

# **The Bauspar System in Germany**

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## Preface

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The acquisition of housing property is a major key for development and prosperity. Housing property provides the prerequisites for a responsible way of life. It encourages personal initiative. In turn, people who live in their own house or apartment develop a special relationship to their home, neighbourhood and city. Owning housing helps its owners to put down roots - it is regarded as a social obligation.

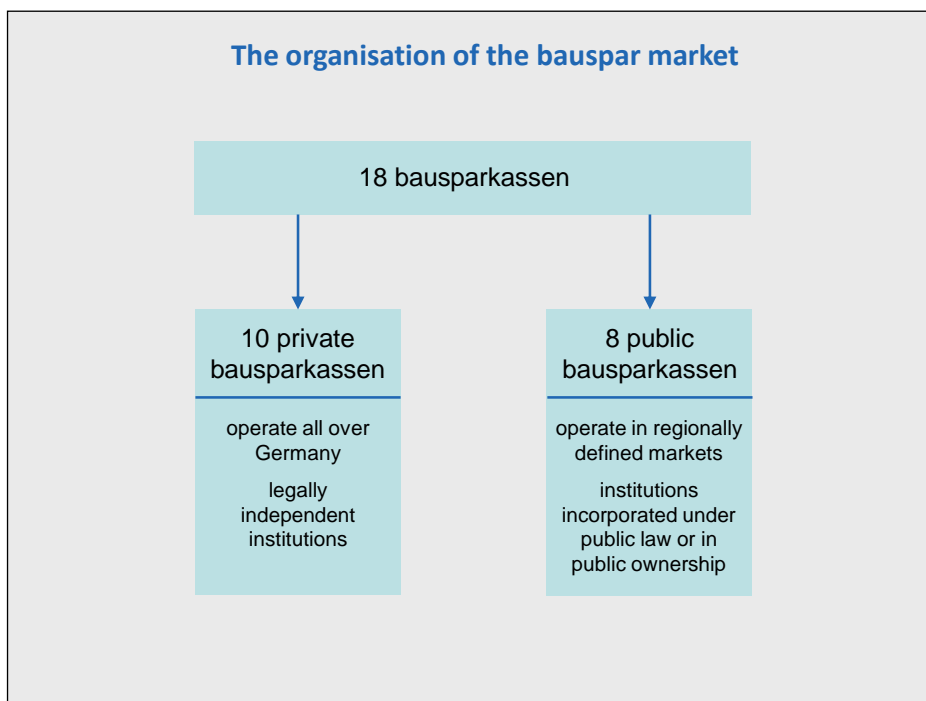
The concept of bausparen achieves a very specific contribution in this context. Its underlying principle of “help for self-help” has not lost its validity over the times. Bauspar savers are part of a bauspar community which imposes very special rights and obligations both on the individual bauspar customers and on the bausparkassen as their custodians. The system has proved to be crisis-proof. It is safe because it relies on solid housing finance techniques with intrinsic risk buffers in the form of the savers’ own assets. Warranting long-term fixed and low interest rates for credits, it protects people against financial overstrain.

The acquisition of housing property should also be possible for average-wage earners. It is a perfect old-age provision which – different from other forms of old-age provision – can be enjoyed at young age already. For many decades, the bausparkassen have successfully pleaded for this social mission, which is of essential importance for the creation and protection of jobs.

## The bauspar market in Germany

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There are currently eighteen bausparkassen in Germany. The eight public bausparkassen operate within regionally defined markets while each of the ten private bausparkassen conducts business nationwide. The public law bausparkassen are either divisions of public banks or institutions incorporated under public law with their own legal personality, or public limited companies. The private bausparkassen operate exclusively as public limited companies. Private banks and insurance companies have also recognized the importance of the bauspar system for the financial services sector and have therefore either acquired shares in existing bausparkassen or have founded their own bausparkassen. The private bausparkassen cover about two thirds of the market and the public bausparkassen one-third.



## The development of the baupar system in Europe

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The European history of the baupar concept begins in Birmingham with the establishment of Kettley's Building Society in 1775. By means of monthly savings contributions, the members of this building society collected a pool of capital from which customers were then able to take out loans to build their homes.

In Germany, the first step in this direction was taken through the initiative of pastor Friedrich von Bodelschwingh in Bielefeld, who founded a German type of Building Society, the "Bauparkasse für Jedermann" ("Bauparkasse for Everyone") in 1885. However, the first actual boom for German bauparkassen only began in 1921, when author Georg Kropp established the "Gemeinschaft der Freunde (GdF)" (Society of Friends), as an organisation to promote home ownership in Wüstenrot near Heilbronn.

Against a background of an acute housing shortage combined with difficulties within the credit market, numerous bauparkassen were founded in the period up to 1931, some of them continuing to be mainstays of the baupar system to this very day.

After World War II, bauparkassen very quickly experienced an upswing, acting as a driving force in the necessary rebuilding of the home ownership sector. Whilst there was a noticeable relaxation in the housing market at the beginning of the eighties as a result of cyclical developments and income trends, by the mid-eighties residential construction and with it the baupar system started recording growth figures once again. The system was successfully introduced into the new federal states in East Germany in 1990.

The increased demand for housing which arose in the nineties as a result of changing socio-demographic trends and political developments will continue also in the next years, mainly because an increasing number of singles and young people are setting up their own homes. This is where the baupar system can help to form home ownership. The move to owner-occupied homes also initiates a removal chain, releasing rented housing for new tenants. It is in this sector that the baupar system continues to have excellent growth opportunities.

The European Federation of Building Societies (EFBS), one of the oldest European associations in the credit sector, was founded in 1962. This organisation, which set itself the goal of promoting and supporting the financing of private home ownership, currently has over 50 members from the EU member states, the Mediterranean countries, the signatory states to the European Economic Area.

## A chronicle of the baupar system

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1775	Foundation of “Kettley’s Building Society” in Birmingham, Great Britain
1885	Foundation of the “Bausparkasse für Jedermann” by Pastor von Bodelschwingh in Bielefeld, Germany
1921-1931	Founding phase of the majority of German bauparkassen
from 1948	Resumption of the baupar business in the Federal Republic of Germany
1990	Introduction of the baupar system in the new federal states in East Germany

### Founding years of the first bauparkassen in other European countries

1925	Austria
1928	France
1928	Czechoslovakia
1930	Switzerland
1927-1930	Poland: foundation of some 20 bauparkassen
1931	Bulgaria
before 1939	Denmark, Norway, Sweden, Belgium, Netherlands
1992	Slovakia: (re-) introduction of the baupar system
1993	Czech Republic: (re-) introduction of the baupar system
1997	Hungary
1998	Croatia
2004	Romania

### Overseas, Africa, Middle East: Founding years of the first building societies/ savings and loan institutions

1831	USA
1840	New Zealand
1840	Australia
1858	South Africa
1904	Brazil
1922	Palestine
2001	India
2003	Kazakhstan
2004	China

### Lobbies / Associations

1914	Foundation of the world organisation International Union for Housing Finance (IUHF)
1947	Foundation of the central office of the public bauparkassen of Germany
1948	Foundation of the Association of Private German Bauparkassen (VdPB)
1962	Foundation of the European Federation of Building Societies (EFBS)

## The historical concept of the bauspar system

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The bauspar system is an important factor in the supply of housing, capital formation and personal retirement provision.

The fundamental concept of the system is based on social-ethic ideas. It can best be illustrated by an example showing the advantages of this mutually supportive group especially when potential home buyers have no access to mortgage loans from a bank - which was the case in Germany in former times and is still true for many developing and emerging countries:

Ten potential home buyers without own capital want to save money with the objective of acquiring their own homes. If each of them is able to save one-tenth of the amount needed every year, then each would have the necessary capital after ten years. If these ten potential home buyers were to pool their resources, the first one could own a home after only one year by drawing on the savings of the other nine.

In the second year, the next one could purchase a home by drawing on the savings of nine plus the redemption payments made by the first participant who had been able to purchase his home in the first year.

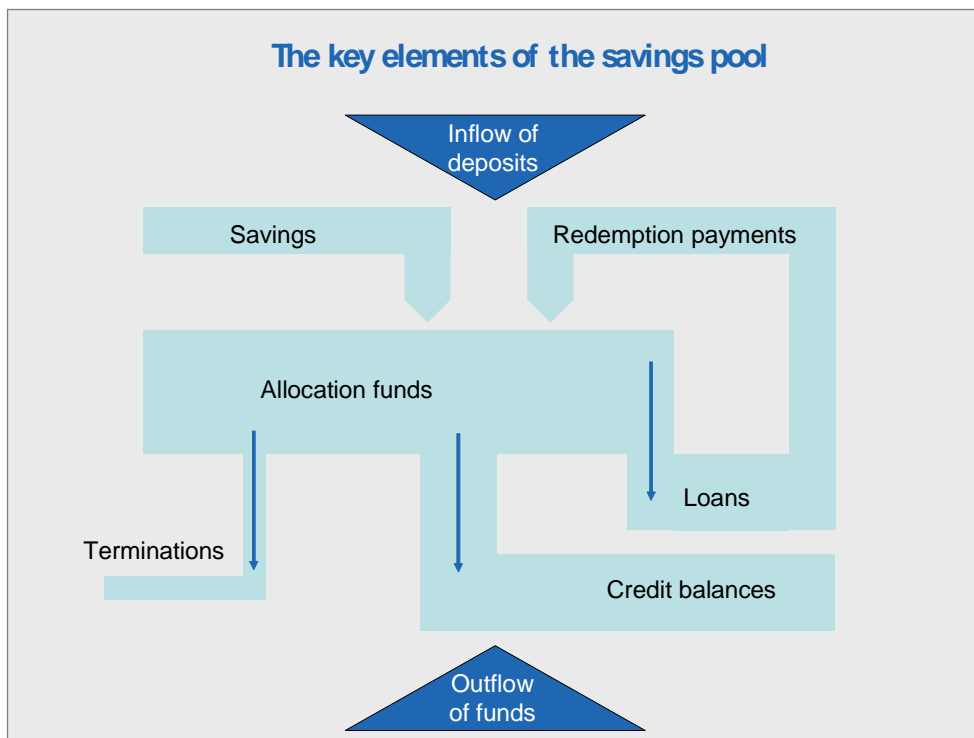
Using this method, all those who have pooled their resources reach their objective over the ten year period and 4.5 years earlier on average than if each had saved the necessary money alone.

The bauspar system made a substantial contribution to overcome the housing shortage in Germany in the 1920s. Nowadays the concept is focussed on a safe way to home ownership and sustained financing.

## The allocation system

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Today, with a total of about 23 million baspar contracts, the baspar business is no longer as continuous as in the historic model and requires precise handling. The number of contracts concluded fluctuates depending on the state of the economy and income levels so that the flow of cash into the pool of funds is uneven. This also applies to the outflow of funds from the pool. One of the major tasks facing the managers of a basparkasse is therefore to keep the fluctuations in the inflow and outflow of funds as low as possible over a longer period of time.



Nevertheless, this does not change the basic idea of a 'closed pool'. The pooled deposits are called the "allocation fund". This fund is fuelled by the combined savings of the potential home buyers during the savings phase as well as by the redemption payments.

The allocation fund is used to pay out the contractually agreed sum to customers when their contracts are allocated. They receive both the credit balance in their account and a low-interest loan up to the amount of the agreed sum.

The advantages are obvious: The capital saved keeps the burden of financing down, the fixed interest on the loan offers protection against rising interest rates on the markets. The independence from the development of interest rates on the capital markets (at the beginning of the nineties interest rates on German capital markets rose to far above 10%) is



another major advantage offered by a bauspar contract. Customers may also terminate their agreements after the savings phase if they do not need the loans and can use the deposits for their individual requirements.

## How a bauspar contract works

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A bauspar contract is divided into four phases: the contract conclusion phase, the savings phase, the allocation phase and the loan phase.

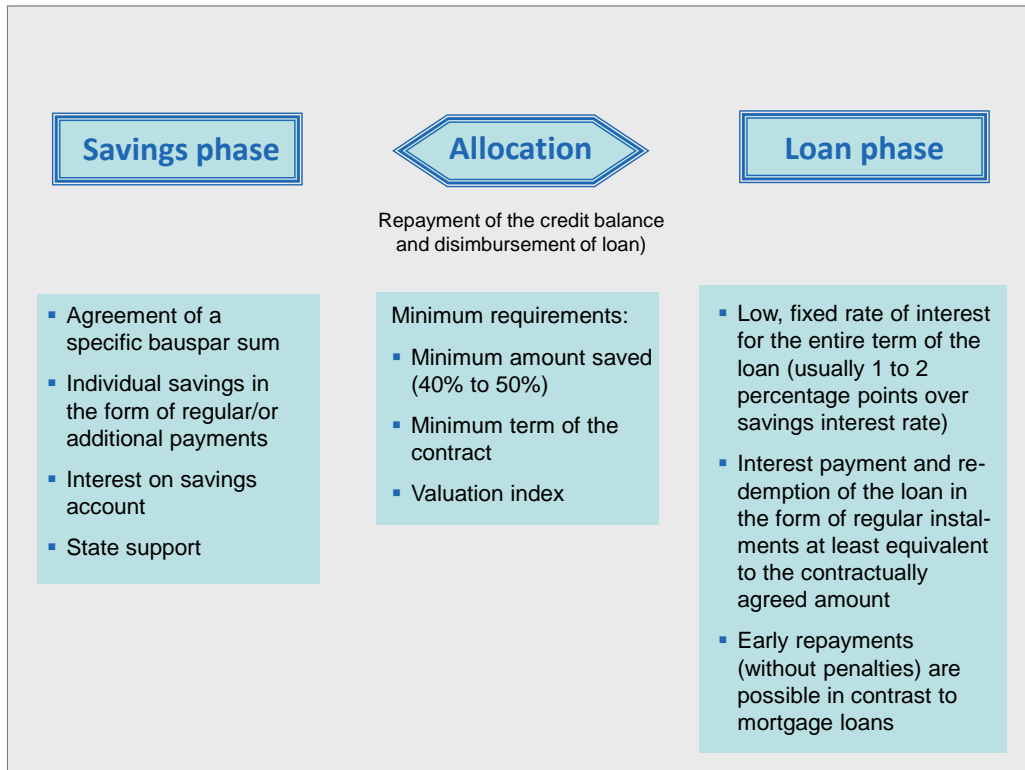
In the contract conclusion phase, the bausparkasse and the bauspar customer agree upon the bauspar sum and the remaining contract conditions, the so-called tariff, defining the saving and loan interest rates and the modalities of saving and redemption. Depending on the tariff, the interest rate of the loan is currently between 1.5 % and 3.5 %. The bausparkassen also offer tailor-made tariffs for different target-groups (standard, fast-track or long-term). So-called option or variable tariffs are also offered in which the customer can choose between several tariff types. This gives him the chance to react flexibly even after the contract has been concluded if his savings objective should alter during the savings process. The contract is concluded through sales representatives, in branch offices or through cooperating or allied companies (e.g. banks, insurance companies, saving banks).

Before customers can draw on their contractually agreed sum, this must be allocated. The allocation is effected when 40 % or 50 % (depending on the tariff) of the bauspar sum has been saved, a certain minimum savings period has elapsed and/or the so-called target valuation index has been achieved. The valuation index stands for the saving performance the bauspar customer has made for the community of savers. The valuation index expresses the customer's saving performance for the benefit of the pool. It is calculated on the basis of the amount of savings and the length of time it has existed ("time-by-money system").

The valuation index also determines the order in which allocations are made to bauspar customers from the allocation fund. The customer with the highest valuation index takes priority over those with a lower valuation index in the allocation of the contractually agreed sum.

The loan phase begins with the allocation. The total bauspar sum, comprising both the deposits and a low-interest loan, which has a fixed rate of interest until it is finally redeemed, is disbursed to the customer. The interest on the loan is usually one to two percentage point higher than the interest attracted by the deposits. The loan is repaid in regular instalments

which, in the most popular tariffs, amount to 6 ‰ per month or 7.2 % p.a. of the baupar sum. In contrast to mortgage loans, the customer may also make early repayments at any time (without being liable to repayment penalties).



## The legal framework of the bauspar business

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As credit institutions, the German bausparkassen are subject to the full provisions of the German Credit Sector Act and therefore to government supervision through the Federal Banking Supervisory Authority. The special structure and techniques of the bauspar system in Germany require that the German Credit Sector Act is supplemented by special provisions governing Bausparkassen. Such provisions are contained in the Bausparkassen Act of 16 November 1972, as last amended in 2021. In addition to the provisions pertaining to supervision, the Act regulates the organisational structure of the bausparkassen and sets forth the regulatory framework for their business operations.

The general bauspar terms and conditions, i.e. the conditions for the contractual relationship with bauspar customers in the saving and loan phase have to be approved by the Federal Banking Supervisory Authority.

The same applies for the general business terms and conditions, i.e. the business foundations of the institute and the mathematic foundations of the bauspar tariffs.

## The legal foundations

### **Statutory requirements**

#### **German Credit Sector Act**

General rules pertaining to the supervision of the operation of credit institutions

#### **Bausparkassen Act:**

Specific rules:

- legal form
- audit and supervision
- permissible business activities
- framework for general business principles and general conditions for bauspar contracts
- appropriation of bauspar funds for housing financing
- securing of the bauspar loan

#### **Bausparkassen Regulation:**

Stipulates ceilings for the investment of available funds and the granting of specific loans

#### **German Civil Code**

Rules concerning the loan contract

#### **Price Indication Regulation**

- rules concerning advertisement for credit agreements
- rules on the calculation of the Annual Percentage Rate of Charge

## The advantages of the bauspar system

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The advantages of a bauspar loan are expressed in the following five points in particular:

- stabile interest rate within the savings and loan phase
- no risk of interest-rate changes
- possibility to early repay the loan at any time without early repayment penalty
- fast freedom from debt
- second-rank provision of security.

These advantages are not available to those funding their homes without bauspar funds. With a traditional mortgage, for example, individuals must pay the interest rate prevailing on the capital market, the amount of which is determined by the interest rates which the credit institutions themselves pay for refinancing. This interest rate is subject to constant fluctuations.

Low interest rates between 1.5% and 3.5% can be provided by the bausparkassen because they do not depend on the capital market for their refinancing needs as they use the appropriated savings deposits of their customers. Moreover, they guarantee this fixed rate of interest for the lifetime of the loan when the saving contract is signed.

With mortgages, the interest rate is only fixed for the first term of the loan, which is usually for a period of 10 to 20 years. If the interest rate on the capital market has risen by the end of this period, then the mortgage can become much more expensive for its remaining term.

Another advantage of the bauspar loan is that borrowers may early repay their loans at any time without having to pay an early repayment compensation to the bausparkasse. This increases the flexibility of the borrower since he can use non-scheduled inflows of funds for repayment and thus reduce his loan burden as a whole.

As bauspar customers “create” their own creditworthiness through the saving phase of the bauspar contract, the bausparkassen are content with “secondary” securities for the bauspar loan. This way bauspar customers can finance their homes with a well-balanced mix of financial resources where the bauspar loan can close the gap between the sum required and the loan granted under first-rank security.

Especially in transition and emerging economies, bausparen offers interesting advantages and options:

In emerging economies, the saving rates are often very low as the confidence in the banking sector is not very high or even got lost. The bauspar system is easy to understand and a safe method of saving and can make a contribution to re-establish the confidence into the banking industry. Bausparen helps to stabilise the banking sector in an indirect way and can thus help to achieve more growth.

In contrast to other credit institutions, bausparkassen are prepared to offer also small-scale loans – depending on the contractually agreed sum. This is an important advantage in emerging countries, as their housing stock is often extensive, but in desperate need of repair for which, smaller loans are required in general.

In many emerging countries the provision of loans for private households is rather restricted or implies exorbitant interest rates and very short repayment times. This is mainly due to the fact that credit institutions are not in a position to evaluate the creditworthiness of potential customers as the majority of people do not have a bank account or because credit agencies do not exist. This lack of information can be closed by bausparen, as bauspar customers establish their own credit-worthiness by their regular saving. Those who are able to save a small portion of their income regularly will be reliable borrowers. This is reflected by the extremely low failure rate of bauspar loans.

## The use of baupar contracts for housing finance purposes

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The German Bausparkassen Act also regulates the purposes for which baupar loans may be used ("purpose to finance housing"). The main use of baupar funds are the construction and/or purchase of homes and owner-occupied flats, the acquisition of building plots, the modernisation and repair of housing as well as the redemption of home loans.

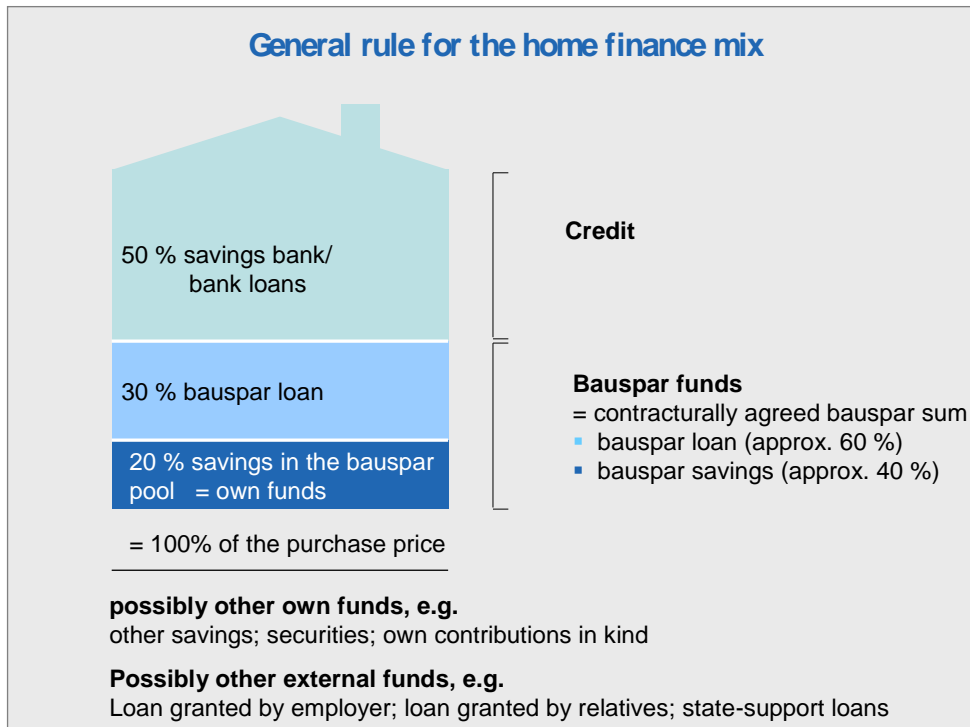
Housing finance purposes include the following:

- Construction / purchase of
  - houses
  - owner-occupied flats
- purchase of a plot
- Modernisation / repair of
  - houses
  - owner-occupied flats
- Tenant-funded modernization of housing
- Redemption of home loans
- Construction cost grants, rent advances
- Inheritance disputes
- Acquisition of homes in other EU member states
- Construction / purchase of combined commercial and residential properties
- Acquisition of dwelling rights in retirement homes
- Measures to develop residential areas

## The ideal mix to finance housing

The most widely-used home finance mix in Germany is a combination of a baupar loan and a mortgage credit. It is of special importance to note that bauparkassen are the only institutional providers who accept junior loans. As a rule, they leave the senior loans to the mortgage lenders (up to a loan value of 60%), providing them with the greatest possible security for the loans, contending themselves with a subordinated security. Nevertheless, they run very little risk in doing so because their customers have already shown that they are able to restrict their consumption during the savings phase. The extremely low failure rates underscore this fact (regularly less than 0.1% of the total loan portfolio of all German bauparkassen).

As a rule it is advisable for a home loan to be structured as follows (see also the chart below): The home buyer obtains a mortgage credit to finance 50% of the purchase price secured by an entry in the Land Register as the so-called first mortgage. At least 20% should comprise the home buyer's own capital including baupar credit balance, and the remaining 30% may be covered by the baupar loan. In practice, the home buyer's own capital ratio is frequently higher. This shows that home ownership is solidly financed in Germany in most cases.





## The importance of the bauparkassen system for housing construction

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Providing the residents of a country with housing that is adequate both in terms of size and quality is an ambitious and difficult task. The Bauparkassen are of great importance in accomplishing this task in Germany, making a substantial contribution to the funding of the construction, purchase and/or modernisation of homes. Particularly during the first few decades following World War II, the bauparkassen system contributed to the reconstruction needed in the housing sector and has today developed into a significant economic factor. In the period from 1948 German bauparkassen have allocated bauparkassen funds totalling over one trillion Euros. These funds have helped to finance over 13 million homes in single-family and apartment houses, including 9 million newly-built homes.

### The economic effects of the bauparkassen system

- The bauparkassen system helps people to buy their own homes.
- In the period from 1948 till today bauparkassen funds totalling over one trillion Euros were allocated.
- The significance of the bauparkassen system in the funding of modernisation measures is rising, particularly in the context of the climate protection efforts.
- The bauparkassen system stimulates private initiative, thus relieving the state in the provision of housing.
- The bauparkassen system leads to a continuous creation of home ownership which in its turn stabilises the level of construction activity.
- The bauparkassen system secures jobs and restrains excessive price jumps in the housing market.
- Home ownership formed by the bauparkassen system is one pillar of financial retirement provisions and provides relief to the welfare state.
- The bauparkassen system makes a contribution to stabilising the financial system and helps to increase economic growths and the government revenue.

## The market financed business of the bausparkassen

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Bauspar customers wishing to have financing at their disposal prior to the allocation of their bauspar contracts may be granted loans by the bausparkassen from funds which do not originate from the pool of deposits. These loans are refinanced on the capital market. A distinction is made here between "intermediate loans" and "anticipatory loans".

Intermediate loans may be used by bauspar customers who have already saved the minimum amount in order to bridge the waiting period until their contracts are allocated for loan disbursement.

Intermediate loans are granted up to the amount of the contractually agreed sum at capital market conditions. During the term of the intermediate loan, the customer pays only the interest on the loan and makes no repayments. Once the bauspar contract is allocated the intermediate loan is discharged at once using the bauspar sum paid out, leaving the low-interest bauspar loan as residual debt.

With an anticipatory loan, the minimum required savings have not yet been accumulated. The customer is therefore required to pay not only the interest on this loan, but also the savings instalments on his bauspar contract.

### Bridging the savings period

The bausparkassen offer two types of loans to bridge the savings period until the bauspar contract is allocated for disbursement:

- Intermediate loans:  
Precondition: attainment of the minimum agreed savings amount – usually 40 %
- Anticipatory loans:  
Requirement: monthly regular savings instalment  
(4 ‰ to 7 ‰)

Both types of loan must be refinanced on the capital market.

The loan terms depend on the capital market situation. Depending on individual requirements, loans may be granted at a fixed interest rate for short, medium and/or long-term requirements.

## Key market data

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The market penetration of the bauspar sector is very high:

- Every second German household has at least one bauspar contract.
- Some 22 million persons in Germany have a bauspar contract.
- About 23 million bauspar contracts are currently in force totalling a bauspar sum of over 930 billion Euro.

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For an unofficial English translation of the Bausparkassen Act and Regulation please scan the adjacent QR code or go to [http://bit.ly/Act\\_VdPB](http://bit.ly/Act_VdPB)

