

Contract savings systems for house purchase

Although these systems enjoy tax advantages, they cannot be seen as the complete answer to housing finance problems

FUNDS for house purchase loans can be obtained either from retail deposits or from the capital markets. The retail deposit market can be further subdivided. Most housing finance institutions, such as building societies, savings associations and savings banks, obtain their funds through retail deposits on the open market. Housing finance has to compete for the funds raised in this way with other demands for funds.

The contract savings system is a special type of deposit-taking activity for housing finance. The basic principle is that the individual enters into a contract whereby he saves a set amount for a period of time after which he becomes entitled to a loan.

'Government bonus attractive'

Both the savings and the loan are at below market rates of interest, and the amount of loan is generally fixed in a mathematical relationship to the amount of the deposit.

A major feature of contract savings schemes is a government bonus or tax relief on the savings. Arguably, it is this that makes the schemes particularly attractive to the individual.

Contract savings schemes are best suited to countries where people buy homes relatively late in life, rather than to countries like the United King-

dom where most households purchase their first home before their late twenties.

Because the contract system is based on anticipatory savings it can never provide more than a proportion of the funds which the house buyer requires, generally no more than 40% and often less than this. It is therefore necessary for the contract system to be combined with one of the other systems of providing housing finance.

Generally, contract savings systems are part of packages put together by financial institutions. Sometimes a number of institutions might be involved and in other cases a single institution provides several loans, the entire package of which is the most efficient for the particular individual.

Only three industrialised countries make extensive use of the contract system. In Austria the system is operated by four *bausparkassen*, each of which is connected with one of the large banking groups (the work of the Austrian *bausparkassen* was featured in the first issue of *Housing Finance International*).

West Germany

West Germany is the home of the contract savings system, and it is a major feature of the housing finance system in that country. The *bausparkassen* account for 18% of the amount of outstanding loans. They have a hand in the financing of a much higher proportion of dwellings.

Under the *bausparkassen* system the saver may contract for any

amount and he agrees to pay a certain subscription each year, generally 5% of the contract sum. He can elect to receive interest at the rate of 2.5% or 4.5% a year. The interest paid by the *bausparkassen* is tax free up to a certain limit and a government savings bonus of 14% (plus an additional 2% for each child under 18) of the amount saved each year is paid up to a maximum of DM800 (DM1,600 for a married couple). The bonus is tax free.

'Combination of systems'

The bonus is available only to families with incomes below a certain level. Those with incomes above the limits can still participate in the contract system by claiming tax deductions rather than a bonus.

Once the saver has deposited a minimum of 40% or 50% of the contractual sum he is entitled to the entire contractual amount. However, there may be a delay before the funds are available. The *bausparkasse* loan carries a rate of interest of 4.5% (if the 2.5% savings rate was selected) or 5.75% (if the 4.5% savings rate was selected). It is normally repaid over 10 or 12 years.

There are 18 private *bausparkassen* accounting for over two thirds of the assets of all *bausparkassen*. They have varied ownership patterns. The

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largest is the Schwäbisch Hall which is featured in a subsequent article. This is part of the co-operative bank network, and much of its business is obtained from individual credit co-operatives. A Schwäbisch Hall Bausparkasse contract would often be combined with a long-term loan from the mortgage bank subsidiary of the DG Bank (the central bank for the co-operative bank system), and a short-term loan, to be repaid when the contract loan has become available, from the individual credit co-operative.

Of a similar size to the Schwäbisch Hall is the Beamtenheim-Stattenwerk (BHW) which is owned by the trades unions. The third largest private bausparkasse is a privately owned one, the Wustenrot, part of a much wider financial grouping.

There are 16 Landesbausparkassen which are part of the regional savings bank systems which operate in each state. The largest of these bausparkassen, and the fourth largest of all, is the Landesbausparkasse Munster/Dusseldorf, which is part of the Westdeutsche Landesbank Girozentrale group.

France

In France the contract system is similar in structure to that in West Germany, but operates under a quite different institutional framework. Instead of specialist institutions providing the contractual savings scheme and working in conjunction with other providers of housing finance, it is open to any financial institution to operate a state sponsored scheme. There are therefore no specialist institutions operating the contract system at all, but rather it is available from a variety of banks and other financial institutions.

The market leader in the contract savings system is the Crédit Agricole, the network of agricultural co-operative banks. The role of the Crédit Agricole in the French housing finance system is described in detail in a subsequent article.

Other countries

A number of other countries have limited contract savings schemes and

the system is being experimented with in several developing countries. The North African countries, in particular Tunisia, have contract schemes which are similar to that in France, and of the South American countries Chile has recently introduced such a scheme. In India, under the influence of the West German bausparkassen, the Housing Development Finance Corporation has recently introduced a contract scheme, although as yet it is very small.

Conclusions

It is clear that contract savings systems can provide only a comparatively small part of the funds which a house purchaser requires, and therefore cannot be seen as the answer to a country's housing finance problem, in particular a developing country. In industrialised countries much of the advantage of contract systems seems to lie in tax advantages. In developing countries a more important advantage is probably the introduction of the concept of thrift to potential borrowers who may not be familiar with financial institutions or even the concept of interest. ■

Bausparkassen, Assets and Liabilities, End-1985

Liabilities	DM m	%	Assets	DM m	%
Deposits from non-banks			Building loans	145,875	91
under savings contracts	120,698	75	Other lending to		
Other deposits from non-banks	4,673	3	non-banks	716	—
Deposits & borrowing from banks	18,926	12	Lending to banks	11,995	7
Provisions	2,583	2	Other assets	2,398	1
Capital	7,344	5			
Other liabilities	6,760	4			
Total	160,984	110	Total	160,984	100

Source: *Statistische Beihefte zu den Monatsberichten der Deutschen Bundesbank*, Reihe 1, February 1986, Table 11.

Note: At end-1985 there were 2.51 marks to the dollar.

Bausparkassen Activity, 1975-85

Year	Net Increase in Contracts 000	Contracts Outstanding 000	Savings Paid in Dm m	Building Loans made DM m	Total Assets Dm m
1975	1,121	16,097	20,241	19,298	86,952
1976	1,241	17,338	22,070	21,404	94,906
1977	1,267	18,605	23,678	23,356	102,153
1978	1,285	19,890	25,707	25,903	111,223
1979	1,297	21,187	27,863	30,990	121,932
1980	1,477	22,664	27,437	31,220	132,501
1981	838	23,502	27,134	31,744	142,979
1982	310	23,812	27,610	20,756	149,655
1983	247	24,059	27,278	19,464	155,392
1984	234	24,293	24,585	20,560	160,937
1985	267	24,560	23,481	19,508	160,984

Source: "Recent Developments in Building and Loan Association Business", *Monthly Report of the Deutsche Bundesbank*, April 1983; 1983-1985 figures are from *Monthly Report of Deutsche Bundesbank* February 1986, Table 21. (There is a discontinuity in the series in 1982.)