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Welcome Address
on the Occasion of the Joint Congress of UN-HABITAT and the European Federation of Building Societies

"Housing Finance in Emerging Markets"

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Ladies and Gentlemen,

On behalf of the German Bausparkassen I, too, would like to warmly welcome you to the joint congress of UN-HABITAT and the European Federation of Building Societies here in Berlin. We are meeting here in Berlin for the second time after 1967 and this is a source of great joy for me.

Very often, in its history, the world has looked to this city. Sometimes full of keen anticipation, sometimes, alas, also filled with fear and horror, but finally, again full of joy. Berlin is breathing history – this is what has become the hallmark of this city.

Like hardly any other metropolis, Berlin has changed its face over the past years. Gradually, the traces of its more than 40 years of division are being erased. New things have emerged, some of them are outstanding. Hence, this city is the ideal venue for a congress which deals with the issue of real estate finance. I do hope, that over the next days, you will also have an opportunity to take in a breath of "Berliner Luft" and that you will be able to enjoy the atmosphere of its "neue Mitte", i.e. the new heart of the city.

I would like to cordially thank EuBV and UN-HABITAT for giving us the occasion to meet here. Behind the scenes, a lot of work goes into preparation of such a congress and very often, this work goes unnoticed. All those helping hands deserve big praise!

But above all, I would like to express my sincere gratitude to you, Ladies and Gentlemen, for coming here. Yesterday and today I have already seen many familiar faces. I wish all of you exciting presentations and discussions.

Ladies and Gentlemen!

What is all this about? - First of we will be dealing with the issue of residential property. Because residential property has a personal component which can also be dubbed as hands-on freedom and security. Above all, it has a stabilising effect on the social fabric of a society. Particularly in countries featuring a major divide between rich and poor, this will be of pivotal importance.

The most important preconditions for successful growth – and these countries shall and must grow – probably include social and political stability.
If there is a lack of such stability, investors will not come. Yet, without investors, it will not work. Hence, we should like to furthermore highlight routes for access to residential property. Routes that are viable across the globe.

The creation of residential property thus plays a very special role. The example of Western Europe shows which volume can be moved by this. With an overall volume of approximately 500 billion euros and an overall share in the total construction volume of almost 50 percent, the field of housing development is, by far, the largest construction sector.

What is the experience we have gained in this country over the past decades? How much of it can be applied elsewhere?

Let me just remind you of the early 1990s. At that time private households, but also banks, in Britain were in severe financial distress. This was essentially due to financing models made up almost exclusively of loans.

Why do I mention this? Because I think this example very clearly shows how not to go about it.
This is because misconceived financing and refinancing systems will increase cyclical fluctuations rather than curbing them. Whilst this might produce short term benefits, these benefits will not be sustainable in the long run. Large parts of the population may thus be deprived of the fruits of their labour. This in turn has negative implications for financial institutions, capital markets and, last but not least, it will have a negative impact on a country's social and political stability.

So how could things be done in a better way, especially in emerging and developing countries?

Or rather: what are the hallmarks of an efficient system of housing finance?

I think such a system includes three characteristics:

– a constant flow of funds to stabilise the economic situation,

– predictability and security for investors and financing institutions,

– quantifiable success in creating home ownership and a low rate of foreclosure sales.

Is financing and refinancing ensured by a constant flow of savings accumulated by large sections of the population? This is clearly the case in Germany. Or will funding models depend more on the decisions of large institutional investors and their objectives? Whatever your choice is, the impact on the system's stability will vary significantly.

By encouraging average consumers to make regular savings you facilitate a constant flow of funds, which in turn stabilises interest rates.

And this both increases predictability for investors and financing institutions and helps to achieve higher levels of home ownership. In this case, saving is not an end in itself, not merely an alternative to consumption. Instead, as a means to an end, savings create residential property and thus ensure sustainability.

Individual conditions clearly vary significantly from one country to the next. What works in a given market cannot be transferred on a one to one basis to other markets. This notwithstanding, we could and should still learn from each other's experience.

This is also true for the German model. I am not just talking about Germany today but also about the country after World War I, when there was no efficient capital market. It was the German home loan and savings associations who created a breakthrough for the principle of "help for self-help" when purchasing residential property.

Today economists worldwide, I should think, agree that in order to prevent inflation housing investments ultimately need to be refinanced by the long-term availability of saved-up capital.

Self-generated capital is of crucial importance for economic growth, particularly in developing and emerging countries.

For housing finance, this means there must be channels capable of linking private household savings and housing investments.

A decisive challenge, therefore, is to convert short-term savings deposits into long-term funds, aptly summarised by the keyword of “maturity transformation”. Economic and fiscal policy should thus aim at increasing the savings ratio specifically for housing construction and equity formation. This provides additional leeway for housing finance.

Ladies and Gentlemen,
You may have guessed that I want to strongly advocate saving through home loan associations. The major advantage of this scheme is that saved-up capital is directly converted into investment capital earmarked for the purpose of home construction.

In any other system which does not feature this earmarking, it will be the funding institutions who accept deposits and may decide on the form and beneficiary of the distributed capital.

Particularly in Eastern European countries people often want short-term, or even instant financing without providing any accumulated savings. This occasionally works for people in the higher income bracket. However, if the majority of the population were to make this choice the result would be inflationary debt. Unless sufficient equity capital is created, even the best mortgage credit system will fail. This is due to the fact that households will be unable to get loans from their banks.

To the individual borrower, housing finance with little or no equity means that interest rate changes on the capital market will almost completely feed through into the loan. This may severely increase the financial burden of the home owner.

Conversely, a relatively high equity ratio, which is common practice in Germany at 30 to 40 percent, ensures that funds are much more independent of capital-market interest rates and thus also more robust with regard to fluctuations.

Equity capital forms a risk cushion for economic ups and downs: the higher the equity ratio, the lower the financial burden.

In terms of macroeconomics this means that the number of foreclosure sales is kept within narrow limits. In Germany foreclosures for non-home savers are several times more frequent than for home savers. In a way this also leads to an automatic risk reduction for other banks.

In countries where home owners are heavily indebted and speculate about an “automatic debt reduction” by way of an increase in real estate value, we usually witness “price bubbles”. These will burst when the uphill trend comes to an abrupt halt, which may be caused by unemployment, lack of income growth, increase in capital-market interest rates, unrealistic price assumptions etc.

Let there be no misunderstanding: I should like to highlight that the point is not to bank exclusively on home loan and savings schemes. Experience has shown, however, that home saving and mortgage funding complement each other well. A combination of the two is more profitable and stable than a system solely based on mortgage credit.

That such a combination model is future viable is not only shown by earlier developments in Germany and Austria, but also by current activities in the Czech Republic, Slovakia, Hungary, Croatia and soon probably also in Romania, Kazakhstan, Bulgaria, Belarus, Russia, the Ukraine and, not least of all, China. This model is extremely well suited for countries that are still lacking a functioning long-term capital market.

It is for this reason that I believe developing and emerging countries are well advised to enable private households to build up savings, even if this means that initially only the accumulated capital of people in the medium or higher income bracket may be mobilised. We must be realistic enough to understand that people with very low incomes will hardly be in a position to contribute at this stage. For them we will need separate solutions.

Let us all together think about how we can bring about change by using what is available today.