

# German Bausparkassen: Instrument for Creating Homeownership in the Transformation Countries

by Carl Gottfried Rischke

The reforms introduced in the transformation states of eastern Europe are aimed at creating market-based structures, although the starting conditions and the measures hitherto taken are at some considerable variance from one reform state to another. The role Germany's Bausparkassen have played in this transformation process can be seen after the change of system in the wake of reunification, i.e., after the economic and the legal systems of the former Federal Republic of Germany (former West Germany) had been installed in eastern Germany (the former German Democratic Republic).

This has permitted us to develop a generally valid opinion about the appropriateness of the German Bausparkasse-system for creating a loan-saving collective, independent from the capital market, in the transformation process.

The following text discusses briefly the basic features of the system of German Baus-

parkassen, its position in the German homeownership financing market, the system applied in the former German Democratic Republic, the achievements made in barely 10 years from the date of reunification and the question whether this model would lend itself to being adopted by other transformation countries.

## THE GERMAN BAUSPARKASSE SYSTEM

The German system of Bausparkassen is a comprehensive instrument for financing homeownership. Its conceptual idea is that of a loan-savings collective, independent from the capital market, to pool the savings individuals pay into the system for the purpose of obtaining loans for the purpose of homeownership acquisition.

The level of the interest payable under this collective system, which cannot be changed during the lifetime of any one loan contract, is fixed unrelated to the capital market and is laid down in the general conditions of contract of the Bausparkassen. The date of allotment, the amount and the lifetime of any one loan depend on the length of the saving phase and the amount of money saved, which may not be less than 40% to 50% of the contractually agreed loan amount. The

legislative bodies and the banking regulators demonstrate through an extensive regulatory framework that they attach great importance to the ability of the German Bausparkassen to meet their financial obligations at any time.

This system gives consumers the confidence that regular small-scale savings will permit them to accumulate "own funds" amounting to at least 15% of the investment necessary, as a rule, for buying a flat or house (although it has turned out in practice that the own-funds Bausparkasse customers are able to contribute closer to 30%).

The amount of own funds a prospective homeowner must be able to put up depends on the total costs of the desired housing project and on how much he can afford to pay in relation to the level of his income. Security senior in rank (i.e., first mortgage) is not necessary because the Bausparkassen are typically satisfied with security junior in rank.

Where the amount of savings accumulated under this collective system or the saving period is not long enough for allotment at a specific moment, the respective Bausparkasse or other credit institutions may grant bridging credit, though this interest rate depends on the capital market rate. Combin-

Carl Gottfried Rischke is Chairman of the Board of Directors of LBS Ostdeutsche Landesbausparkasse AG. The LBS is participating in a joint venture for the creation of a Bausparkasse in Poland.

ing bridging money with Bausparkasse loans makes it possible to design financing packages whose credit costs do not change throughout the lifetime of the loan, often 22 years or more.<sup>1</sup>

Bausparkasse funds may be used for buying land as well as owner-occupied houses and flats, and they may also be used for modernizing residential buildings or for debt rescheduling purposes. No saver is obligated to take up the loan for which he has saved.

#### Savings Phase Crucial

Banks in Germany generally do not like the idea of financing homeownership acquisition before a Bausparkasse customer has successfully gone through the whole saving phase provided for by the terms of his contract with a Bausparkasse. Accumulation of the necessary own funds is deemed to represent proof to the effect that the saver is willing and able to bear financial burdens.

The financial risks the Bausparkassen run in the field of homeownership financing is lower than average since they have the privilege of getting to know their customers during the multiple-year saving phase. Because of its long-term character and its base-product nature for cross-selling purposes, building-saving contracts have become strategic banking products that are rated higher than many a complementary financing method. That is why, for many years, all of the banking groups have had a Bausparkasse either as their subsidiary or as their co-operation partner.

The number of contracts concluded with the German Bausparkassen is in excess of 33 million, and the aggregated loan amount contractually agreed upon is over 1.2 trillion German marks. Thirty-seven percent of all German households hold at least one contract with a Bausparkasse. The Bausparkassen record an average share cur-

rently of 16% in the total amount of housing loans made annually of just under 300 billion German marks. The share of Bausparkasse funds in the aggregated total of individual borrowings for housing finance purposes amounted to 47%. From 1948 to 1996, the German Bausparkassen made available 1.1 trillion German marks for housing construction, thereby co-financing more than 12 million housing units.

#### Government Incentives

Because of the key position building-saving schemes enjoy particularly with the middle and the low-income brackets seeking to acquire homeownership, the government provides small incentives in order to stimulate individual resource accumulation. This support provides in a small way a beginning of private property formation on a larger scale and ultimately provision for old age.

Government subsidies to foster building-saving by husbands and wives amount to 200 German marks p.a. at the most, which is psychologically sufficient for getting the message across to Bausparkasse customers that saving is a worthwhile exercise.<sup>2</sup>

Public promotion of building-saving has a substantial effect on the trend in homeownership acquisition. Public subsidies trigger private savings several times larger than their own amount, thereby reducing people's dependence on public support for housing, while, on the other hand, the burden on public budgets stemming from money given in support of building-saving is marginal.

In many cases, moreover, this is also a way for vacating social housing units to the benefit of population groups depending on government for housing support. In Germany the proportion of subsidies in support of building-saving is not more than 3% of the total funds earmarked as public housing subsidies, or roughly 0.1% of total govern-

ment spending. The better part of the housing subsidies goes into new and on average well-furnished apartment block construction. This policy is partially responsible for a relatively high level of construction and real estate prices in Germany.

#### FORMER GERMAN DEMOCRATIC REPUBLIC HOUSING SYSTEM

In the former German Democratic Republic (GDR), socialist ideology was at the base of political decision-making of any kind after the Second World War. In line with this ideology, housing property was not treated as a freely tradable and profit-oriented commodity, but rather as a consumer item government was free to make available at will to the population. Housing was deemed an instrument of social-welfare policy, with economic necessities being deliberately neglected. Government had a legal right of disposal over the entire housing stock, regardless of the ownership situation.

Rents amounting to just 3% to 5% of tenants' average income were fixed in line with political considerations. Since the costs of maintenance and administration were significantly higher than the rents to be paid, the inevitably growing deficits had to be closed by public money. For lack of funds, the housing shortage kept growing and became a visible sign of the failure of the entire socialist system.

Only 23% of the flats were owner-occupied, a relatively low percentage. Having been continuously eroded in economic terms, building-saving was ultimately prohibited in 1956.

Some 16.7 million people lived in the former German Democratic Republic in about 6.9 million households. Children remained in their parents' households for a disproportionately long period of time, because they were unable to find accommodations of their own.

According to GDR statistics, the number of flats was 7 million, but at least 0.5 million of them were uninhabitable and therefore empty. In purely mathematical terms, this meant a housing deficit affecting approximately 0.4 million households. But actual needs were significantly higher because additional flats were needed not only for quantitative, but also for qualitative reasons.

#### TRANSFORMATION OF THE HOUSING INDUSTRY IN THE FORMER GDR

Upon transformation, the stock of government-owned flats was transferred to the cities and local communities on condition that they set up a decentralized market-based housing industry. This made it necessary for them to cope with two basic problems:

1. First, the amount of debt local communities "inherited" from the central government when they took over the rental accommodations transferred to them often exceeded the actual value of the housing stock. On the other hand, they were not permitted to cover costs by immediately raising rents.
2. It was urgent to invest in the modernization of flats and to make the repairs long overdue. In order to mobilize private capital and to inject liquid resources into municipal housing companies, these companies were encouraged to privatize 15% of the housing stock entrusted to them. By way of compensation, a portion of the debts they had inherited could be waived. The prime objective of this measure was to sell flats to their tenants and to give broad sections of the population access to property ownership.

Private sector-financed construction of apartment block buildings has made homeownership acquisition possible on a wider scale as well. Construction of new apartment block buildings began on a major scale

after it was clear that, after several decades of neglect under the old system, the demand for quality housing products was substantial.

The tax system and disproportionately large subsidies to construction of rental accommodations, although politically wrong in terms of individual property formation and counterproductive for giving preference to a particular tenure type, initially triggered construction of rental projects on an above-average scale. But, more recently the emphasis has been more strongly laid on individual housing construction.

#### Growth in Owner-occupied Homes

Prior discrimination against owner-occupied home construction in the former GDR and the fact that building sites are cheaper in eastern than in western Germany have added a new dimension to the construction of new single-family homes. It should also be noted that people's housing wishes are no longer at variance in the two parts of Germany.

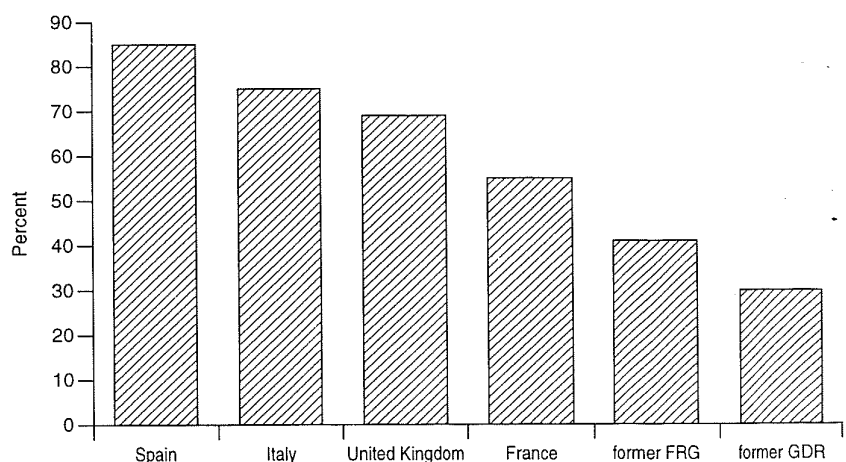
Homeownership acquisition attracting tax relief before 1996 is now eligible for public subsidies. The combined effect of all measures has undoubtedly been successful within a very brief period of time. Housing needs in eastern Germany have been fully met in quantitative terms, and the rate of housing ownership is up from 23% to 31% at present in eastern Germany, compared with 42% in western Germany (see Figure 1). The discrepancy has shortened considerably.

#### INTRODUCTION OF THE BAUSPARKASSE SYSTEM

Replacing the socialist economy of bottleneck and shortage management after reunification with market-based structures, initially resulted in increased consumption of goods previously on short supply in eastern Germany. The demand observed especially in fields such as foreign travel, cars, electronics, furnishings and furnishings, fashionable clothing and other products was enormous.

For a limited period of time this fact overshadowed people's desire for homeowner-

Figure 1. Owner Occupation Level 1998



ship; this did not show on any major scale until after it was clear that rents were on the increase and that individual property formation and the income situation of many was significantly better.

On the other hand, the levels of income and of own funds, lower on average in eastern compared with western Germany, placed tight limits on such wishes. Households in eastern and in western Germany had fairly different amounts of money at their disposal as a consequence of the divergent economic systems.

In 1991, private households in eastern Germany owned just 5% of Germany's total German financial resources, although about 20% of the population lived in eastern Germany. East German households owned less than one-third of the monetary assets owned by west German households. Similar discrepancies existed in the rates of housing ownership, which in 1991 was 23% in eastern and 42% in western Germany.

The conditions that existed for introducing building-saving in eastern Germany were apparently optimal. The west German legislation governing the activities of the Bausparkassen and the principles of government support to people willing to save for homeownership acquisition were installed in eastern Germany without modification.

Thus, west Germany's proven Bausparkasse-system was extended by including into it without adjustment the difficult new market in eastern Germany. To stimulate individual capital formation in eastern Germany and to create the prerequisites for increasing homeownership acquisition in the long term, additional support was made available to prospective homeowners in eastern Germany between 1990 and 1993.

This encompassed, in addition to the 10% flat premium, an extra premium of 5% and a bonus of 2% for every child under the age of

18. Singles were eligible for premiums of up to 400 German marks per annum, and husbands and wives for a maximum of 600 German marks per annum. Since the amounts of income of only a few individuals exceeded the limits governing eligibility for support, practically everybody in eastern Germany had the benefit of this extra premium.

#### Experience With Blended System

The German Bausparkassen commenced their operations in eastern Germany as early as 1990. Marketing the product of building-saving was relatively easy because a large part of the GDR population already knew the product, including the names of its most important suppliers, from western radio and television advertising before 1990. The product was deemed to be of great value. But more important, initially, was the stimulus from government-paid premiums that were regarded as a kind of quality mark.

This product was well accepted in eastern Germany. A total of 2.89 million building-saving contracts were concluded in the

years from 1990 to 1993, i.e., the period in which east German households benefited from the extra premium (see Figure 2).

In subsequent years, the annual growth in the number of new contracts slowed somewhat because incomes rose quickly and because household income levels exceeded the levels governing eligibility for extra premium payment. In 1996, income limits were raised. This strongly pushed the number of new contracts again. By 1998 the proportion of the population owning a Bauspar contract was nearly the same in the GDR as in the former West Germany (see Figure 3). This shows that the market responds to changes in the support framework (twice within six years) quickly and flexibly.

#### SHOULD OTHER TRANSFORMATION COUNTRIES ADOPT THE SYSTEM?

##### Housing and Social Welfare Policy Objectives

The situation of the housing industry in the other member states of the former socialist

Figure 2. Sale of Bauspar Contracts in the Territory of the Former GDR

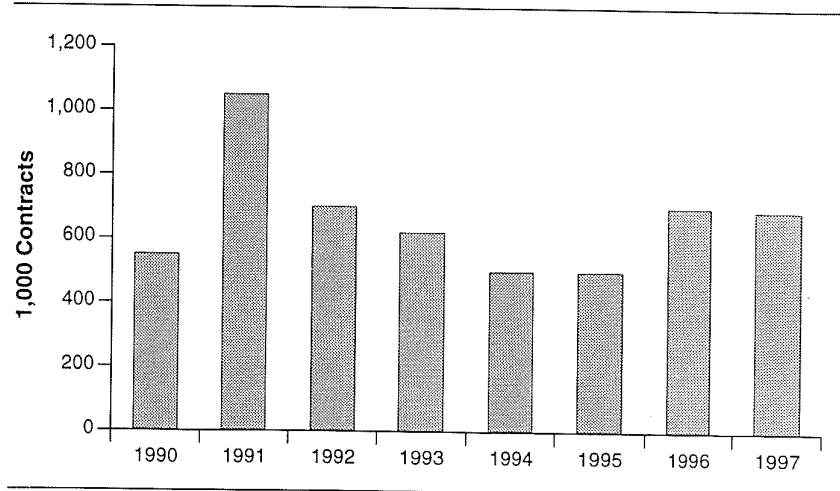
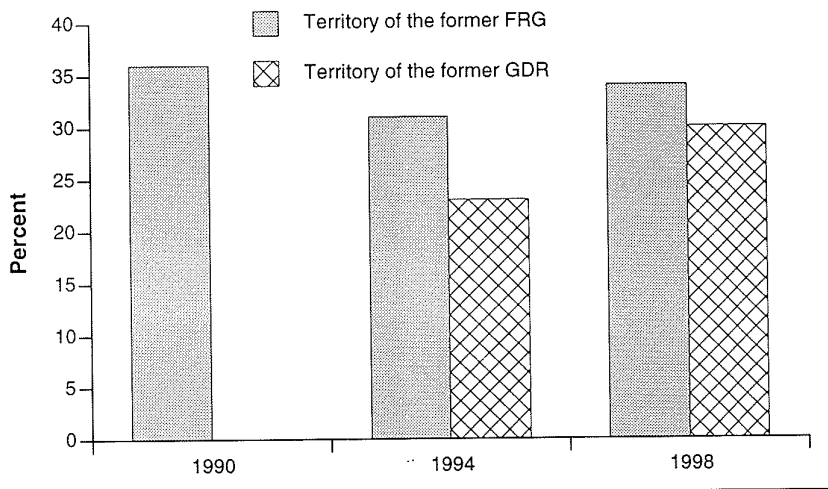


Figure 3. Ownership of Bauspar Contracts (population 14 years and older)



camp was fairly similar to that of the former GDR's housing industry. The better part of the rental accommodation sector was owned by government, which had the right to decide about tenancies and strongly subsidized rentals. Housing space was in short supply, and the structural condition of the existing stock was poor.

Housing policy developments in the transformation countries show significant differences. Identifying problem solutions that take account of social as well as economic requirements presupposes consistent policymaking and stable conditions. The success of any building-saving concept depends on whether government deems homeownership acquisition by many a priority goal. Where this is the case, there are good chances for a successful implementation of a housing policy whose framework conditions are predictable also in the long term.

#### Legal and Economic Prerequisites

Setting up a Bausparkasse presupposes the existence of a legal basis regulating the position and the functions of the institution as part of the banking system; formulation of the security requirements for bank deposits; and installing an independent supervisory body for monitoring compliance with contractual obligations and for ensuring proper operations.

The system's special characteristic of being a loan-saving collective independent from the capital market makes it necessary to ensure its functioning ability in different market situations and in spite of fluctuations in the number of new contracts.

The country's legal system must permit private ownership, and real estate must be freely tradable regardless of the form of ownership. The law must permit securing Bausparkasse lendings against the real estate to be financed by these lendings.

Banks must be enabled to enforce their claims against debtors who are unwilling or unable to pay.

Any building-saving system requires an economic environment stable in the long term and with positive development prospects. This applies especially to monetary stability and to income development, since high inflation rates and/or insecure development prospects may deprive savers of an important part of the success they seek to achieve in exchange for foregoing consumption.

#### Extent and Importance of Public Support

Government support primarily addressed to the lower and middle-income brackets is essential to stimulate long-term saving and private capital formation. What is important is not so much the level of public support, but the psychological effect it exerts on the willingness of individuals to save.

Government supports building-saving to make it clear that property formation by large sections of the population is one of its most important policy goals. The point is to make lasting and predictable regulations allowing individuals to lay claim to the benefits of the system provided that the pertinent legal criteria have been satisfied. The framework conditions for taxation are to be adjusted to meet these goals.

Compared with other housing promotion programs, the burden on public budgets stemming from building-saving incentives is small. Apart from this, such incentives requiring individuals to save generate strong multiplier effects. By adopting appropriate income limits governing eligibility for promotion, the need to pay such incentive money can be confined to a calculable number of beneficiaries. Furthermore, undesired effects can be avoided by tying savings for a

specific period of time—currently seven years in Germany—to investment in homeownership.<sup>3</sup>

In the long term, every household willing to put money into a Bausparkasse for the purpose of homeownership acquisition represents a fiscal policy asset. The support for self-help government grants on a short-term basis reduces the need to make social-welfare payments at a later date. Rent-free housing in debt-free property is an essential contribution to developing and supplementing social-welfare systems, if only from the aspect of providing for old age.

Especially in the transformation countries where people are not used to market-economy traditions and to the very basis on which these traditions rest, i.e., private ownership, it is absolutely necessary to support individual property formation by many.

Owning and/or acquiring property individually is the material basis of freedom and self-determination. Acceptability of the new social conditions depends on whether individuals will be permitted to have a fair share in the new opportunities and possibilities themselves. Developing a sense of individual responsibility and initiative that promises success makes it necessary to show that goals are within reach. In relation to the social benefit that stems from individual property formation, the financial outlays in its support may be deemed negligible.

#### EXPERIENCES OF EAST EUROPEAN COUNTRIES

Various German Bausparkassen acting as business partners in the set-up of new organizations have introduced the building-saving concept in Slovakia (1992), the Czech Republic (1993) and Hungary (1997). A building-saving law adopted in Poland in

1997 has permitted the first companies to establish themselves and to apply for the necessary permissions, although they have not yet commenced operations.

Experience to-date suggests that the building-saving system has been accepted extremely well right from the beginning. The population's willingness to save and eagerness to invest in homeownership are strong. In the first business year, 2% to 3% of the population of the first three countries mentioned above have entered into a contract with a Bausparkasse. In the meantime, almost a fifth of the population is contributing to the system in the Czech Republic and in Slovakia. Furthermore, the first bridging and building-saving loans have been granted in these two countries.

#### Adopted Frameworks Vary Widely

The above-mentioned countries have adopted laws regulating the activities of their Bausparkassen and public incentives to building-saving. But the regulatory framework and the provisions governing support vary widely from one country to another. The knowledge some countries (Poland) have gathered about methods for making collective systems secure has not yet been translated into all regulations.

It is not yet possible to judge the effect this has on the level of construction activity and on the ratio of individual homeownership because the saving phase has not yet been concluded for most of the contracts with a Bausparkasse. However, it can already be seen that significant volumes of support funds are being made available to a growing number of Bausparkasse customers.

A strong multiplier effect means that large amounts are available for investment in housing ownership, and substantial progress is within reach as to the politically

desirable property formation by individuals. In as much as people in the transformation countries take advantage of government support in order to meet their own housing requirements in the medium and long terms, government is relieved of its obligation to make available heavily subsidized rental accommodation.

#### CONCLUSIONS

The system of Bausparkassen has stood the test in Germany for many decades and has proved to be a reliable financing instrument, helping especially people of the lower and middle-income brackets in homeownership acquisition. These income groups need more time for accumulating the own funds they require for investment in this field, and low-cost loans are necessary for them so that they can meet their obligations to pay interest and amortize the loans they have obtained.

Building-saving promotion makes it easier for people to forego consumption in exchange for the expectation of homeownership in the longer term. The fact that this makes sense has been convincingly confirmed by the transformation process involving the former German Democratic Republic.

The economic situation in the transformation countries cannot be improved solely by foreign capital and know-how. Economic and social development crucially depend on the actions enabling people to develop a sense of responsibility and show individual performance in the interest of improving their own material and social position. Homeownership acquisition is useful not only for individuals; it also stabilizes the demand for construction products, improves the housing situation and relieves the social-welfare systems.

### Building-saving Special Advantages

The special advantage of building-saving over other forms of support to housing property formation, such as subsidizing owner-occupied flat construction/purchasing, permitting debt interest to be deducted from individual income tax bills or reducing real wealth taxation rates, is found in the approach that lowers hurdles in the beginning stages of homeownership acquisition.

The lack of own funds is the main barrier preventing many households from acquiring homeownership. This lack also prevents them from taking advantage of the other financial incentives (subsidies and taxes) attached to homeownership acquisition.

The larger an investor's own funds, the smaller his borrowed-capital requirements and his credit cost burden; these are of great importance with regard to the often wide discrepancies between income and price levels. Beneficial side effects of saving are shopping discipline over a long period of time and reliability as regards interest and amortization payments at a later date.

The specific characteristics of the German system of Bausparkassen and the requirements of the process of transformation in a number of countries can be combined in an optimal way in the interest of homeownership acquisition and of housing supply to large groups of the population.

### NOTES

<sup>1</sup> There are two ways of combining bridge loans with Bausparkasse loans: The first way is to replace the higher rate bridge loan by the lower rate Bausparkasse loan (from the date of allotment). The second way is a special product offered by most of the Bausparkassen which consists of a real combination of both loan types. The bridge loan can sooner be replaced by a Bausparkasse loan because an additional pre-financing loan is used as a starting fund to accelerate the saving phase for an earlier allotment. Based on a mixed calculation (of saving rates, interests and redemption rates), the monthly rate of this loan product is constant through the term of the contract (offered alternatively for 15, 20 or 25 years) which makes it advantageous in the current low-interest period.

<sup>2</sup> The premium of 10% is granted on Bausparkassen savings up to 2,000 German marks p.a. for married persons (up to 1,000 for single persons) within legally fixed income limits; i.e., the individual maximum of the subsidy is 200 German marks p.a. for couples and 100 German marks for singles. In 1997 the average size of the subsidies in eastern Germany (customer statistics of LBS) was 93 German marks; the figures in western Germany are estimated to be higher.

<sup>3</sup> The subsidy on Bauspar savings (10% premium, as explained above) is granted under two alternative provisions. The customer has to keep his or her savings for at least seven years to get the premium. After that the fund can be used by choice without any qualification. Within those seven years the fund may only be used for proven housing expenditures (such as new construction, home purchase, modernizing and repairing construction). The use of funds for any other purposes within this period means renunciation of all annual premiums.