

Homeownership: A Solution for Providing Financial Security for Old Age

by Andreas Zehnder

Not only in Germany, but in virtually all other European states, further shifts in the age structure are foreseeable in the coming years. These will lead to a conflict in the so-called "generation contract," according to which young people in working life pay the pensions for older ones who have retired.

The number of 65-year-olds and older rose in Germany by 12% or 1.4 million to 13.5 million in the '90s alone. Their percentage of the total population has increased from 14.9% to 15.7%. By contrast, the number of young persons (up to 21 years of age) rose by only 0.5% or 100,000 to 18.5 million in the same period.

This uneven development will intensify in the coming years. At the same time, German citizens will live longer and will, therefore, spend an increasingly longer time as pensioners. The percentage of over 80-year-olds in the total population has increased eight-fold since the beginning of this century, from 0.5% to a current level of 3.9%. It is expected to more than double again by the year 2040.

The situation is even more extreme in other European countries. At 17.5%, Sweden has the greatest number of over-65s, followed by Italy with 16.8%, Belgium with 16.0% and the

United Kingdom with 15.7%. The Netherlands with 13.3%, and France and Austria each with 15.2% are to be found at the other end of the scale. At 12.6%, this figure is currently much lower in the United States.

In the coming years this so-called old-age ratio will increase in all countries—drastically in some of them. By the year 2020 every fifth inhabitant in Europe will be 65 years of age or older. The highest percentage will then be found in Italy with 22.7% and Germany with 20.9%, although Sweden (20.8%), Belgium (20.7%) and France (20.5%) will be only slightly behind (see Table 1).

The life expectancy (see Table 2) has also increased in all countries over the past 46 years, in some cases by 10 years and more. This means the time in which pensioners are dependent on a pension is becoming longer and longer in all European countries; the clear differences among nations which used to exist have now been virtually wiped out.

While the male life expectancy in 1950 in the European countries in question here ranged from between 59.8 years (Spain) and 70.6 years (Netherlands), i.e., differing by more than 10 years, there was by 1996 only

Table 1. Ratio of Elderly People to Total Population in Europe

Country	Projected change in ratio of those over 65 to the total population in percent	
	1996	2020
Sweden	17.5	20.8
Italy	16.8	22.7
Belgium	16.0	20.7
Germany	15.7	20.9
United Kingdom	15.7	19.3
Spain	15.4	19.6
France	15.2	20.5
Austria	15.2	18.9
Netherlands	13.3	19.3

Source: Statistical Office of the European Union; own calculations

Andreas Zehnder is with the German Association for Private Bausparkassen.

Table 2. Life Expectancy of Newborns in Europe (expressed in years)

Country	Males		Females	
	1950	1996	1950	1996
Sweden	68.1	76.5	70.6	81.5
Italy	63.7	74.9	67.2	81.3
Belgium	62.0	73.5	67.3	80.2
Germany	64.6	73.3	68.5	79.7
United Kingdom	66.2	74.7	71.2	79.3
Spain	59.8	74.4	64.3	81.6
France	62.9	74.0	68.5	81.9
Austria	61.9	73.9	67.0	80.2
Netherlands	70.6	74.7	72.9	80.3

Source: Federal Statistical Office

around three years difference between 73.3 years (Germany) and 76.5 years (Sweden).

The same applies to the female life expectancy, although the figures are generally higher (four years in 1950 and six years in 1996) than for males.

During the same period in the U.S., the average male life expectancy increased from 65.7 to 72.7 years and the female life expectancy from 71.3 to 79.4 years.

Whereas in 1950 the average life expectancy of newborn males was sometimes below the pensionable age of 65, it is now already 10 years above it in the majority of countries.

CHANGE IN THE 'CONTRACT' MUST COME

As a result, those working now should not, or not exclusively, rely on the state system in the form of "generation contract" between old and young for their old age financial security.

In the future the individual must make his own provisions to a far greater extent than

has been the case up to now. Each individual must decide for himself how he wishes to supplement his state pension by making his own provisions.

The three pillars on which one can rest one's old age provisions are legal (state) pension, a possible company pension and one's own financial precautions via savings plans, endowment insurance and above all homeownership.

Whoever lives in his own house saves rent and will usually have a substantial additional income which can be used for other (consumption) expenditure. This aspect is of great importance first and foremost in countries in which the state old age pension plays only a subordinate role and timely private provisions are paramount.

It is not, therefore, surprising that the homeownership ratio in the U.S. of 65% is relatively high because the citizens there are primarily responsible for making their own provisions for the time after retiring from working life. Structural problems resulting from an increase in the ratio of old people to the total population and the associated prob-

lems for the working population of supporting pensioners do not as greatly affect individuals in these countries.

Relative Growth in Value of Differing Assets

However, in those countries in which the state pension system has so far been a central component of old age provision, the age development of the population and above all the relationship between the "active" and "passive" population has played an increasingly larger role in recent years. The social benefits now already exceed the financial strength of the working population by far.

A scientific study of different investment forms and their development in value over the past 25 years in Germany provides the following picture for the period 1970 to 1995: At 8.5%, the by far highest annual yield is produced by one's own home, calculated from rise in value and imputed rent. This is followed by shares (8.1%) and fixed-interest securities (7.8%). An investment in gold produced an average yield of only 5.9%. Savings books and savings deposits brought up the rear at 4.5%.

An original investment in a home of DM 100,000 would have generated DM 769,000 in 25 years. The savings deposit would have produced an end sum of only DM 315,000, i.e., less than half (see Table 3).

By comparison with living in tenant housing, homeownership has the decisive advantage that rent-free housing during old age is a "second pension," thus substantially relieving the household budget. The rental value (saved expenditure on rent) for pensioners living within their own house in West Germany is currently DM 840. Assuming a total income of DM 2,100, these households can increase their income by 40% to DM 2,940.

Table 3. Value of Comparative Asset for Retirement

Investment form	Value development from 1970 to 1995	
	Percent per year	in DM (1970=100,000)
Own home	8.5	769,000
Shares	8.1	701,000
Fixed-interest securities	7.8	654,000
Gold	5.9	419,000
Savings deposits	4.5	315,000

Source: Gewos-Institut für Stadt-, Regional- und Wohnforschung

In Eastern Germany the rental value of one's own home of just under DM 470 is not quite as high. Accordingly, the share of 15.1% of total income of DM 2,940 is also considerably lower. Nevertheless, rent-free living still represents an income rise of almost one fifth.

Homeownership: A Key to Retirement Living

These figures document the great significance of one's own home for the retirement period. Citizens are increasingly recognizing the significance of homeownership. According to the latest survey published, security in old age is cited by home buyers as the main reason for purchasing in Germany, even more important than the arguments of no longer wishing to pay rent and wishing to be "one's own boss."

At the start of the '90s provisions for old age took third place behind these other two reasons. While this turn-about in purchasing reasons is pleasing, there is still much catching up to be done on the German home purchasing front.

Whereas the homeownership ratio, i.e., the percentage of households living in their own

homes, was 40% in West Germany in 1950, it dropped down as far as 34% as a result of the extensive new tenant housing construction in the '50s and '60s, and only increased noticeably to 42% in the '80s and '90s.

By international comparison, this is still an extremely low figure. In Eastern Germany the ratio has now risen from 25% in 1990 to a current 31%. This produces a ratio of 39% for Germany as a whole. At 31%, only Switzerland has a lower ratio (see Table 4).

Table 4. Homeownership Ratios in Europe

Country	Percent*
Spain	85
Italy	75
Belgium	70
United Kingdom	68
Sweden	61
Austria	55
France	54
Netherlands	48
Germany	40

By comparison:

Canada	63
U.S.	65

* Last available figures

Even if the countries with an agricultural structure with a traditionally high level of homeownership are ignored, and the Federal Republic of Germany is compared with other industrial countries, Germany is still last: Belgium with 70%, the United Kingdom with 68%, Austria with 55%, France with 54% and the Netherlands with 48% all have considerably higher levels.

The steep rise in new tenant housing construction in the first half of the '90s as a result

of greatly extended government subsidies was the main reason for the homeownership ratio dropping in West Germany again. An upswing has only been recognizable since the new own-home subsidy came into operation on January 1, 1996.

The share of new owner-occupied homes in West Germany thus dropped continuously from around 58% at the end of the '80s to 50.8% in 1990, 40.5% in 1992 and 38.3% in 1995.

Only after this did the ratio increase again to 42.2% in 1997. In Eastern Germany too, the increase in tenant housing construction caused the share of homeownership to drop from 60% in 1993 to 37.1% in 1997.

RATIO IMPROVEMENT DIFFICULT TO ACHIEVE

Since the homeownership ratio is measured in relationship to the housing stock, changes can be achieved only very slowly through new housing construction alone.

The politically aspired-to increase in the homeownership ratio in West Germany from 40% to 50% is synonymous with increasing owner-occupied homeownership by 3 million residential units.

If this were to happen—a realistic possibility, part or half of this figure being achieved, for example, through privatization of housing stock—an additional 1.5 million new homes for owner-occupiers would have to be built. The same applies to East Germany if the ownership ratio is to be brought in line with the West German ratio: an additional 1.8 million homes would be required.

Tenant Resistance

Conversions in the housing stock are also traditionally difficult to achieve in Germany because they immediately meet with mas-

sive resistance from the tenants associations. In England the ownership ratio was increased in a relatively short period of time by 10% from some 56% to around 66% under the Thatcher government as a result of such conversions.

The extent to which it is possible to reduce purchasing costs in Germany—the highest hurdle so far—to such an extent that broad strata of the population are able to purchase their own homes will be decisive. According to a survey among tenant households, there is a potential of some 3.5 to 4.0 million households which would consider purchasing their own homes if it were possible to reduce the costs to DM 350,000, a DM 100,000 drop from the current DM 450,000.

Traditionally, however, Germany is a "tenant country." Tenant housing construction is always preferred to owner-occupied housing, in the first place because it attracts considerably higher government subsidies. This has not only led to the lower homeownership ratio but primarily to a higher quality of tenant housing stock by international comparison.

This applies both to so-called privately financed tenant housing construction (without direct state assistance) and in particular to welfare tenant housing construction. The differences in the quality standard between new owner-occupied homes and tenant homes are not very large. They essentially differ in cost and size.

At the same time, the average tenant costs in Germany are only half as high as for owner-occupied housing. If the tenant had to bear the actual costs of his housing consumption the ownership ratio would rise very quickly.

Other Barriers to Ownership

There are also a number of other reasons for the low ownership level in Germany. One

is that building land in Germany is particularly scarce and expensive. This is associated with the relatively dense settlement of population. In addition, the municipalities assign too little land for building purposes. This in its turn leads to an additional scarcity and expensive plot costs.

What is more, the building costs in Germany are considerably higher than in other countries. While in Germany the construction of a single-family home represents eight or nine times the individual's annual income, it accounts for only three to four times the annual income in neighboring countries.

This is partly associated with the relatively high quality expectations of the home buyers and partly attributable to a number of other factors, such as government regulations, a mode of production which is not particularly rational and high fees.

Architects fees, for example, are dependent on the building costs: the higher the building costs, the higher the architect's fees. There is, therefore, little incentive to build less expensively. This state of affairs has recently been remedied in that there is now a possibility of linking the fee to cost reductions, i.e., to agree to fees which rise as building costs are reduced.

The requirements placed on noise and fire protection, heat insulation and other imposed standards also make building very expensive.

FINANCING PLAYS A CRITICAL ROLE

The financing conditions also most certainly play a role in the creation of homeownership. Financing without or with only little equity with an initially low financial burden which increases over time, and low requirements placed on the credit standing and financial strength of the borrower make it easier to purchase homes but simultaneously entail

substantial risks, not only for the home buyer but also for the credit institutions.

It may even lead to massive problems for an entire economic segment and thus for the economy as a whole. The developments in the United Kingdom and the Scandinavian countries at the end of the '80s and start of the '90s involving collapses in the property markets are vivid examples of what can happen if financing is extensively dependent on the capital markets and is also built on inflationary trends. Thanks to a sound financing structure, the (housing) property markets in Germany have so far been spared such problems.

The example of the Netherlands shows that the opportunity to deduct the interest paid on money borrowed for home purchase from taxes (as discussed in Germany on numerous occasions by different parties) is in no way a guarantee for a high ownership ratio.

For a long time now it has been possible in the Netherlands to deduct the loan interest from taxes without restriction. Nevertheless, at 48%, the Netherlands has the third-lowest ownership ratio, after Switzerland and Germany. At the same time, this type of "promotion of indebtedness" is probably also responsible for the Netherlands having the lowest savings ratio of private households (0.9%) by far for years (see Table 5).

The Bauspar System

The Bauspar system, which has been widely spread for decades in Germany and Austria and is not dependent on the capital market, accommodates quite well a life plan with rent-free living in old age. One forms equity, is given a loan at a favorable rate of interest and pays back the debt in a foreseeable period of time.

- Upon conclusion of the contract, the building-saver knows the conditions on

Table 5. Savings Ratios for Private Households in Europe

Country	Savings Percentage in 1997
Belgium	16.3
France*	13.6
Spain*	12.5
Italy*	11.7
Germany	11.0
United Kingdom*	10.8
Austria	8.5
Sweden	2.6
Netherlands	0.9
<i>By comparison:</i>	
Canada	1.4
USA	4.0

* Gross savings

Source: OECD

which he will later receive the Bauspar loan.

- The loan interest will be guaranteed over the entire term as a fixed rate of interest.
- The loan can also be secured with a lower priority in the land register behind other mortgage loans.

Three of four home buyers therefore use a building-saving contract when financing their home. More than 22 million German citizens currently possess one or several Bauspar agreements. In the post-war period a building-saving contract was involved in the financing arrangements of more than 12.5 million residential units.

In view of the fact that the system of Bausparen is becoming increasingly established

in other countries (Czech Republic, Slovakia, Hungary, Croatia), it is developing more and more into a basic building block of home financing in Europe.

The government is absolutely correct in promoting the creation of homeownership and Bausparen as a special path towards this objective.

CHANGE IN THE ASSISTANCE TARGET

At the beginning of 1996 state housing assistance was fundamentally placed on the basis of an income-independent subsidy and thus primarily concentrated on middle and low income levels. At the same time, wealth creation has been effectively improved, after having been gradually dismantled for 20 years in succession.

The increase in the income ceilings of relevance to state assistance has led to the incorporation particularly of the middle income earners, e.g., skilled workers, into the state assistance program. Both measures—conversion of the home subsidy and improvement of Bauspar promotion—can without exaggeration be described as milestones in the history of homeownership assistance.

The assistance has for the first time been geared to specific target groups, and an about-turn has set in for the first time in the gradual shift of focus of assistance from the savings phase to the financing phase.

These two aspects are of fundamental significance for the target group of the new state assistance. Households which do not have an appropriately high level of income and which cannot usually expect large inheritances are dependent on a timely and adequate creation of financial resources before purchasing their own homes.

They also need effective financial assistance following purchase so that they may develop

their own house as a form of wealth and provision for old age.

Changes Help Single-family Production

The new or improved housing assistance program has been noticeable in a positive way for two years. The construction of new single-family homes is developing clearly in contrast to the downward trend in flat construction. The number of approved single-dwelling homes increased by 10.5% from January to August 1998; the number of completed single-dwelling homes increased in the same period by 13.7%.

By 1997 building permits for single-family dwellings had increased by 22.6% compared with 1995, the last year with the old state assistance arrangement. By contrast, the remaining new housing construction sector diminished by 27.8%.

Even if owning their own home is on the top of the German citizens' list of priorities, this under no circumstances means that this objective can be automatically achieved. The formation of equity in good time and sufficiently in terms of the investment sum, as well as freedom from debt upon reaching a pensionable age, does not happen on its own. Help towards self-help, therefore, remains an important component of state housing policy in the years to come.

When planning and shaping owner-occupied houses as a provision for old age, one trend must be observed which will automatically arise through citizens making their own provisions. Owing to the fewer financial resources available in old age, the extended family unit will become more important again. The different generations will become more dependent upon each other again. The multi-generation house will experience a renaissance.