

# Bausparkassen and Globalisation

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## Introduction

The Federal Republic of Germany is facing radical changes, which are emerging at many levels and which have already seriously altered or will still further alter life in Germany. These modifications are not taking place abruptly, but more gradually as an ongoing process. This is especially true of the population trend and the age structure, the frontiers of economic growth, the fundamental budgetary difficulties of the public authorities, the associated problems of the social security systems and finally the change of an industrial society into a services society occurring as part of the process of globalisation.

## The Bausparkassen

With the change, people too are adapting in respect of both the supply of, and the demand for, goods. In turn, this means that financial services institutions, and especially the Bausparkassen, have a massive need to adapt: from single product producer to member of a group of suppliers with a differentiated product range.

The Bausparkassen were founded after the First World War – in the mid-1920s – a period characterised by lack of housing on a massive scale, unemployment, high inflation and a collapse of the market for junior mortgages. A clear division of labour very quickly emerged in the ensuing years between first-ranking financing by banks and savings banks and second and lower-ranking financing by Bausparkassen, which was very successful and continued even

after the Second World War, when Germany was again facing huge reconstruction and integration problems. In this respect, a decisive role was played by the fact that the Bausparkassen on the one hand ensured sufficient equity capital formation through the accumulation of savings deposits and on the other hand made loans available at very favourable interest rates which were independent of the capital market.

This link ultimately ensured that housing finance, and especially the financing of owner-occupied housing, has been relatively continuous and stable in Germany in the past decades, whereas in many other countries there have been very sharp fluctuations to be observed in new construction and so on the financing side too.

The German Bausparkassen can therefore also boast an extremely successful balance sheet: since the end of the war, they have been involved in the financing of well over 13 million dwellings. During this period, they have paid out over €900 billion for new buildings, existing housing, modernisation and renovation work, etc. In the past 10 years alone, between three and four million new building loan contracts per year have been concluded on savings of €70 to 80 billion and sometimes even more.<sup>1</sup> At present, the German Bausparkassen manage 33 million contracts of some 25 million members on total savings of over €720 billion.

Through these services, the Bausparkassen have contributed substantially to the current relatively satisfactory housing supply

situation and the largely balanced housing markets in Germany, although the public authorities have always focused aid on housing for rent.

## The Role of the State and Demographic Change

With the growing demand being met over the years, certain regulatory principles developed in housing policy, which were of far-reaching importance for housing finance, although some of them were not implemented to the necessary extent by the politicians. For instance, public aid should in principle play only a subsidiary role. This applied in particular for the acquisition of owner-occupied housing with tax incentives pursuant to § 7 b and later § 10 e of the Income Tax Act, through which it was intended to mobilise “self-help” on the part of house-hunters. For many years, far too little account was taken of this principle, which has only come to the fore again recently – in view of empty government coffers.

In the coming years, fundamental changes to the general conditions are to be expected, which will be accompanied by substantial effects on the housing markets and housing policy. The State can no longer play the role of universal “provider”. The social services can no longer be maintained on the old scale because the number of “beneficiaries” of the social security system is constantly rising and the number of contributors currently declining. The individual will have to look after himself and provide for his own future to a considerably

<sup>1</sup> One reason for the renaissance of the bauspar product in Germany was the stock market crash in the late 1990s. German savers sought safe investment possibilities and bausparen was considered one of them.

greater extent than before. This is particularly applicable in view of the shifts in the age structure of the population. Authoritative experts<sup>2</sup> agree that although the number of German inhabitants will remain more or less constant in the next 20 years and the number of households relevant for housing construction will rise further by about one to two million, there has already been a distinct rise in the age ratio for years. Whereas in the mid-1990s there were only 37 German citizens of over 60 years of age to 100 German citizens of working age of 20 to 60 years, this figure is currently already 45 and will rise to 56 in the year 2020. Two workers will then already have to support more than one pensioner. This means drastically rising social insurance contributions or correspondingly higher self-provision.

Furthermore a similar trend is to be seen not only in Germany, but also in all other industrialised countries. Sweden, for example, has the largest proportion of over 65 year-olds (of the total population) at 17.5%, followed by Italy with 16.8%, Belgium with 16.0% and the United Kingdom and Germany with 15.7% each. Spain, France and Austria too are above the 15% threshold. In the coming years, this age ratio will rise in all countries – in some cases drastically. By the year 2020, every one in five inhabitants in Europe will be 65 years of age and over.

In parallel to the ageing of the population, the typical (German) house-building family, the married couple with two small children, as traditional target group of the Bausparkassen, is increasingly becoming a dying breed. The proportion of single-person households has risen considerably in recent years. The birth rate is extremely low.

### The Impact on Financial Services

Not least as a consequence of this clearly emerging demographic trend, the financial

services market – as for that matter the markets in other economic sectors too – is fighting considerably harder. The keener competition, as a result of the market entry of foreign institutions (eg Citibank or ING Bank), so-called “near banks” and direct banking, has certainly also contributed to this.

Greater market transparency and growing customer demands have led to an increasing forfeiture of margin and commission and to rising pressure to rationalise in the credit industry, which has also not left the Bausparkassen unscathed. Competition compels ever larger units in order to be able to cut costs and to hold one’s own in international competition. Cooperation agreements, mergers and amalgamations are the consequence. The number of savings banks has fallen in recent years from over 700 to under 500 now, the cooperative institutions have nearly halved in number from nearly two and a half thousand to 1,300. The number of Bausparkassen has fallen from 34 in 1998 to 26 institutions today.

In addition to this, the formerly clear frontiers between bank and insurance products are becoming increasingly blurred. Whereas hitherto the focus was on the opening up of new sales channels, in recent years especially – not least with a view to private pension provision – competition has erupted on the product side. This has led to new financial groups coming into existence. In view of the order of magnitude of these financial conglomerates, some of which have already reached the international sector, there is still quite some pent-up demand on the German market. This field will play a key role in the significance of property assets and housing finance.

The Bausparkassen are therefore not only in competition with one another, but increasingly also in competition with other suppliers of construction financing and pension products and notably other finance distribution organisations (eg assurance

companies, banks and state savings banks). In the meantime, the inclusion of all Bausparkassen in groups or networks has been the consequence.<sup>3</sup>

According to the findings of the Deutsche Bundesbank,<sup>4</sup> efficiency gains through the exploitation of advantages of scale and networks have increased the “risk-bearing capacity of the financial conglomerates”. For example, in this way, cross-selling activities have contributed to the income position of Bausparkassen which are incorporated in such financial conglomerates being better in the past seven years than in the other Bausparkassen. On the other hand, there are also examples of efficiency gains through synergy effects not occurring, or not to the extent hoped for. Hence changes of strategy are to be observed in the credit industry too: participating interests held by banks in insurance undertakings are sold and instead contractual cooperation agreements entered into. Moreover, the greater readiness of customers to change their behaviour, increasingly observed for some time, has resulted in “one-stop shop” concepts being reconsidered and a reversion to the “core competence” being brought to bear.

Furthermore, not least, cost considerations have resulted in outsourcing certain processes from the actual field of activity of the Bausparkassen, ie the withdrawal of business processes, such as the establishment of so-called “credit works”, which can deal with large numbers of loans using standardised procedures – not only for their own customers. Also in the field of data processing, the development of new IT systems, purchasing or in building management, specialists are taking on the work for them.

### New Markets for Bausparkassen

The opening up of new markets abroad has also contributed to the further growth and

<sup>2</sup> Reports and statistics released by the Statistische Bundesamt and Bundesamt für Raumwesen und Raumordnung.

<sup>3</sup> For example this is the case of the Wüstenrot Bausparkasse AG which is a subsidiary of the Wüstenrot & Württembergische Group.

<sup>4</sup> German Bundesbank, monthly report, Nr. 4/2005.

success of the Bausparkassen. Whereas before the fall of the iron curtain, German Bausparkassen committed themselves and offered building loan contracts or housing finance mainly in the Western European neighbouring States – especially in the border areas with Belgium, the Netherlands, Luxembourg and France – they expanded their business activities after 1990 to Central and Eastern Europe.

Already before German reunification, saving for home ownership was introduced in 1990 in what was still the former GDR. The introduction met with an extremely large response among citizens and as a whole can be considered an extraordinary success.<sup>5</sup> This rapid success was primarily attributable to the fact that institutions established for many years in West Germany could transfer their distribution system to East Germany at very short notice. In this way, a comprehensive supply of building loan contracts was provided very rapidly. The financial services of the Bausparkassen not least contributed to new housing construction activity in East Germany, which had come almost entirely to a standstill after the period from 1990 to 1992, being cranked up very quickly and on a quite considerable scale. Other groups of institutions made housing finance loans available only very hesitantly, because from their point of view, the corresponding collateral provided by borrowers was insufficient or because they were not interested in smaller scale financing, especially for modernisation and renovation work.

Two years later, in 1992, saving for home ownership was introduced in Slovakia according to the German model. Two Bausparkassen were set up under joint venture agreements, which so far have been operating very successfully on the market.

In 1993 followed the introduction of saving for home ownership in the Czech Republic.

Here too, the German institutions work in joint ventures with domestic institutions. Saving for home ownership has rapidly become established as a very popular saving and financing instrument. Two in every three Czechs today have a building loan contract.

In Hungary too, saving for home ownership has become an essential component of housing finance since 1997. Two institutions are currently working there.

In Croatia, and recently in Romania too, building loan contracts, according to the German model and with German participation, have been offered to the institutions. Bausparkassen are even active and extremely successful in China and India. At present, investigations are being carried out in Bulgaria and Kazakhstan to see whether these States offer potential to be able to establish saving for home ownership there too.

In New Zealand, the introduction of a so-called “Kiwi Saver” system is planned, which closely resembles the building for home ownership system: firstly own capital must be saved before a loan is received. A State premium is given as an incentive to saving. In contrast to the German (collective) system, corresponding contracts can be concluded here with all credit institutions; this is therefore an open saving for home ownership system, similar to that existing in France.

It is of great importance in the countries mentioned that saving for home ownership increases the chance to acquire ownership especially for lower and middle income groups and offers an opportunity to finance the constantly growing demand for housing and housing modernisation.

### The Changing Role of Bausparkassen

Globalisation has caused very rapid acceleration of the direct networking of the various national capital markets into a single capital market. Monetary policy is scarcely controlled at all any more by the individual central banks, but is under the pressure of worldwide “vagabonding” of capital flows which, thanks to the electronic media, can be moved round in fractions of a second to make extra profit. The massive stock market boom with the ensuing heavy crash at the turn of the millennium was only one indicator of this trend, which ultimately has also led to the capital market interest rate currently reaching record lows – and not only in Germany – because large volumes of capital are in search of investment opportunities.<sup>6</sup>

The Bausparkassen, with their traditionally low, but agreement-tied, interest on loans, are particularly hard hit. Whereas 5% interest on loans was still unbeatably favourable up to the mid-1990s, because the long-term interest on capital market mortgages stood at 8.5%, mortgage rates today, even with a fixed period of several years, at about 4%, are not even half the previous level and are hence below those offered by the Bausparkassen.

The saving for home ownership institutions have taken account of this for some time by offering new rates with essentially lower interest on loans which have been lowered as far as 2%. In addition, nearly all institutions today offer a variety of rates or rate variants so that the customer can choose from a whole range of products. In some cases, the possibility even exists for members, even after concluding the contract, to make changes subsequently to the rate conditions if how they are going to use the loan changes. The rates on building for home ownership loans therefore offer a high degree of flexibility and variety today

<sup>5</sup> Success is measured in the achieved new business.

<sup>6</sup> A further reason is the nearly infinite pool of cheap labour in China that has pushed down prices of many goods world-wide, thus easing inflationary pressures in developed countries. This development allowed central banks to keep inflation rates low. The return on capital increased. The result has been a misallocation of capital, most obviously displayed at present in the shape of excessive mortgage borrowing and housing investment.

which allow a tailor-made product for the customer. With the extensive offer of different interest rates and different length saving and redemption periods, the modern building loan contracts offer optimum possibilities also to combine them with other property finance modules, such as bank and mortgage loans.

In contrast to many other suppliers on the property finance market in Germany, which provide for minimum limits for the granting of mortgages at €50,000 or €100,000, the Bausparkassen are specialists in the "micro" field. This will be to their advantage in the coming years if building new housing should play an increasingly less important role in housing finance as a whole. Demand will come increasingly from income groups, and especially too from smaller households,

which cannot or do not wish to afford expensive properties because, for example, they (will) inherit a property. These target groups will focus on existing properties or carry out modernisation and renovation measures in the housing stock. In view of the age structure of the German housing stock, with an average age of nearly 50 years, and in view of a relatively high proportion of dwellings which were built in the 1950s and 1960s with very basic equipment, there is a huge demand for conversion and renovation. Bausparkassen should be the first choice precisely for such measures with a need for financing of between €20,000 and €50,000.

The property bubbles currently appearing in a whole series of countries, such as Spain, the United Kingdom and the USA, as a

consequence of speculative sharp price rises could, should they burst, have serious consequences for both the property owners and the financing institutions. In most of these countries, the proportion of equity capital is infinitely small so falling prices lead very rapidly to forced sales because the risk buffer in the form of appropriate equity capitalisation is lacking. Such a development, as in the meantime is also viewed very critically by international organisations, such as the Bank for International Settlements or the OECD, could considerably boost as well the international position of the Bausparkassen and their products based on the formation of equity capital.