the same amount is tax deductible under the same principle, with tax relief conditional upon living in the housing property financed by the loan.

The citizens buying their first homes (and first-line inheritors) are exempted from the usual transaction tax, imposed at a rate of 5%. When buying new dwellings, the 5% tax is payable on the base that includes the accompanying portion of the land and public utilities services, and is calculated by builders that have to issue appropriate receipts to buyers. Such receipts also have to show the amount of Value Added Tax paid on the material and services built into the dwellings, and buyers (provided that they are part of the VAT payment system) may benefit from the amount of VAT paid. So, when purchasing a new dwelling, parties subject to VAT payment (craftsmen, companies etc.) will fare considerably better (concrete examples known to the Author show that a price reduction by 15-18% is possible).

**Table 22. Housing Taxation**

SUBJECT	NAME	OUTLINE OF THE TAXATION
Taxation of home-acquisition	Transaction tax	- no charge when first home is bought - when new dwelling is bought it is taxed at a rate of 5% on the base that is calculated by a builder (builder issues a receipt). The base for 5% taxation consists of appropriate part of the land and public utilities (municipal services).
	Value-added tax (VAT)	- 22% on the base calculated by a builder could be saved when parties subject to VAT payments are buying new dwellings
Taxation of house-holding	Rents	- when a dwelling is rented the tax base equals the market rent reduced by 30% and than it is to be taxed at a 15% rate (valid for private lessor)
		- in the corporate sector rents are taxed at a 22% VAT rate
Taxation of house-transfer	Transaction tax	- 5% of the value for used dwelling
	Capital gain	- when a second dwelling is sold within three years of the purchase date the capital gain would be taxed as personal income
	Inheritance	- tax free for the closest family (first line), others will be taxed at a 5% rate

The rented housing market is not regulated by the current housing policy measures and that is the area where least work has been done as part of the housing reform. There is no tax relief or anything else that may spur investment into rented housing or its better supply on the market.

## 5. Concluding Remarks

On the basis of an analysis of the housing financing models presented in this paper one may conclude that Croatia has traditionally been dominated by a deposit-based housing financing model, with commercial banks appearing as the main creditors, although new models and products that have emerged in the past few years are also being developed. As part of the moves to help households resolve their housing problems, the State-Supported Long-Term Housing Financing Fund Act, the Housing Saving and Government Incentive to the Housing Saving Act and a Socially-Supported Housing Construction Programme were adopted. Croatian citizens have shown particular interest in the housing savings bank products and the Socially-Supported Housing Construction Programme, while a state-supported long-term housing financing fund did not take off in practice.

The ratio of housing loans granted by commercial banks and housing savings banks to the Gross Domestic Product has been rising continually over the past few years (it stood at 9.85% at the end of 2003), so it can be expected to continue rising in the future thanks primarily to an increase in the living standards and more accessible financing.

Out of the total outstanding housing loans in Croatia, 98.6% were granted by commercial banks while housing savings banks granted no more than 1.4% of all housing loans. Housing lending is led by the banks with more than 5 billion kuna in assets, and they accounted for 88.65% of the total outstanding housing loans at the end of 2003. Most of the housing loans granted by Croatian commercial banks and housing savings banks are indexed to the euro. Nevertheless, the interest charged by commercial banks is for the most part variable, while housing savings banks grant loans at fixed interest rates.

Whereas bank assurance policies are very frequent and popular instruments of securing regular loan repayment by retail clients in the world, very few insurance companies in Croatia offer or design such

products. Nevertheless, it is certain that they will be improved in the future, and the Government might begin by setting the necessary standard and even introduce such instruments through its own institutions.

The operations of housing savings banks in Croatia, as well as those in a number of other countries, depend primarily on state incentives (premium) paid into individual accounts of housing depositors. The Croatian housing savings model could develop further through a process of deregulation of the housing savings bank operations, which would enable interim financing of housing depositors and provision of some other banking services. During such a process, housing savings banks would assume many of the characteristics of banks so it is entirely possible that, some time in the future, they may start operating regardless of the existence or the level of the government premium.

The latest housing financing model (POS) bears a certain resemblance to the social housing programmes in Finland (as households are required to provide 15% of the funding) and France (since part of the responsibility for the programme is shared by the central and local government, with the local government units responsible for the urban and housing planning and preparing the sites for building). Still, the fact that it is heavily subsidized by the government, apart from its “political charge”, is a major shortcoming of this model. Its development might be helped by structural changes to enable private sector investment and initiative, thereby reducing state funding for this model.

The rented housing market has not been part of the housing reform to date as far as the supply or the demand side is concerned, so regulating this segment might benefit all stakeholders.

When providing incentives to the housing construction, it would be vital to take note of the volume of construction work and the capacity of local builders, while also improving the accompanying administrative procedures and activities since stimulating measures on the demand side, while supply remains unchanged, are likely to lead to higher housing prices. The data presented here points to an increase in the housing prices, while the construction inputs and other costs have not changed sufficiently to prompt or justify such growth. However, if the purchase of homes is most often financed by the loan products of financial institutions, as is the case in Croatia (often up to 100%), it is right to wonder how realistic those prices truly are, whether a price bubble is being created and what might happen when it bursts. Such an outcome might provoke a financial system crisis, and this should definitely be taken into account when deciding on the housing policy measures.

The problems related to housing financing with the help of the models presented in this paper have not been completely resolved. Therefore it seems justifiable to launch an initiative for designing a national model to envisage resorting to the capital market as a source of funding for housing financing. To that end it is necessary to set the standards or criteria for granting housing loans on the primary market, establish an efficient and comprehensive credit register and a single register of pledged property, while also spurring the development of a system of housing loan repayment insurance (not vital). Certain laws (depending on the model to be developed) would also need to be modified and amended to make sure that the issues such as who may trade in credit portfolios and in what circumstances, are properly and accurately regulated. Licensing and establishment of legal agencies to take part in such a model would also have to be regulated, and Croatia would have to pass legislation governing national mortgage bonds (or mortgage-backed securities), and then set and supervise the minimum criteria that the securities issued on the basis of a mortgage pool have to meet.

Since housing creditors in developed countries are striving to expand their business to foreign markets (through international operations), we may expect them sooner or later to opt for entering the markets of transition countries and, therefore, also the Croatian housing financing market. In that case a wave of refinancing of the existing credit liabilities from more favourable sources may be expected, as well

as mergers and acquisitions among national housing creditors. As the process of housing loan refinancing etc. unfolds, we can foresee an increasingly active role of consumer protection institutions.

Resolving the problems of housing financing is a complex task that depends on a number of national specifics so, when determining the national housing strategy measures and policies, conclusions should be made on the basis of the state of the housing sector and the current fiscal policy (particularly as far as tax relief, subsidies, state guarantees etc. are concerned). If Croatia were to embark on reforms so as to reduce budgetary spending on the existing housing financing models (mostly under the POS programme) and design new models (based on market principles), it would be recommended to include international institutions (UN, World Bank, EBRD etc.) in the process.

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**APPENDIX: LIST OF BANKS' BASIC INDICATORS AS AT 30 JUNE 2004**

No.	Bank name	Total assets (000 HRK)	Share in total assets (%)	Asset growth (%)	Pre-tax income/loss (000 HRK)	Capital adequacy ratio (%)
1.	BANKA BROD d.d.	118,104	0.06	10.93	2,403	39.62
2.	BANKA KOVANICA d.d.	470,954	0.22	17.91	271	17.77
3.	BANKA SONIC d.d.	519,806	0.25	9.42	4,525	15.62
4.	BANKA SPLITSKO-DALMATINSKA d.d. <sup>1</sup>	130,457	0.06	8.58	-1,602	27.20
5.	BRODSKO-POSAVSKA BANKA d.d.	113,857	0.05	-12.22	-14,732	11.91
6.	CENTAR BANKA d.d.	555,927	0.26	1.50	3,001	20.86
7.	CREDO BANKA d.d.	686,976	0.32	5.71	2,958	11.59
8.	CROATIA BANKA d.d.	1,490,012	0.70	2.08	624	16.01
9.	DRESDNER BANK CROATIA d.d.	751,686	0.35	4.08	3,021	35.55
10.	DUBROVAČKA BANKA d.d.	3,106,219	1.46	-6.01	25,659	14.72
11.	ERSTE & STEIERMÄRKISCHE BANK d.d.	20,439,123	9.64	4.72	159,645	15.12
12.	GOSPODARSKO KREDITNA BANKA d.d.	334,794	0.16	9.80	12,634	54.11
13.	HRVATSKA POŠTANSKA BANKA d.d.	5,699,905	2.69	5.20	59,349	26.69
14.	HVB SPLITSKA BANKA d.d. <sup>2</sup>	19,646,792	9.26	3.22	100,680	13.94
15.	HYPO ALPE-ADRIA-BANK d.d.	16,113,271	7.60	14.61	123,207	12.67
16.	IMEX BANKA d.d.	372,911	0.18	-0.20	3,495	21.84
17.	ISTARSKA KREDITNA BANKA UMAG d.d.	1,445,597	0.68	0.48	9,053	16.44
18.	JADRANSKA BANKA d.d.	1,541,661	0.73	-2.69	9,208	17.05
19.	KARLOVAČKA BANKA d.d.	1,126,600	0.53	-2.64	3,951	13.80
20.	KREDITNA BANKA ZAGREB d.d.	765,531	0.36	-0.56	7,302	26.59
21.	KRIŽEVAČKA BANKA d.d.	207,229	0.10	46.38	2,695	19.22
22.	KVARNER BANKA d.d.	243,922	0.12	1.15	3,441	28.95
23.	MEĐIMURSKA BANKA d.d.	1,937,831	0.91	3.44	16,912	15.42
24.	NAVA BANKA d.d.	343,097	0.16	8.93	820	18.67
25.	NOVA BANKA d.d.	5,511,358	2.60	2.14	15,016	13.08
26.	PARTNER BANKA d.d.	705,049	0.33	14.60	10,790	18.95
27.	PODRAVSKA BANKA d.d.	1,388,976	0.65	4.98	5,150	14.63
28.	POŽEŠKA BANKA d.d.	425,861	0.20	-3.50	-974	27.33
29.	PRIMORSKA BANKA d.d.	85,898	0.04	3.52	-690	72.80
30.	PRIMUS BANKA d.d.	248,690	0.12	-14.88	-23,662	10.47 <sup>4</sup>
31.	PRIVREDNA BANKA - LAGUNA BANKA d.d.	721,339	0.34	2.82	6,963	23.09
32.	PRIVREDNA BANKA ZAGREB d.d. <sup>3</sup>	38,916,829	18.35	2.98	359,669	13.40
33.	RAIFFEISENBANK AUSTRIA d.d.	21,472,559	10.12	15.41	124,363	12.35
34.	SAMOBORSKA BANKA d.d.	362,233	0.17	-1.42	1,448	33.81
35.	SLATINSKA BANKA d.d.	721,008	0.34	1.71	6,085	22.81
36.	SLAVONSKA BANKA d.d.	4,919,817	2.32	5.81	19,033	28.36
37.	ŠTEDBANKA d.d.	777,439	0.37	-1.38	15,862	38.44
38.	VARAŽDINSKA BANKA d.d.	3,425,072	1.61	-17.13	45,365	16.57
39.	VOLKSBANK d.d.	2,967,278	1.40	10.81	7,705	15.27
40.	ZAGREBAČKA BANKA d.d.	51,288,539	24.18	3.78	644,603	13.18
<b>Total (all banks included)</b>		<b>212,100,209</b>	<b>100.00</b>	<b>3.91</b>	<b>1,775,245</b>	<b>14.92</b>

Source: Croatian National Bank (Preliminary unaudited data)

Note: Data on the growth in assets are calculated on a year-to-date basis.

<sup>1</sup> Splitsko-dalmatinska banka changed its name into Banka splitsko-dalmatinska on 3 March 2004.

<sup>2</sup> Splitska banka changed its name into HVB Splitska banka on 21 April 2004.

<sup>3</sup> Riadria banka merged with Privredna banka Zagreb on 1 January 2004.

<sup>4</sup> As at 31 March 2004.



## NOTES

- 1 Official gazette Narodne Novine, issue 12/2002
- 2 According to the Ministry of Environmental Protection, Physical Planning and Construction 2003 Status Report for the Republic of Croatia, 23.7% of the population was young (between 0-19 years of age), mature population (between 20-59 years of age) represented 54.5%, while the old population (60+ years old) accounted for 21.3%.
- 3 After: Fröhlich, Z., Bežovan, G. and others (2001): Housing Construction – Development Strategy of the Republic of Croatia, pp. 10-13
- 4 Bežovan, G., Tepuš, M. M., Fröhlich, Z. (2004): «The City of Zagreb Housing Strategy Draft», p. 35.
- 5 The same ratio at the European Union level totalled approximately 40% at the end of 2003, and was particularly high in Denmark (70%), the Netherlands (more than 60%), as well as in Germany and England (more than 50%).
- 6 Official gazette Narodne Novine, issue 94/1993
- 7 Official gazette Narodne Novine, issue 161/1998
- 8 Official gazette Narodne Novine, issue 84/2002
- 9 Leko, 1999
- 10 Banks in the majority foreign ownership had a 91.1% share in total banking assets at the end of the first half of 2004, compared with a 6.7% share at the end of 1998.
- 11 See: Kraft, Dolenc, Duliba, Faulend, Galac, Šošić and Tepuš, 2001, p.5, almost a half of all commercial banks offered no long-term loans early in 2000. Nowadays, long-term housing loans are available from most banks and the level of interest rate charged makes them most favourable since the country gained independence, i.e. since the beginning of transition.
- 12 The Croatian National Bank has set the effective interest rate, i.e. the unique method of calculation of interest rates that the banks have to present to clients and public, since 1st January, 2002.
- 13 The mortgaged property has to be insured against fire, natural disasters etc. in the minimum amount equal to the loan amount (hazard insurance).
- 14 The first housing savings banks in the transition countries of the region were founded in: Slovakia in 1992, Czech Republic in 1992 and Hungary in 1997.
- 15 PBZ Stambena Štedionica d.d. began operating early in 2003. At the time Hrvatska Stambena Štedionica d.d. ceased to operate as its entire portfolio was taken over by Prva Stambena Štedionica d.d., Zagreb.

16 For further material on the operations of housing savings banks in Croatia see Tepuš, 2002.

17 The lending policy of housing savings banks is regulated by Art. 10 of the Housing Saving and Government Incentive to the Housing Saving Act, which stipulates that the funds may be used for financing clients' housing loans, investment into the financial market instruments with first-class guarantees (deposits), as well as for the purchase of first-class sovereign securities issues and other securities issued with state guarantees or bank guarantees and placements with safe credit institutions.

18 The level of penalty interest is set by the Croatian Government, it currently stands at 15%.

19 Jelinić, 1994

20 Bežovan, 1998

21 For further material on the Government-Supported Long-Term Housing Financing Fund see: Tepuš (2004)

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