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# Building an Inclusionary Housing Market: Shifting the Paradigm for Housing Delivery in South Africa

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*For an Equitable Sharing of National Revenue*

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# Foreword

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Over the past 17 years, the South African Government has exerted a massive effort to deliver 3 million fully subsidised houses to low-income households, a feat that few other countries in the world have achieved. Despite this, there is mounting evidence that the current housing policies are not working optimally and are unlikely to do so in the future. They are financially unsustainable, unlikely to deliver on the scale required, have significant quality challenges and distort the housing market. An urgent paradigm shift is needed, in favour of more viable alternatives.

Against this backdrop, the Financial and Fiscal Commission (the Commission) hosted public hearings on housing finance to gather a more nuanced understanding of the challenges and their underlying drivers, and to begin to explore feasible policy options. Perspectives were sought from a wide range of stakeholders, including the three spheres of government, housing finance institutions, developers, non-government organisations, banks, research organisations and independent consultants. This was the first time that the Commission has held public hearings of this nature, and it is the Commission's view that this is a novel contribution to the current debate on human settlements and in particular the financing of housing.

This report summarises the problem statement, processes and feedback that emanated from the public hearings and gives, from the Commission's view, the direction that future work must follow.

On behalf of the Commission, I wish to thank all the participants in this initiative for their enduring commitment and dedication to solving South Africa's housing finance challenges. All your contributions have been valuable, and I hope that your thoughts, insights and perspectives are appropriately captured in this document. In particular, I would like to thank the Mayor and the Municipal Manager of Ekurhuleni Municipality and the staff for their support in hosting the hearings. I would also like to thank Kecia Rust from the Centre for Affordable Housing Finance in Africa (a division of FinMark Trust) for her role in this project, and my fellow Commissioners for their support and dedication in ensuring the Commission's reputation is maintained and enhanced. Lastly, I would like to convey a very special thanks to the administrators and researchers of the Secretariat of the Commission for their efforts in ensuring that this process was, and will continue to be, a success.

Dated in Midrand on this 31<sup>st</sup> day of January 2012



Bongani Khumalo (Mr)  
Acting Chairperson/CE

# Acronyms

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BNG	Breaking New Ground
DFI	Development Finance Institution
DOR	Division of Revenue
FFC	Financial and Fiscal Commission
FLISP	Finance Linked Subsidy Programme
FSC	Financial Sector Charter
GDP	Gross Domestic Product
MEC	Member of the Executive Council
MFMA	Municipal Finance Management Act
SHRA	Social Housing Regulation Authority
UISP	Upgrading of Informal Settlements Programme
USDG	Urban Settlements Development Grant

# Executive Summary

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Despite the government delivering more than 3 million fully subsidised housing units to poor households over the past 17 years, South Africa still has a backlog of over 2 million houses, which is rising annually. The actual delivery of subsidised housing units has consistently fallen short of the government's annual target of 300,000 houses per year, with for example only 161,854 housing units and 64,362 serviced sites delivered in 2009/10. Within the current subsidy framework, this backlog, at R140,000 per unit and assuming no further growth in demand, would cost over R300 billion. Assuming a projected delivery rate of 250,000 houses per year, the annual budgetary implication is R35 billion, which is far beyond the state's current fiscal capacity. This is further affected by the reduced GDP growth rates in the wake of the global financial crisis, continuing Euro zone uncertainty and rising unemployment. The failure to deliver to the required scale is the result of various factors, including delays in township establishment processes, infrastructure constraints and the limited availability of well-located and affordable land.

In short, the current housing market, which is incomplete and exclusionary, is not working adequately. A particular concern for public policy is that the supply-side state-driven approach of fully subsidised housing provision is not only inadequate and inefficient, but is also causing significant distortions in access to housing – and is thus unlikely to work in the future. There are also dysfunctions in the rental housing market where about 40% of tenants live in what constitute slum conditions, highlighting the need for quality, affordable rental housing,

In a bid to better understand the dimensions of this problem, and explore more effective and efficient alternatives, the FFC released a draft problem statement on the challenges and opportunities in housing finance in South Africa. The draft problem statement was presented for discussion at public hearings, which were held in terms of the Financial and Fiscal Commission Act of 1997 on 13–14 October 2011 at the Ekurhuleni Civic Centre, Ekurhuleni, Gauteng Province, and attended by 83 stakeholders. This is just one mechanism that the Commission has at its disposal to execute its mandate, with the aim of contributing to the mainstream policy debate. Submissions from a broad range of stakeholders (including the three spheres of government, housing finance institutions, developers, and NGOs) on the draft problem statement are included in this final document.

## **Dimension of the problem**

The issues affecting the delivery of housing are: (a) the impact of the housing subsidy, which is unsustainable, creates perverse incentives and distorts prices, which has resulted in a growing gap market; (b) a lack of understanding and accurate estimation of the housing demand, due in part to poor data, especially for the informal housing market; (c) problems with supplying houses because of lack of access to well-located land and bulk infrastructure, and housing delivery chain inefficiencies; and (d) legislative and administrative barriers.

Stakeholders agreed that the delivery of around 3 million fully subsidised houses since 1994 is insufficient. Furthermore, the current housing finance policy is unsustainable, as costs and demand for housing are increasing, which means that more and bigger subsidies will be required to deliver on expectations. In addition, the current housing subsidy scheme has created perverse incentives; for example corrupt ward councillors who control waiting lists in

their favour, poor quality workmanship and households splitting in order to increase their chance of accessing a subsidised house. Although national government has shifted from providing housing to establishing human settlements, an undesirable outcome of the subsidy scheme is the continued dependency on the state. The 60% of households currently qualifying as beneficiaries are just waiting for government to deliver. The result is a failure to encourage the private sector and households to invest and participate in the housing market. The failure to transfer title deeds to many subsidised housing beneficiaries is further preventing participation by these households in the formal property market. Of concern is the decrease in the rate of formal registration of newly built houses in the Deeds Registry, with only 50% of subsidised homeowners estimated to have title deeds. Title deeds play a crucial role, as without a title deed, an owner is prevented from trading their home, which limits choice, mobility and the development of a secondary market in low-cost houses. The result is a bottleneck, as households are unable to move out of low-income homes into middle-income homes, and lower-income households are displaced to backyard shacks and informal settlements.

The current subsidy system distorts prices in the gap market, which continues to grow because home ownership is unaffordable for households whose income is too high for state subsidies (i.e. earning just above the subsidy threshold of R3,501 per month) and too low to attract loans from the private sector (i.e. below R10,000 per month, the household income required to purchase the cheapest, newly built house on the market). Making home ownership even more unaffordable are the current levels of unemployment and household debt that affect households' ability to save and raise finance.

The demand for housing in South Africa is poorly understood, mainly because of the lack of a common understanding of how backlogs are estimated. As a result, backlogs may be overstated and assumed to be effective demand for new housing, rather than demand that could be met through upgrading existing dwellings or social housing rentals. This focus on backlogs also excludes those who do not qualify for housing subsidies but continue to live in inadequate housing. Understanding the characteristics of the population and its movements is also essential for determining the mix of housing supply required to meet demand, as the need for housing depends on where the individual is in their life cycle.

Stakeholders argued that public spending should focus on upgrading informal settlements and encouraging informal self-build. While the Urban Settlements Development Grant is a step in the right direction for creating integrated human settlements, the grant system still focuses primarily on housing. The increasingly unrealistic expectations created by the current housing subsidy programme, whereby the poor receive a free, completed house, also need to be addressed.

The major challenges for housing supply are access to well-located land and bulk infrastructure, and housing delivery chain inefficiencies. Although up to 70,000 hectares of state-owned land has been identified for housing purposes, none have been made available. However, even when land has been made available for housing developments, it can take another three years to complete the other steps: township establishment and approvals, installation of services, house construction, and transfer and handover. The housing delivery chain needs to be made more efficient, as delays have an impact on the affordability of housing delivery. Delays and uncertainty also deter the participation of other role players, for example smaller developers, in low-income housing projects. Furthermore, municipalities pass on costs regarded as unfunded mandates, for example costs of connecting water and

electricity (internal reticulation), to developers who in turn pass them onto the buyers of bonded units in mixed developments.

The supply-side driven policy is a problem, as it focuses on delivering fully subsidised new-build houses instead of considering all means of supplying houses and forms of tenure. For example, smaller, multilevel, mixed-use developments are able to reuse and reposition old or underutilised buildings and sites, often in city centres. By making the city centre more densely populated, such developments have the potential to increase the rates base (provided the municipality collects the property rates charged). A greater focus on the rental market is also required, including reviewing the institutional and management capacity at local level. Practically, the design and administration of housing grants needs to be looked at, and municipalities should be more actively involved in the supply of housing, as cities are playing an increasingly important economic development role. Some suggestions made included direct funding flows to metros and allowing development finance institutions to provide sufficient bridging finance to speed up the delivery of low-income housing.

### **Principles guiding the Commission's response to this problem statement**

The old system of fully subsidised houses is not sustainable and causes significant and exclusionary distortions. The four components of the required paradigm shift in housing finance policy are:

- a) *Refocusing on building a single, inclusionary housing market.* The current, de facto housing finance policy fails to adequately recognise the role of the housing market in providing access to housing at scale. This market already operates, either formally or informally, across all market segments and in both primary and secondary markets. But it fails the poorest households the most.
- b) *Redefining the role of state:* Houses are the only single component of human settlements and are themselves essentially a private good. The infrastructure, services and facilities that build healthy, vibrant communities have larger public good characteristics. Even serviced land, with secure title, has a greater public good characteristic than houses themselves. This suggests that the state should focus on delivering appropriate public goods to support human settlements, focussing in streamlining the institutional and regulatory red tape in the delivery of human settlements
- c) *Rethinking housing entitlements:* households move from being passive beneficiaries dependent on the state, to being actively engaged in meeting their own housing needs and mobilising their own resources as end-user contributions as well as private sector financing in addition to public resources.
- d) *Addressing the needs of informal settlements:* the proliferation of informal settlements reflects the current dysfunctions in the housing sector, due to an inability of both the state and the market to address adequately household needs. Global experience suggests addressing state and market failures alone will not meet the needs of many households already living in informal settlements. A dedicated focus on upgrading these settlements is critical. Importantly, however, this informality must not be addressed as a problem but rather as an opportunity to empower households and redesign our cities. Upgrading efforts must prioritise in-situ upgrading.

**Research Gaps**

The public hearings identified a number of areas that require thorough and systematic research. The research gaps identified below are not exhaustive but highlight key themes that warrant further investigation.

1. Determine what is slowing down housing delivery, how to involve individual households and the private sector, and how to unlock the supply of land for housing.
2. Gather up-to-date and credible data in order to understand the current housing needs or housing backlogs, and how the demand is likely to evolve in the future.
3. Reform intergovernmental fiscal arrangements and improve institutional relationships to support the development of sustainable human settlements in South Africa.
4. Look at how to reduce delays that increase developers' costs and hinder delivery of housing to beneficiaries.
5. Review the current funding framework for the built environment in the context of integrated housing and human settlements.

Based on the principles articulated in this document, the Commission will identify an initial set of policy options and recommendations which will then be considered at a second public hearing. It is hoped that this research will precipitate urgent action by policy-makers in response to the country's housing shortage.

# Chapter 1: Introduction

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## 1.1 Rationale for the Public Hearings and Relationship to FFC Work

The Financial and Fiscal Commission (the Commission) has a legislative mandate to make recommendations on issues pertaining to financial and fiscal matters across all three spheres of government in terms of Section 214(1) of the Constitution, the Financial and Fiscal Commission Act of 1997, the Intergovernmental Fiscal Relations Act of 1997 and the Money Bills Amendment Procedure and Related Matters Act of 2009. The Commission held special hearings into the implications of the housing policy on the fiscus on 13 - 14 October 2011, at the Ekurhuleni Civic Centre, Ekurhuleni, Gauteng Province.

## 1.2 Process

The process followed in this project is intended to stimulate public debate on policy options and private interventions across key stakeholder groups and to create momentum proactively for changes to housing policy – specifically its subsidy and financing arrangements – by using the powers and profile of the Commission more fully.

The objective of the public hearings was to discuss a draft problem statement document, which the Commission had released in order to strengthen analysis of the challenges at hand. In considering the stakeholders' perspectives on the challenges in the housing finance policy, the Commission has arrived at a final problem statement, which is presented in this document. In addition, the report outlines the principles guiding the Commission's response and the areas identified for future research.

The Commission will then produce a draft report, containing an initial set of recommendations and policy options, which will be considered at a second public hearing. Thereafter, the Commission will finalise the technical report, which will inform a structured research agenda and provide policy options to the issues raised, based on sound research. In so doing, the report will contribute to the debate on housing finance policy.

## 1.3 Why This Project Is Important

Section 26 (1) of the South African Constitution states that “everyone has the right to have access to adequate housing”. Sub-section 26 (2) requires that “the state must take reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of this right”. There have been various interpretations of this clause and the role of the state envisaged. In terms of the housing subsidy policy, set out in the Housing White Paper of 1994, the State has promoted a supply-side approach which, in the past 17 years, has seen the construction of more than 3 million subsidised housing units. The 2004 housing policy, popularly known as “Breaking New Ground” (BNG), promoted a shift from quantity (the number of units delivered), to quality (the location, structural integrity and spatial integration of units) and raised the role of the State in facilitating functional housing and property markets.<sup>1</sup> In September 2004, Cabinet approved this “Comprehensive Plan for the

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<sup>1</sup> The “Breaking New Ground” policy is framed around the following objectives:

- Accelerating the delivery of housing as a key strategy for poverty alleviation
- Utilising provision of housing as a major job creation strategy

Delivery of Sustainable Human Settlements”, which represented a shift in policy, from housing provision to sustainable housing settlements that balance economic growth, social development and the natural systems. The aim was to integrate housing delivery and land use, transportation and bulk municipal infrastructure investment planning to create spatial, social and economic inclusion. Inhabitants of sustainable human settlements located both in urban and rural areas would live in a safe environment, have adequate access to economic opportunities, a mix of safe and secure housing and tenure types, reliable and affordable basic services, educational, entertainment and cultural activities and health, welfare and police services.

Despite these policy adjustments and government’s enormous delivery effort, the housing backlog persists. Today, South Africa sits with the same backlog as estimated in 1994. In 2009 the National Department of Human Settlements undertook an exercise that looked at the capacity of South Africa’s housing finance framework to address its human settlements challenges. From that exercise emerged a report that was presented at the National Department’s Social Compact meeting in November 2009 (FinMark Trust, 2009). The paper identified three main challenges facing the housing sector: (1) insufficient scale of delivery – in both the subsidised housing and non-subsidised housing markets; (2) limited housing affordability among those households with incomes outside the subsidy eligibility band; and (3) the non-sustainability of the housing subsidy regime, given the scale of demand for housing<sup>2</sup> and the costs involved in delivering the standard product. In the ongoing debate among practitioners in the public and private sectors, a critical issue appears to be the extent to which the housing policy encourages or discourages householders and lenders to participate in the housing finance market, and the resulting impact on the state’s capacity to perform its mandate. Key questions to be explored are how this relates to the current subsidy regime, the South African housing sector’s ability to reduce housing backlogs across the market, the spatial form of our cities, and the overall functioning of housing markets.

The objective of this project is to review challenges in housing funding and delivery, with the aim of making recommendations on issues relating to housing finance, and specifically to:

- (i) develop a consensus position on the dimensions and drivers of the challenges in housing delivery and housing finance policy;
- (ii) consider whether South Africa’s housing finance sector (including public and private finance, and individual household finance) is able to address the challenges; and
- (iii) make detailed, recommendations on more effective and sustainable approaches to housing finance.

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- Ensuring property can be accessed by all as an asset for wealth creation and empowerment
  - Leveraging growth in the economy
  - Combating crime, promoting social cohesion and improving quality of life for the poor
  - Supporting the functioning of the entire single residential property market to reduce duality within the sector by breaking the barriers between the first economy residential property boom and the second economy slump.
  - Utilising housing as an instrument for the development of sustainable human settlements, in support of spatial restructuring.

<sup>2</sup> Housing demand in this paper is loosely defined as it also includes those that need housing but cannot afford to pay.

## 1.4 Objectives of This Report

The objective of this report is to present the final problem statement, which captures the Commission's formal position. In addition, the report outlines the principles guiding the Commission's response and identifies areas for future research.

This report also presents consolidated views expressed by stakeholders during the plenary and group discussions. The 83 stakeholders represented were drawn from the three spheres of government, housing finance institutions, developers and non-governmental organisations (see Annexure 2). The draft Housing Finance problem statement, along with stakeholder submissions and group feedback presentations, is on the FFC website (<http://www.ffc.co.za/index.php/media-a-events-interactive/public-hearings.html>).

## Chapter 2: Formal Problem Statement

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This section sets out a broad problem statement, which was the subject of public hearings and was subsequently expanded to take into consideration stakeholder feedback.

### 2.1 Housing Backlogs

Although the government provides a comprehensive and substantial housing subsidy<sup>3</sup>, meeting the growing backlog is a serious challenge, especially given reduced GDP growth rates in the wake of the global financial crisis, continuing Euro Zone uncertainty and rising unemployment. Current estimates suggest that, although the government has been delivering houses for the poor through the housing subsidy scheme, the housing backlog remains on the increase, as Table 1 shows.

**Table 1 Housing backlog 1996–2011**

Year	Housing backlog
1996	1.5 million
2001	1.8 million
2011	2.1 million

*Source: Department of Housing, 1994 and Department of Human Settlements, 2011.*

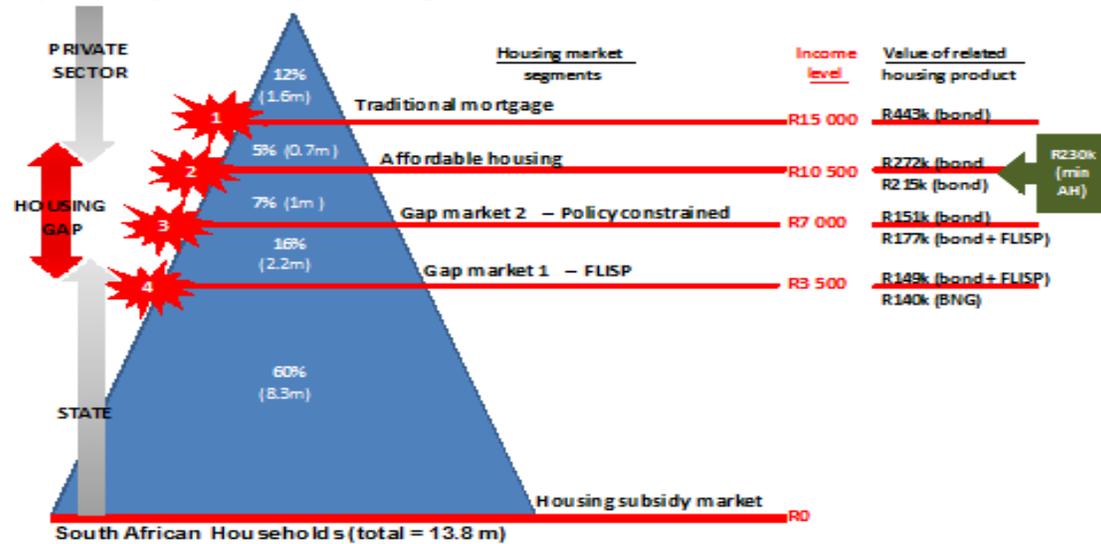
Currently, the housing backlog remains substantial at 2.1 million units and is rising annually.<sup>4</sup> Sing (2010) provides the diagram in Figure 1 to illustrate the segments that comprise the current market.

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<sup>3</sup> The housing subsidy is currently valued at about R140,000, which includes the provision of a 40m<sup>2</sup> house on a 250m<sup>2</sup> plot of serviced land, entirely for free, to households earning less than R3,500 per month.

<sup>4</sup> Speaking at the Human Settlements Youth Summit at Durban's Olive Convention Centre in July 2011, Human Settlements Minister Tokyo Sexwale said that three million housing units had been delivered. The Minister said the backlog was "plus 2.1 million housing units, which translates into approximately 12.5 million people."

Figure 1 Gaps in housing finance – points of inflection



Sources: Melzer (2010), Sing (2010)

## 2.2 The Housing Subsidy Market

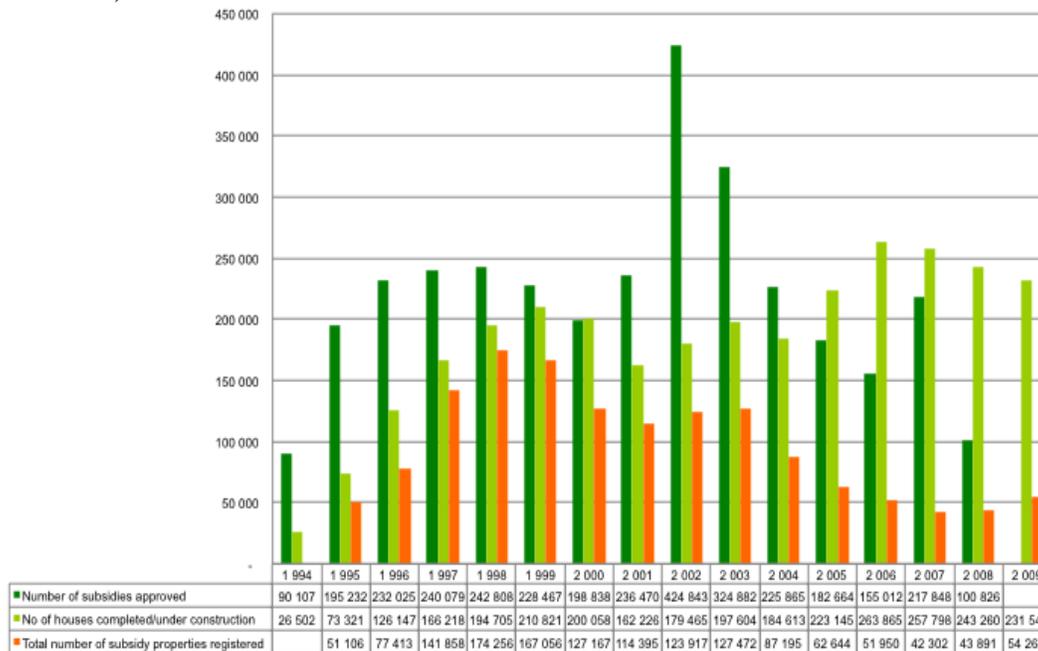
As Figure 1 illustrates, 60% of households in South Africa are eligible to apply for a housing subsidy. The housing subsidy currently delivers a house that costs the state approximately R140,000 (estimates range from R84,000 – the individual subsidy – to R200,000). According to the Department of Human Settlements, since 1994 over 3 million housing units have been delivered. As Figure 2 shows, these units have been spread across the years (Shisaka, 2011) and are drawn from three different data sets:

- *Number of subsidies approved* reflects data that the National Treasury reports on and publishes regularly. While this data is only available until 2008, the National Department of Human Settlements database illustrates that since the start of the scheme in 1994 until September 2010, housing subsidies were approved for about 3.8 million individuals.<sup>5</sup>
- *Number of houses completed or under construction* is the figure the National Department of Human Settlements reports annually to the National Treasury. It includes houses completed, houses still under construction and serviced stands. The Department of Human Settlements reports that between 1994 and 2009, a total of 2.94 million housing units were completed or were under construction.<sup>6</sup>
- *Number of subsidy properties registered* comes from matching the ID numbers of individuals approved for subsidies with existing properties on the deeds register. Fifty-one percent, or 1.44 million, of the 2.94 million subsidised properties built or under construction by 2009 are registered on the Deeds Registry.

<sup>5</sup> As this figure includes spouses, it is expected to be generally higher than the number of houses actually delivered. It also includes beneficiaries approved to receive title under the Discount Benefit Scheme, for old township stock.

<sup>6</sup> Delivery figures are reported on a financial year basis, and so these have been annualised for the purposes of the analysis: the numbers here assume that 60% of the delivery reported occurred in the first calendar year, and 40% in the first three months of the second calendar year, e.g. for 1994/95 reported figures, 60% of the delivery is accrued to 1994, and 40% of delivery to 1995.

**Figure 2 Reported annual subsidies approved, houses delivered and properties registered (1994–2009)**



Data sources: National Treasury, 2007 and 2009 and Department of Human Settlements<sup>7</sup>; Deeds Registry Data. This graph was prepared as part of the RDP Assets project commissioned by the FinMark Trust with support from the National Department of Human Settlements, Western Cape Department of Human Settlements, the South African Cities Network; the FB Heron Foundation and Urban LandMark.

The delivery of government subsidised housing should be analysed within the context of housing backlogs and the government’s delivery goal of at least 300,000 housing units per year (Knight, 2001). The actual delivery of subsidised housing units has consistently fallen short of this target. For example, in the 2009/10 financial year the government only delivered 161,854 housing units and 64,362 serviced sites. The failure to achieve targets is the result of various factors, including delays in township establishment processes, infrastructure constraints and the limited availability of well-located and affordable land.

The decreasing rate of formal registrations of houses in the names of beneficiaries is as worrying as the limited scale of delivery. Assuming all 2.94 million houses were built, the difference in delivery figures and deeds registry figures implies that 1.5 million subsidy beneficiaries received an asset that has not been registered in the deeds registry.<sup>8</sup> Up until 2004, more than 60% of the subsidy houses reported as delivered was registered every year. However, since 2005, the percentage of subsidy houses registered has consistently decreased and is becoming worse. By not receiving title to their houses, these beneficiaries are being denied a critical point of entry into the formal property market.

<sup>7</sup> Delivery statistics available at the department’s website. [www.dhs.gov.za](http://www.dhs.gov.za)

<sup>8</sup> This is higher than the amount estimated by the National Department of Human Settlements in the policy document *The Comprehensive Plan for the Development of Sustainable Human Settlements* (2004), commonly referred to as “Breaking New Ground”, which estimates that at least 35% of subsidised houses – some 900,000 units at the time of the report – had been delivered without the registration of formal title.

Since 1994, the government has been involved in delivering housing for the poor, mainly through mass production of similar and fully subsidised housing units. The weaknesses of this form of housing delivery include: running out of steam and being unsustainable, failing to leverage private finance and end-user contributions, and lacking focus in resolving administrative problems associated with land release, tenure security and the subsidy waiting lists, which leads to both inclusion and exclusion errors because of the stepped nature of the income bands. The result is an undermining of the contribution of non-state sectors (including households and businesses) to the nation's housing goals.

The current housing delivery system has resulted in beneficiaries who rely entirely on government to provide them with housing. Those who reside in informal settlements feel entitled to free housing and use informal settlements as a waiting place. Evidence for this is that in South Africa informal settlements remain in the same condition for decades, whereas in many Latin American and Asian countries, land invasions are followed by shack construction and consolidation of shacks into permanent structures/houses over the next decade (Kellett and Napier, 1995). However, some households are actively involved in the informal self-build housing using their own savings, local constructors, incremental construction, and in most cases without government subsidies or formal credit. Self-build housing is widespread, especially in Gauteng, Limpopo and Mpumalanga,<sup>9</sup> and has a major role to play in delivering housing in South Africa but currently receives little or no formal support.

Furthermore, human settlements have two elements: one that relates to a public good and one that relates to a private good. Characteristics of a public good include non-rivalry in consumption (i.e. one individual consuming the good or service does not diminish other people's consumption, e.g. defence or television signals) and non-exclusivity (difficult to exclude individuals from enjoying the good e.g. anti-air pollution services). Certain elements of human settlements, such as the provision of bulk services, have public-good characteristics, but the top structure<sup>10</sup> of a house is a private good (i.e. has an element of rivalry in consumption and is easy to exclude individuals from enjoying the service). Key for state intervention is differentiating between the public-good and private-good elements of housing or human settlements. The government should concentrate on providing elements of housing that are public goods and provide a conducive environment for the private sector and individuals to provide elements categorised as private goods. This highlights a need to review the role of government in providing housing and human settlements.

The demand for housing in South Africa remains high, with an estimated 12.5 million people in need of shelter, which translates into about 2.1 million housing units. Especially in urban areas, many households stay in shacks, backyard dwellings, squatter settlements and mobile homes – forms of dwelling that reduce the quality of life. The increase in informal settlements is due to a number of factors, especially the failure of the current housing delivery system to deliver affordable housing on the scale required and in locations close to potential job opportunities, and the dynamics associated with the gap market as explained below. The rate at which households move from informal to formal settlements is very low, while the rate at which informal settlements are forming has been increasing. Between 1999 and 2004, only 10% moved from informal to formal settlements (Lall et al., 2007), whereas informal settlements grew from 300 in 1994 to 2,700 in 2010 (Stophan, 2011). Between 1995 and

<sup>9</sup> See presentation made by the Human Sciences Research Council during housing finance public hearing.

<sup>10</sup> Top structure within the context of housing refers to the actual house which includes wall and roofing.

2002, the overall demand for housing, especially in urban areas, is estimated to have increased by 90% (Lall et al., 2007).

### 2.3 Integrated Housing Development

A recent positive development is that some cities have embarked on an integrated approach to housing delivery. Practical examples of integrated housing development include Cosmo City and Pennyville (both in Johannesburg, Gauteng). Under this delivery model,<sup>11</sup> developers gain project approval based on an agreed amount of subsidised units within the project. This model is an attempt to ensure mixed-income communities and works well when the other units in the development are bonded housing (financed by commercial mortgage bonds), catering for middle and upper income groups. However, if the other housing units are for low-income groups, undesired consequences may be that the poor end up subsidising the very poor. In this model, developers cross-subsidise housing to the poorest by recouping their loss from those who are paying. The viability of this model depends on getting the right mix of subsidised to non-subsidised bonded housing units. To make these projects attractive, developers say that the ratio of bonded to subsidised housing units needs to be over 60%. However, integrated housing projects are only effective up to a certain point. The low-income market represents approximately 60% of the total housing demand, and so the market (of people able to pay) will become saturated before the full demand for housing can be met.<sup>12</sup>

### 2.4 The Gap Housing Market

The gap housing market starts with households earning just above the subsidy threshold of R3,501 per month and extends to the household income required to purchase the cheapest, newly built house on the market (about R10,000 per month). Those that fall into this segment include key public sector workers and entry-level workers in the private sector. What also defines the gap market is the cost of the subsidy house delivered, which is given away at no cost to households earning below R3,500 per month. A household earning about R5,000 per month (just over the subsidy income threshold) could afford to purchase a subsidy house valued at about R140,000 with mortgage finance, which in principle could be available.<sup>13</sup> However, the R140,000 house is not available for sale, as developers and financiers fear market risks, and borrowers expect better housing than that available for free to the subsidy target market. As a result, as depicted in figure 1, two gap markets are created:

1. Gap Market 1, in which a current, finance-linked subsidy is offered, which, for a range of reasons, is inappropriate, insufficient and insignificant, and does not address the challenge at all.
2. Gap Market 2, where no state support is currently available. Other than resale stock (the supply of which is also limited because of constraints in the primary market), no housing is available in this market.

<sup>11</sup> The integrated housing delivery approach/model is characterised by a mixture of units funded via the housing subsidy for low income beneficiaries and other units with commercial mortgage bonds, with bonded units to some extent subsidising non-bonded units (cross-subsidisation).

<sup>12</sup> PDG submission to the Commission on “Challenges and Opportunities in Public Housing Finance In South Africa”, October 2011.

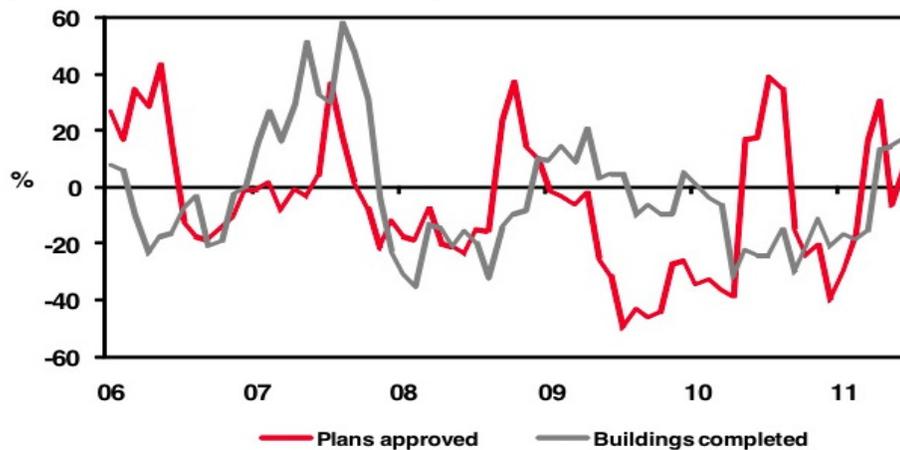
<sup>13</sup> There are, of course, problems with access to mortgage finance. However, lenders have offered lower value mortgage loans to clients – in the Financial Services Charter (FSC) period, the average loan size was in the range of R100,000 – R120,000.

Consequently, any efforts by lenders to extend housing finance to households earning between R3,500 and R10,500 necessarily goes towards home improvements and not new supply. In time, these home improvements will offer a more diversified housing market that will better support resale activity and enable market filtering as expected by policy. However, in the short term, households in these two gap markets are not able to meet their housing needs adequately and for many the constitutional provision of the right to access to adequate housing is not realised (Rust, 2010 unpublished).

In the current environment, access to credit exists even for lower income households. Households earning as little as R2,000 per month can access a credit card, and the Financial Sector Charter (FSC) sought to extend housing loans to households earning over R1,500 per month. However, in the absence of housing supply and of loans covering partial construction of a property (i.e. commercial incremental housing products), access to credit does two things. First, it puts inflationary pressure on what housing is available for sale, undermining household affordability. Second, households who are unable to access housing that they can afford are encouraged to invest elsewhere, often in consumer goods. Melzer (2010, unpublished) shows how 50% of households earning between R3,500 and R7,000 per month have formal credit (vehicle finance, credit from retail stores, bank overdraft facilities and loans), while only 3.4% have a mortgage. About one third of the population in this income bracket has liquid savings. When households spend their incomes on other (often consumer) goods, their ability to afford housing (if available) diminishes. The National Credit Regulator has highlighted the dominance of consumer credit as an important financial sector stability issue.

## 2.5 The Affordable Housing Market

New housing delivery starts within the affordable market segment, although not yet on the scale required. A household earning about R10,000 per month could afford the cheapest, new-build house in the current market, costing about R250,000. However, delivery in this segment of the market is far below the estimated demand. According to the Affordable Land and Housing Data Centre, in 2010 only 6,252 new units priced between R250,000 and R500,000 were registered on the Deeds Registry. Houses in this segment of the market are generally smaller than 80m<sup>2</sup> (although 80m<sup>2</sup> houses are also found in the traditional mortgage market). According to Statistics SA (2011), residential building activity for this segment of the market has been negative since about 2009 and has only recently started moving again.

**Figure 3 Growth in residential building activity: houses (<80m<sup>2</sup>), 2-month moving average**

Source: Statistics SA

A critical issue facing this segment of the market is the affordability of housing finance, especially given the extent of non-mortgage credit indebtedness. According to the National Credit Regulator's Credit Bureau Monitor for the second quarter in 2011, just over half (53.3%) of the 18.84 million credit active consumers were in good standing. The number of consumers with impaired records<sup>14</sup> stood at 8.8 million, while only 39.1% of all consumers were current with their credit. A further 14.2% were between one and two months in arrears, 18.5% were in arrears of three or more months, and just under a third had adverse listings<sup>15</sup> or was under judgement or administration orders. With this level of debt, households in the gap and affordable market segments will struggle to afford housing finance, while some households at the bottom of the traditional mortgage market may find themselves falling into the lower market segments.

## 2.6 The Traditional Mortgage Market

The traditional mortgage market refers to the top 12% of the population that earns sufficient income to afford new-build or resale housing generally available in the market. This market does not suffer from housing backlog and quality challenges, has significant financial leveraging, and has the highest proportion of mortgages and lowest loan-to-value ratios.

The banking sector plays a major role in housing finance in South Africa. At the end of 2009, residential mortgages<sup>16</sup> from banks accounted for 39% of total credit extended to the private sector and 31.7% of GDP, the highest of any African country (Melzer, 2010 unpublished).

<sup>14</sup> Impaired records refer to an account that has three or more missed instalments or judgment or administration order against it.

<sup>15</sup> Adverse listing includes adverse classifications of consumer behaviour, such as absconding, defaulting, slow payment, etc.

<sup>16</sup> A mortgage bond is a loan at variable interest rates made by commercial banks to conventional (high- and moderately high-income) households, secured by a first lien on the house and repayable over 20 to 30 years. Mortgages typically allow pre-payment at any time at a nominal or no cost and require 20% (or less) down payment. Different banks offer small variations around this standard design, including relatively limited fixed-rate lending.

However, these mortgages are only for the top 10–15% of income earners, earning more than about R10,000 per month.<sup>17</sup>

The SA Reserve Bank has recently begun to track re-advances, which allow an individual to access funds that make up the difference between the original registered home loan amount and the outstanding balance. The data indicates that in 2009 re-advances accounted for 32% of all new mortgages and re-advances, suggesting that households are able to leverage their housing assets to access further finance.

Nevertheless, this market segment has not escaped the pressures of the recent economic downturn. Levels of default have risen with, and perhaps ahead of, the entire market. Preliminary research conducted by Eighty20 and XDS Credit Bureau for the FinMark Trust found that, between 2004 and 2008, mortgage loans extended to clients in the FSC target market performed slightly better than the market as a whole and had a lower percentage of non-performing loans (FinMark Trust, 2011).

## 2.7 The Rental Market

South Africa's rental housing sector accounts for about one-fifth of all households in South Africa (Melzer, 2008). In 2008 a report commissioned by the Social Housing Foundation found that the majority of renters were low-income earners: 55% earned less than R3,500 and another 20% between R3,500 and R7,500. About 40% of tenants live in what constitute slum conditions, highlighting the need for quality, affordable rental housing (Melzer, 2008). Landlords servicing this market have near zero vacancy rates and claim they don't have to market their stock, as the demand for rental is almost insatiable.

The different types of rental accommodation cater for different types of rental demand. At the very bottom end, backyard shack rentals offer cheap accommodation to tenants and an income to landlords. Municipal investment in infrastructure and support for water and sanitation delivery to these new housing opportunities could address the slum conditions. Inner city conversions, especially in Johannesburg, offer a higher quality, more affordable rental opportunity for inner city dwellers, but demand far exceeds supply. Constraints to the development of this market are found in the legal, regulatory, policy and finance domains.

## 2.8 Informal Settlement Upgrading

The Upgrading of Informal Settlements Programme (UISP) is a policy response to the growth of informal settlements and supports the Presidency's Outcome 8, to upgrade 400,000 accommodation units within informal settlements. The UISP highlights the importance of assisting households living in informal settlements in situ (i.e. on site, or just where they are) and clearly states that relocation should be the last resort, to be undertaken only in exceptional circumstances on a voluntarily and cooperative basis. While the UISP has the potential to offer important lessons for the government's wider approach towards subsidising housing, how it integrates in the wider subsidy scheme entitlements is unclear. Upgrading informal settlements and existing but dilapidated houses could help reduce the current backlogs in the ongoing demand for housing.

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<sup>17</sup> The Income and Expenditure Survey 2005/06 shows that mortgages become a feature of the market at monthly household income levels of between R7,500 and R10,000 in 2006 Rands, or between R9,590 and R12,787 in 2009 Rands (Melzer, 2010).

## 2.9 Future of the Housing Subsidy Programme and Sustainability

Some hope that further subsidising will solve the housing challenges raised above, and indeed proposals include a new subsidy, a larger Finance Linked Subsidy Programme (FLISP) or extending the existing subsidy programme for the gap market. However, a critical issue is whether *the current subsidy programme is sustainable*. Under the current subsidy framework, it would cost over R300 billion to clear a backlog of 2.2 million units (at R140,000 per unit), a sum that is far beyond the fiscal capacity of the state, and excludes any extras suggested by additional market demands.<sup>18</sup> Assuming a delivery rate of 250,000 houses per year, the annual budgetary implication is R35 billion. Even if the government combined the housing and infrastructure subsidies and provided land for free, there would still be a budgetary shortfall. In the context of the current global economic environment, it is unlikely that revenue will increase sufficiently (if at all) to accommodate the necessary budgetary growth. It is also unlikely that South Africa will be able to raise sufficient debt capital to subsidise housing on this basis.

## 2.10 Institutional and Legislative Challenges

The delivery of human settlements in South Africa is a shared responsibility among the three spheres of government, public entities and the private sector which includes commercial banks. One of the major institutional challenges is that the institutions involved in delivery housing lack coordination and do not have clear, distinct roles in the process. These institutional and legislative framework bottlenecks stall the delivery of housing. Figure 4 illustrates the housing value chain, showing how long housing delivery takes from the land assembly to handover.

**Figure 4 Housing value chain**



Source: Department of Human Settlements, 2010 as cited by the National Treasury<sup>19</sup>

The complete housing delivery process takes on average more than three years, which escalates costs for housing delivery.

In recent months, many stakeholders have scrutinised the challenges in the housing finance sector<sup>20</sup> and in all instances the housing subsidy has come under the spotlight. However,

<sup>18</sup> More sophisticated analyses have been done. Shisaka Development Management services is currently working on a similar exercise for the National Department of Human Settlements, and has estimated the all-in figure to be R500 billion, given the breadth and depth of the housing policy in South Africa and the range of subsidy instruments involved.

<sup>19</sup> Presentation made by the National Treasury during the housing public hearing held at Ekuruleni in October 2011.

<sup>20</sup> In July 2009, the Department of Human Settlements requested the FinMark Trust to prepare a report setting out the extent to which our housing finance systems and framework could address the human settlements challenges facing the nation. FinMark Trust funded this work, and a draft report was prepared for and presented on behalf of the department at the social contract meeting in November 2009. The National Department of Human Settlements and the Western Cape Department of Local Government and Housing have respectively commissioned research into the market-distorting impact of the housing subsidy and the cost of the subsidy to

although all agree that the subsidy programme needs revision in order to tackle the problems of inadequate scale of delivery, affordability and sustainability in the housing sector, none have proposed any parameters of a new arrangement. Detracting from this debate is the enormity of the infrastructure challenge and the non-financial interventions that are critically required. Another point of discussion is the extent to which the state should intervene and encourage individuals to provide for their own housing needs without crowding out other role players such as banks. Some analysts believe that the starting point should be to analyse the whole housing sector and understand its dynamics, taking into account issues such as demographic and economic growth, household fragmentation and changes in households' life cycle.

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the state. The Social Housing Foundation also commissioned a cost-benefit analysis of the RDP subsidy programme versus subsidised rental housing, and the Presidency commissioned research into its monitoring and evaluation programme for improved outcomes of government programmes. All of these pieces of research challenged the sustainability of the subsidy programme as currently structured. The UISP, which is framed to support Outcome 8 of the Presidency, offers very useful proposals for a more rational approach to improving housing circumstances.

## Chapter 3: Summary of Stakeholder Perspectives on the Problem Statement

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This chapter summarises stakeholder views on the problem statement expressed during the public hearing plenary and focus group sessions.

### 3.1 Stakeholder Perspectives on the Impact of the Housing Subsidy

#### **Insufficient delivery to scale, unsustainable in the future**

Stakeholders agreed with the Commission's problem statement analysis, that the delivery of around 3 million fully subsidised houses since 1994 is insufficient. The budget allocated to human settlements has increased significantly but has not resulted in increased delivery, and backlogs remain at levels similar to those in 1994. It was pointed out that a household qualifies for a housing subsidy if their monthly income is less than the nominal value of R3,500. Households who qualified for the subsidy in 1994 (based on their nominal income at the time) currently have earnings of around R9,000 and are still on the waiting list. Population growth and migration to cities add to the demand for housing and housing subsidies. Stakeholders expressed concern that, as costs increase over time, more and bigger subsidies are required to deliver on promises, which makes the current housing finance policy unsustainable.

#### **Fully subsidised housing creates perverse incentives and other related problems**

Stakeholders confirmed the Commission's analysis that the current housing subsidy had created perverse incentives. Examples cited included corrupt ward councillors controlling waiting lists in their favour, poor quality workmanship and households splitting in order to increase their chance of accessing a subsidised house.

An undesirable outcome of the housing subsidy is the continued dependency on the state; 60% of households presently qualify as beneficiaries and are passively waiting for government to deliver. Stakeholders questioned the role of the state and recognised that national government's shift in mandate from providing housing to establishing human settlements requires dealing with political and community expectations including whether communities' expectations of progressive realisation of their constitutional right to access housing is being progressively realised by state. Stakeholders also pointed out that the subsidy system fails to encourage desirable levels of investment and participation by the private sector and households themselves.

The problem statement raised the concern that the rate of formal registrations of newly built subsidised houses in the Deeds Registry is decreasing, thereby denying their owners entry into the formal property market. An objective of the BNG policy is to ensure that all can access property as an asset for wealth creation and empowerment. The estimated 50% of government subsidy beneficiaries living in their houses without title deeds are homeowners who are prevented from using their assets to reduce poverty. Stakeholders emphasised the crucial role that title deeds play in enabling household mobility and tradability of houses.

Once a home is owned, the owner must be able to sell it in order to move for economic or social reasons. Owners without the title deed are prevented from trading their homes in one area for another, which limits choice, mobility and therefore participation by private households. Additional reasons why owners may not be able to sell their houses formally include: the eight-year sale restriction, poor location and the relaxation in 2004 of the requirement that building contractors must transfer title deeds of transfer to beneficiaries prior to claiming their last payment. As a result of the above-mentioned difficulties in selling houses formally, informal transactions take place, effectively removing the housing stock from the formal secondary market and further limiting supply. Consequently, as the economy grows households often do not move out of low-income homes and into middle-income homes. Instead, these households remain in homes intended for low-income beneficiaries who are then displaced to backyard shacks and informal settlements.

### **Gap market growing, largely due to affordability constraints**

In line with the Commission's analysis, stakeholders argued that the current subsidy system distorts prices in the gap market, which continues to grow mainly because home ownership is unaffordable for households whose income is too high for state subsidies but too low to attract loans from commercial banks. This situation is exacerbated by the lack of commercial incremental housing products.<sup>21</sup> The FLISP has not managed to incentivise the private sector to provide mortgages for households in the gap market, and this burden has by default passed onto the state. The current levels of unemployment and household debt mean that households' ability to save and raise finance is making home ownership increasingly unaffordable for many. Stakeholders pointed out that the appetite for mortgage finance in the current economic context should not be assumed even among the traditional mortgage market, where the rate of mortgage applications being declined is very high. A macroeconomic perspective illustrated the important role that housing plays in the economy given the significance of mortgage loans as a percentage of GDP. However, joblessness, lack of savings, existing credit obligations and pressure on household income were considered to be important constraints in the design of the appropriate housing finance instruments for low-income households. Other factors driving up costs of housing include unfunded mandates, lack of funding for mixed developments and administrative and regulatory barriers – these are discussed further below.

## **3.2 Stakeholder Perspectives on the Demand for Housing**

### **Poor data and understanding of housing demand**

The problem statement submitted that the demand for adequate housing remains high. Stakeholders agreed but perceived the demand for housing in South Africa to be poorly understood. The National Department of Human Settlements estimated the adequate housing backlog to be over 2 million households. While the estimated backlogs in adequate housing may be based on informal settlements, backyard shacks and traditional dwellings etc., it was argued that the demand-for-dwellings data should indicate whether these need to be replaced entirely or could be upgraded in situ to meet the required standard. For example, many traditional dwellings may not need to be replaced, although the owners may wish to improve

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<sup>21</sup> Commercial incremental housing products are bank housing finance instruments aimed at funding part of the construction of a new house, e.g. for purchasing a serviced site only, as opposed to covering the cost of an entire house.

their homes as and when they have the financial means to do so. This lack of a clear definition of how backlogs are estimated may result in backlogs being overstated and assumed to be effective demand for housing. On the other hand, focusing only on backlogs excludes from the housing demand figures those who do not qualify for housing subsidies but continue to live in inadequate housing. Stakeholders urged government to decide on a uniform approach for estimating housing demand accurately, linked to the products on offer, that supports effective planning, monitoring and oversight. The absence of a standard definition may lead to misinterpretation and inappropriate planning and allocation of resources.

Good data improves understanding of the current situation and can be used to inform housing policy. Stakeholders expressed concern about the lack of research and data on real housing demand, both current and future. This should be informed by, among others, population growth, household formation and size, urbanisation, movement between rural and urban areas, movement between outlying areas and city centres and life stage. Stakeholders cited research that indicated housing need is a moving target, with unemployed youth being the most critical constituency. The need for housing depends on where the individual is at in their life cycle: unemployed youth come into central cities, where job density is highest, to look for work as singles or as new couples. As they get more job information, these rural-born migrants move from inner cities to the suburbs. Unemployed work-seekers first need ultra-cheap, immediate-access informal shelter, then family housing later. Until a job is secured, no household is formed, delaying the demand for permanent housing. An understanding of the characteristics of the population and its movements is essential for determining the mix of housing supply required to meet demand.

### **Accepting informality as a reality and as a point of entry into the housing market**

With formal jobs shrinking, most households are living on unstable temporary work. Those with monthly incomes below R2,000 per month are considered unbankable, which makes mortgage finance unfeasible. The number of households in this segment of the market is high and expanding, accounting for most of the shack population. Stakeholders suggested that the 60% at the bottom of the market could access decent housing through informal self-build and government financing assistance could have a real impact on reducing backlogs. As recognised by the Commission, this would also provide an entry into the housing market, from which point they progress to more formal housing. Such a progression (from informal to formal housing) is not the general experience of South Africa's informal settlements, which are seen as places to wait for access to subsidised state housing and where little investment takes place. Households may also prefer to wait for a complete and fully subsidised free house (in the future) rather than accept a serviced site (in the present) that they themselves are expected to improve gradually to the required standard.

As informal settlements continue to grow, stakeholders argued that public spending should focus on upgrading these settlements by providing water and electricity infrastructure to serviced sites, which individual households could improve themselves over time, rather than the state funding the delivery of houses (top structures). Stakeholders proposed that state support be targeted geographically (area based) rather than at eligible beneficiaries, which would support a human settlements approach of using public funds to purchase public goods. Stakeholders considered the Urban Settlements Development Grant (USDG) as a step in the right direction for creating integrated human settlements. However, it was mentioned that informal settlement upgrading is human-resource intensive, can take 10 to 15 years and is

therefore often avoided by provincial and local governments. Settlement upgrading requires practitioners to have a new set of skills and tools. In addition, this new policy deviates from the expectations created by the current housing subsidy programme whereby the poor receive a free, completed house. The problem statement itself highlighted the importance of the new approach towards human settlements, but how it integrates with the wider subsidy scheme is unclear.

### 3.3 Stakeholder Perspectives on the supply of housing

#### **Major challenges for housing supply are access to well-located land and bulk infrastructure and housing delivery chain inefficiencies**

As identified in the Commission's problem statement, stakeholders mentioned the main challenges for affordable housing supply as being access to well-located land and bulk infrastructure and inefficiencies in the housing delivery chain. Although up to 70,000 hectares of state-owned land have been identified for housing developments, none have been made available for this purpose. This is largely because of land assembly problems, including the costs of and difficulties in accessing well-located state land and acquiring well-located private land due to a lack of appropriate fiscal instruments and incentives. This is a major barrier in what is only the first step in the housing delivery chain as illustrated in Figure 4.

Once land has been made available for housing developments, it takes at best another three years to complete the other steps: township establishment and approvals, installation of services, house construction, and transfer and handover. Government was urged to make the housing delivery chain more efficient. The delays experienced in tender processes, zoning approvals and issuing development rights create risks, add substantially to the cost of development, and ultimately have a negative impact on the affordability of the housing product. Administration and regulation costs are estimated to drive up house prices by 30% on average, which is exacerbated by further delays due to poor intergovernmental relations.

Stakeholders urged the state to champion projects that encourage, not hinder, participation by other role players. Uncertainty and protracted delays in the development process creates financial risk, which deters smaller developers from participating in low-income housing projects. Participating in low-income housing means that developers have to forgo other, more lucrative ventures and may not be able to obtain the presales that are typically a source of finance for developments. While successful partnerships for certain developments were reported, some stakeholders stated that the public-private partnerships regulated by National Treasury are so cumbersome that they are not worthwhile for either party. In addition, stakeholders explained that the over ambitious number of objectives and targets per project made the administration of housing projects challenging.

Stakeholders argued that the lack of clear policies and procedures covering bulk contributions results in a poor infrastructure financing framework. This is especially true for mixed developments consisting of fully government-subsidised housing units for low-income households and bonded units financed by banks, including bonded affordable housing units. Certain costs such as for the internal reticulation (connections of water, electricity etc.) to the subsidised housing units in mixed developments are regarded as unfunded mandates by municipalities that, however, routinely fund bulk connections. While many municipalities traditionally finance bulk infrastructure through imposing development charges, the cost of

internal reticulation has always been for the account of the developer who recoups it when the house is sold to the end user. Municipalities pass the costs of these unfunded mandates on to developers who – unable to recover these costs from the low-income end users of housing units fully subsidised by government – in turn pass them costs on to the buyers of the bonded housing units. In mixed developments, bonded units (including affordable housing) therefore cross-subsidise the costs of low-end units provided free to low-income households, driving up the costs of affordable housing in ways unrelated to the construction cost.

From a lifecycle cost-of-asset perspective, while it may be cheaper for municipalities to provide tarred roads than dirt roads and internal sewers for fully subsidised housing units etc., the Municipal Finance Management Act (MFMA) prevents them from doing this, as public resources of ratepayers cannot be used on private land. Further, municipal capacity constraints result in the existing infrastructure being inadequately maintained, while the limited rates base and balance sheet restrict access to finance.

### **Shift from a focus on ownership to all forms of housing supply**

Stakeholders agreed with the problem statement's analysis that the supply-side driven policy, in which the state delivers fully subsidised houses for all eligible beneficiaries, was problematic. Instead of a narrow focus on ownership, stakeholders argued that all means of supplying housing and forms of tenure should be considered. This includes evaluating the impact of the various types of housing supply on each other, and looking at incentivising and regulating them.

Stakeholders pointed out that, although government had mentioned self-build as an option for housing delivery, the extent of the informal housing sector (in particular in the rural areas) is not acknowledged. Similarly, although national policy provides for microfinance-enabled incremental housing developments and improvements to existing houses, they have not yet been sufficiently recognised at local level.

To date the government's objective has been the mass delivery of housing, yet stakeholders urged the state to appreciate the value of smaller, multilevel, mixed-use developments. Instead of demolishing units and rebuilding at a high cost, these developments usually take place in an already built-up area where infrastructure exists and focus on reusing and repositioning old or underutilised buildings and sites. These developments also allow for cross-subsidisation, whereby higher prices are charged to one group of end users in order to subsidise lower prices for another group. They are typically in the city centre, where rental demand is growing at a rate of 250,000 units per annum. A good incentive for the state to invest in such developments is that the rate base potentially increases as the city centre becomes more densely populated. However, municipalities would only realise a return if property rates are charged and collected across the board. Stakeholders argued that rental stock should be stimulated through a more effective subsidy, especially in the inner city.

Stakeholders stated that a greater focus on the rental market was required, including understanding the impact of relevant legislation and regulations, which the problem statement recognised as constraints. Additional challenges in the rental market identified by stakeholders include insufficient capitalisation of Social Housing Regulation Authority (SHRA) and rental management capacity constraints that are not addressed at the project design stage. The industry, institutional and management capacity to support an increasing

rental housing market are also required. Municipalities have historically struggled to maintain and typically try to get rid of council-owned rental stock.

### 3.4 Stakeholders Perspectives on the Administration of Housing Finance

Stakeholders' experience shed further light on some of the practical challenges of administering housing finance.

#### **Policy flexibility versus implementation rigidity**

While national policy gives provincial and local governments the flexibility to adapt housing policy and plans according to their context, stakeholders perceived national government as dictating a “one size fits all” approach. This perception is created during implementation, when accessing finance from national government. While the BNG policy takes a human settlements approach, the subsidy instrument stipulates only one house per plot, which is not appropriate for settlement-level interventions. Stakeholders argued that the practical design and administration of housing grants often come with restrictions that limit the ability of provincial and local government to respond adequately to the needs of their communities.

#### **Legislative and administrative barriers in the housing market**

Factors hindering municipalities' capacity to act included limited accreditation<sup>22</sup> and legislative restrictions. Five of the eight metros account for 43% of the total demand for housing. As cities play an increasingly important economic development role, full accreditation of metropolitan municipalities is essential for ensuring that they contribute to national built-environment outcomes. Stakeholders argued for considering direct funding flows to metros and secondary cities with fewer conditions. Poor intergovernmental relations, insufficient authority and responsibility at municipal level, lack of long-term spatial planning and problems in land use and zoning persist.

In terms of legislative restrictions, the MFMA does not allow metros to use their own revenues as bridging finance for low-income housing developments. Nor are development finance institutions (DFIs) providing sufficient bridging finance to speed up the delivery of low-income housing. A legislative change is required that will allow DFIs to provide significant financial backing to metros – currently the housing DFIs have no more than R3 billion between them in funding.

The silo approach found in municipal systems is contrary to an integrated development approach. Stakeholders voiced their frustration with individual departments that focus on accountability for compliance and their individual budgets, instead of accountability for outcomes that require integrated planning and a pooling of resources to meet government's strategic objectives.

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<sup>22</sup> An accredited municipality has been approved to undertake similar functions to provincial governments, i.e. receiving, evaluating and approving or denying applications for subsidies, preparing a local housing strategy and setting housing delivery goals. The process of accreditation is governed by the National Housing Act. To become accredited, a municipality must apply to the Member of the Executive Council (MEC) who, after consulting with the relevant provincial housing board, will allocate funds to the municipality for the Housing Subsidy Scheme or any other national housing programme.

## Chapter 4: Principles Guiding the Commission's Response to this Problem Statement

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Since the inception of housing delivery programme in 1994 to assist the poor in accessing adequate housing, the government has focused on the provision of a complete and free housing product to qualifying households. By promoting the state as the central provider of housing for 60% of households, the current arrangements actively crowd out participation by individuals and the private sector. This occurs both within the subsidy market, by creating an entitlement to a house that potential beneficiaries passively wait for rather than mobilising communities to meet their own shelter needs, and outside the subsidy market by creating distortions that undermine full private sector participation.<sup>23</sup> The capacity of non-state sector (including households and businesses) to contribute to the nation's housing goals is therefore being undermined.

The current system of providing qualifying households with a complete housing product needs to be reviewed as it is not sustainable. The Minister of Human Settlements also indicated earlier this year (April 2011) that the government could not continue offering free housing indefinitely. With this background, and in response to stakeholders' inputs made at the housing public hearing, the Commission has indicated that the following principles would guide its future response: the old system of fully subsidised houses is not sustainable and causes significant and exclusionary distortions. A paradigm shift in housing finance policy is required. There are four core components to this shift:

- a) *Refocusing on building a single, inclusionary housing market.* The current, de facto housing finance policy fails to recognise adequately the role of the housing market in providing access to housing at scale. This market already operates, either formally or informally, across all market segments and in both primary and secondary markets. But it fails the poorest households the most.
- b) *Redefining the role of state:* Houses are the only single component of human settlements. A sustainable human settlement consists of two components: the public good and the private good. In the provision of housing, it is therefore important to differentiate between human settlements components that can be considered to be public goods from those that are private goods. Some characteristics of a public good in theory are non-rivalry and non-exclusivity. Understanding this difference is key and will enable the state to concentrate on the delivery of those components of human settlements relating to a public good and create a conducive environment for the individual households and private sector to concentrate on providing those components of human settlements relating to private goods. Houses themselves, are essentially a private good. The infrastructure, services and facilities that build healthy, vibrant communities have larger public good characteristics. Even serviced land, with secure title, has a greater public good characteristic than houses

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<sup>23</sup> The government for example could take on functions that could be done more efficiently by the private sector, limiting the role the private sector could play in the delivery and funding of housing.

themselves. This suggests that the state should focus on delivering appropriate public goods to support human settlements, focusing on streamlining the institutional and regulatory red tape in the delivery of human settlements.

- c) *Rethinking housing entitlements*: The Bill of Rights (Section 26 (1) of the Constitution of the Republic of South Africa) entitles everyone to have access to adequate housing. Section 26(2) of the Constitution takes this further as the state must take reasonable legislative and other measures to ensure the progressive realisation of this right. However, the state is not obliged to provide free housing. There is a need to shift the thinking and perception of households from being passive beneficiaries dependent on the state, to being actively engaged in meeting their own housing needs and mobilising their own resources as end-user contributions as well as private sector financing in addition to public resources.
- d) *Addressing the needs of informal settlements*: the proliferation of informal settlements reflects the current dysfunctions in the housing sector, due to an inability of both the state and the market to address household needs adequately. Global experience suggests addressing state and market failures alone will not meet the needs of many households already living in informal settlements. A dedicated focus on upgrading these settlements is critical. Importantly, however, this informality must not be addressed as a problem but rather as an opportunity of empowering households and redesigning of cities. Upgrading efforts must prioritise in-situ upgrading; this also provides an opportunity for densification as informal settlements are mostly already dense.

## Chapter 5: Research Gaps

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Emanating from the problem statement drafted by the Commission, submissions and presentations made by the stakeholders and the discussion during the housing public hearings, a number of gaps have been identified. These gaps are areas for future research and encompass the housing supply-side, housing demand-side, institutional arrangements, policy and legislative framework and financing arrangements. It is also important to note that some of these challenges or gaps are cross-cutting. These issues are briefly discussed below.

### *a) Supply-side*

The inability of the current system to consider long-term human settlement planning is because it is supply driven and not sufficiently related or linked to the demand. The system currently delivers housing to the needy without a nuanced understanding of the overall level of housing demand (as opposed to other forms of shelter), its composition or the factors influencing the demand for housing. In some instances demand may be over-stated (e.g. where all traditional dwellings are regarded as inadequate accommodation to be done away with rather than improved).

The current system fails to enable individuals to move up the housing ladder by, for example, placing restrictions on the resale of subsidised housing. In practice, the households' needs and what they can afford (which is driven by income level) change with time, and thus individuals move higher up the housing ladder.

The gaps in supply-side research are:

- in determining whether supplying top structures or providing serviced land and bulk infrastructure is slowing down housing delivery;
- in understanding what exactly is constraining private sector involvement (particularly in the gap housing market) and in developing effective intervention strategies to fully involve the private sector and individual households in the delivery of housing;
- in understanding the effectiveness of government interventions to unlock the supply of land, which is a major obstacle to delivering housing.

### *b) Demand-side*

A problem remains the accurate quantification of housing demand and a nuanced understanding of its composition and underlying drivers. In most cases, the estimations normally used for housing demand are based on the Statistics SA data, which include informal dwellings, backyard shacks and traditional dwellings. Yet, demand for housing is limited in some instances to those who qualify for the national subsidy scheme and so ignores those who do not qualify but continue to live in informal settlements, backyard shacks and overcrowded dwellings.

The difference between a demand for housing and a demand for shelter is still not clearly understood. Thus, for example, young migrants to the inner cities seeking work may want low-cost, safe accommodation near places of potential employment but would not necessarily demand a house there permanently at that stage in their life cycle.

Up-to-date and credible data and information about the demand for housing is also one of the constraints that deter planning for housing delivery, which in principle is supposed to be

demand driven. Major issues for future research are understanding the current housing needs or housing backlogs (vis-à-vis social housing rentals for instance), predicting how the demand is likely to evolve in future, and developing appropriate long-term housing finance strategies.

*c) Institutional arrangements*

All spheres of government have a role to play in the delivery of housing, but one of the major challenges is the lack of coordination and clear understanding of the role of each sphere. Their roles range from policy formulation to funding, planning, project approval, zoning and registration among other things. Over and above the spheres of government, public housing entities were also established to play specific roles in the delivery of housing. Such housing development institutions include the Housing Development Agency, National Housing Finance Corporation, Rural Housing Loan Fund and SHRA. Other key role players in the delivery of housing are the private sector, in the form of developers, commercial banks and non-governmental organisations. The gap is reforming intergovernmental fiscal arrangements and improving institutional relationships and coordination in South Africa in line with the concept of sustainable human settlements.

*d) Policy and legislative challenges*

The delivery of housing and human settlements is subject to policy and legislative processes, which sometimes hamper the speed of housing delivery. This is linked to institutional bottlenecks. One example is how long it takes to deliver a complete housing product from the planning and zoning stages up to the actual handover to beneficiaries. In some instances, regulatory red tape substantially increases the developer's costs, which are not directly related to the input costs of constructions, and implies that fewer units are delivered at higher prices to the end user. Delays resulting from the complex legislative framework and the low capacity of municipalities to administer these regulations effectively push up cost to developers by about 30% on average; such costs are then passed on to non-subsidised households (bonded units), making them less affordable.

On the other hand, while developers have traditionally funded the delivery of bulk infrastructure, the funding of internal reticulation infrastructure to subsidised housing units within mixed developments is unclear. Under the current MFMA, municipalities are finding it difficult to use public resources of rate-payers on private land. Similarly, from a lifecycle cost-of-asset perspective, it may be cheaper to provide tarred roads rather than dirt roads. Another challenge is that the MFMA does not allow municipalities to use their own resources for bridging finance for housing development, yet housing finance institutions are not providing bridging finance either.

*e) Financial and fiscal – integrated and coordinated funding for the delivery of human settlements*

The delivery of integrated human settlements implies more than just the delivery of housing and needs a consolidated effort by various role players responsible for various components of human settlements. Therefore, the current funding framework for the built environment in the context of integrated housing and human settlements needs to be reviewed. Furthermore, funding from the fiscus does not cover all costs of housing delivery and does not currently take into account land value and its costs.

## Chapter 6: Conclusion

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Through a complementary process that runs parallel to the DOR submission, the Commission held special hearings intended to stimulate public debate on policy options and to create momentum for changes to housing policy, specifically its subsidy and financing arrangements. The purpose of the hearings was to discuss the draft problem statement released by the Commission and to get stakeholders' perspectives on the challenges in housing finance. A final problem statement, which captures the Commission's formal position after considering input from 83 stakeholders at the hearing, is presented in this document.

The Commission's formal problem statement describes the housing backlogs that remain at significantly high levels, despite government's concerted efforts over the past 17 years, and the challenges currently experienced in the housing subsidy market, the gap housing market, the affordable housing market, the traditional mortgage market, the rental market and in upgrading informal settlements. Also raised were the problems relating to the absence of title deeds and the poor definition and understanding of housing demand. The current housing subsidy programme is unsustainable, being beyond the fiscal capacity of the state, especially in the current austere global economic environment. Another concern is the institutional and legislative challenges, specifically the lack of clearly defined roles and coordination among the various role players.

At the Commission's public hearing on housing finance, stakeholders largely validated this problem statement. The delivery of around 3 million fully subsidised houses since 1994 is insufficient, and the current housing policy is unsustainable given the increased costs and demands for housing that will demand more and bigger subsidies to deliver on promises. The current housing subsidy has created perverse incentives, distorts prices in the gap market and resulted in continued dependency on the state, rather than encouraging investment by the private sector and households. In addition, around 50% of government subsidy beneficiaries live in their houses without title deeds, which prevent housing mobility and deny entry to formal property markets. Stakeholders agreed on the need to accept informal settlements as a point of entry into the housing market, from where people can progress to more formal housing. The importance of the new approach to human settlements rather than housing delivery was recognised, but how it integrates into the subsidy scheme is unclear. The major challenges for housing supply were identified as access to well-located land and bulk infrastructure, as well as housing delivery chain inefficiencies. In addition, government needs to move from a narrow focus on ownership to looking at all forms of supplying housing and at different forms of tenure; for example, smaller, multilevel, mixed-use developments in already built-up areas and the rental market.

Based on the principles articulated in this document, research by the Commission will identify an initial set of policy options and recommendations which will then be considered at a second public hearing. The Commission's sincere hope is that this research will help to precipitate urgent action by policy-makers to reform the housing finance policy and to address the pressing need for housing and sustainable human settlements in the country. In so doing, the government will be able to meet the constitutional right of all South Africans to have access to adequate housing.

## Appendix 1: Glossary

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Accreditation	When a municipality has been approved to undertake similar functions to provincial governments, i.e. receiving, evaluating and approving or denying applications for subsidies, preparing a local housing strategy and setting housing delivery goals. The process of accreditation is governed by the National Housing Act. To become accredited, a municipality must apply to the Member of the Executive Council (MEC) who, after consulting with the relevant provincial housing board, will allocate funds to the municipality for the Housing Subsidy Scheme or any other national housing programme.
Adequate housing	No clear definition of adequate housing exists. However, for the purpose of this document, adequate housing refers to a house that has some core factors such as legal security of tenure, the availability of necessary basic services such as infrastructure and amenities, habitability; accessibility; location and cultural adequacy.
Bulk infrastructure	Dams, canals, water transfer schemes and purification plants.
Commercial incremental housing products	Bank housing finance instruments aimed at funding part of the construction of a new house, e.g. for purchasing a serviced site only, as opposed to covering the cost of an entire house)
Development charge	A once-off infrastructure charge imposed by a municipality on a land owner, as a condition of approving a land development that will result in an increase in the use of or a need for municipal engineering services infrastructure. Development charges allow municipalities to recover from developers the full costs of infrastructure resulting from urban development, such as storm water drainage, water, electricity or roads.
End user	The purchaser of the completed housing unit or the beneficiary of a government-subsidised unit.
Fiscal capacity	Fiscal capacity is defined as “the amount of revenue a particular municipality can raise using the revenue instruments that it has at its disposal and applying a standard set of rates” (Reschovsky, 2003)
Gap market	These are households which do not qualify for free housing since their incomes exceed the subsidy threshold of R3500 a month, but whose incomes fall below R10 000 per month required to buy the cheapest newly built house on the market.
In situ	In the case of informal settlements, this refers to upgrading accommodation units on site, or just where they are (as opposed to relocating households).

Incremental housing	A phased process by which the constitutional right to adequate housing is satisfied. It starts with allowing people to access a housing opportunity, first by right of tenure with rudimentary service, followed by basic services (i.e. a serviced site) and then eventually by acquiring a self-built top structure.
Informal settlements	Areas where groups of housing units have been constructed on land that the occupants have no legal claim to, or occupy illegally. Being unauthorised and unplanned, housing settlement patterns and construction do not comply with planning and building regulations.
Internal reticulation	The connection of a plot of land or building to water (e.g. a metered standpipe per erf), sanitation (e.g. a ventilated improved pit latrine), roads (e.g. graded or gravel paved roads access to each erf) and storm water drainage (e.g. lined open channels).
Lifecycle cost of asset	The full cost of constructing or acquiring an asset, including its operation and maintenance over its useful economic life and its disposal.
Mortgage bond	A mortgage bond is a loan at variable interest rates made by commercial banks to the conventional (high- and moderately high-income) households, secured by a first lien on the house and repayable over 20 to 30 years. Mortgages typically allow pre-payment at any time at a nominal or no cost; and require 20% (or less) down payment. Different banks offer small variations around this standard design, including relatively limited fixed-rate lending.
Primary market	In housing, the primary market refers to the buying and selling of newly constructed houses (see also secondary market).
Private good	An item that yields positive benefits to people and is rival and excludable. For example, a house is a private good, as it has an element of rivalry in consumption and is easy to exclude individuals from enjoying the service.
Public good	A commodity or service provided without profit to all members of a society. A public good is non-rival (i.e. one individual consuming the good or service does not diminish other people's consumption, e.g. defence or television signals) and non-exclusive (difficult to exclude individuals from enjoying the good e.g. anti-air pollution services).
Secondary market	In housing, the secondary market refers to the buying and selling of existing, pre-owned houses (see also primary market).
Serviced site (2)	A vacant plot of land with access to services such as water, sanitation, stormwater drainage and roads on which the top structure of a house can be built.
Sustainable human settlements	“Well-managed entities in which economic growth and social development are in balance with the carrying capacity of the natural systems on which they depend for their existence and result in sustainable development,

Tenure	wealth creation, poverty alleviation and equity” (from the BNG policy). The financial arrangements under which someone has the right to live in a house. The most frequent forms are tenancy (rent is paid to a landlord), owner occupancy (person living in the house either owns the house outright or has a mortgage bond), and social housing (government owned and leased at a subsidised rental rate).
Title deeds	Legal documents that provide evidence of the right of ownership to a property.
Top structure	The actual house, which includes wall and roofing.
Traditional dwelling	A traditional hut or structure used for accommodation and made of traditional materials such as mud, thatch or grass (from Statistics South Africa General Household Survey)

## Appendix 2: List of Stakeholders

### A1 List of Stakeholders who attended the Public Hearings

	<b>Name</b>	<b>Institution</b>
1	Anton Pretorius	Absa Bank
2	Pierre Venter	Banking Association of SA
3	Ndivhuho Mafela	Banking Association of South Africa
4	Yusuf Patel	Basil Read
5	Ernest Sonnenberg	City of Cape Town: Human Settlements
6	Wayne Muller	City of Cape Town Metro
7	Joshua Ngonyama	City of Tshwane Metro
8	Yasmin Coovadia	Consultant
9	Rashied Essop	DBSA
10	Geshie Naidoo	DBSA
11	Tshepiso Kobile	DBSA
12	Funani Matlatsi	Department of Human Settlements
13	Anton Arendse	Department of Human Settlements
14	Revelation	Department of Human Settlements
15	M Maphisa	Department of Human Settlements
16	Neville Chainee	Department of Human Settlements
17	Luanne Werner	Department of Human Settlements
18	A Vawda	Department of Performance Monitoring and Evaluation, Presidency
19	Mr Mohammed Hassan	Eastern Cape Provincial Treasury
20	Cllr Bennet Nkani	Ekurhuleni Municipality
21	Elizabeth Ramaoka	Ekurhuleni Municipality
22	David Morema	Ekurhuleni Municipality
23	Steven Nowatha	Ekurhuleni Municipality
24	P Silal	Ethekwini Municipality
25	Mark Bailey	Ethekwini Municipality
26	Neli Shezi	FFC Commissioner
27	David Savage	FFC Commissioner
28	Tania Ajam	FFC Commissioner
29	Luci Abrahams	FFC Commissioner
30	Mashumi K Mzaidume	Financial and Fiscal Commission
31	Ramos Mabugu	Financial and Fiscal Commission
32	Vincent Makinta	Financial and Fiscal Commission
33	Sasha Peters	Financial and Fiscal Commission
34	Marina Marinkov	Financial and Fiscal Commission
35	Mkhululi Ncube	Financial and Fiscal Commission
36	Lydia Ntenga	Financial and Fiscal Commission
37	Sabelo Mtantato	Financial and Fiscal Commission
38	Tebogo Makube	Financial and Fiscal Commission
39	Nomonde Madubula	Financial and Fiscal Commission
40	Donald Sibanda	Financial and Fiscal Commission
41	Conrad van Gass	Financial and Fiscal Commission

	<b>Name</b>	<b>Institution</b>
42	Leigh Berg	Financial and Fiscal Commission
43	Dolapo Adejuyigbe	FinMark Trust
44	Zanele Madadasana	FS SALGA
45	Thandekile Mbunge	Gauteng Department of Local Government & Housing
46	Sethu Lubisi	Gauteng Department of Local Government & Housing
47	Lena Weiler	GIZ
48	Joseph Leshabane	Housing Development Agency
49	Zinhle Mbanjwa	Housing Development Agency
50	Lebeko Madikgetla	Housing Development Agency
51	Kecia Rust	Housing Finance SA
52	Catherine Cross	HSRC
53	Olivia van Rooyen	Kuyasa Fund
54	Machwene Semanya	Limpopo Legislature
55	Thapelo Mashabane	National Department of Human Settlements
56	Headman Gumbo	Northern Cape Provincial Treasury
57	Matthew Nel	NDHS / Shisaka
58	Kosalin Naicker	Nelson Mandela Bay Metro
59	Luxien Ariyan	NHFC
50	Samantha Naidoo	National Treasury Provincial and LG Infrastructure
60	Malijeng Ngqaleni	National Treasury Provincial and LG Infrastructure
61	Ulrike Rwide	National Treasury Provincial and LG Infrastructure
62	Dr Morgan Pillay	NURCHA
63	Tom Ludlam	NUSP
64	Doris Hlakude	Portfolio Committee on Human Settlements
65	Tracy Jooste	Palmer Development Group
66	Jabulani Fakazi	Rural Housing Loan Fund
67	Michael Kihato	SACN
68	Sandi Baai	South African Human Rights Commission
69	Kerwin Lebone	SAIRR
70	Brian Moholo	Social Housing Regulatory Authority
71	Manda Nkuhlu	Social Housing Regulatory Authority
72	Lael Bethlehem	Standard Bank
73	Mankodi Moitse	Standard Bank
74	Nicholas Nkosi	Standard Bank
75	Paul Jackson	TUHF
76	Mark Napier	Urban Landmark
77	Mbulelo Tshangana	Western Cape Department of Human Settlements
78	Jacqui Samson	Western Cape Department of Human Settlements
79	Ravan Rughubar	Western Cape Department of Human Settlements
80	Malcolm Booyesen	Western Cape Provincial Treasury

	<b>Name</b>	<b>Institution</b>
81	Hishan Allie	Western Cape Provincial Treasury
82	Ivo Imperato	World Bank
83	Subethri Naidoo	World Bank

## Appendix 3: Stakeholder perceptions of principles that should drive solutions and knowledge and data gaps

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### A3.1 Stakeholder perceptions of principles that should drive solutions

Stakeholder perceptions of principles to drive solutions in housing finance which were articulated at the public hearings included:

- (a) The role of the state should be to create an enabling environment for sustainable human settlements. Public funds should be invested in public goods and the private sector and households should be enabled and incentivised to participate in the housing market.
- (b) There is a need to accept that the progressive realisation of rights in terms of adequate housing should be expressed through gradual improvement in the human settlements package over time. Strong interactions between bureaucracies and households must be cultivated to engage with this effectively.
- (c) Human settlements planning and grant allocations should be based on real understanding of actual demand. Housing opportunities and financing arrangements must consider all segments of the housing market, instead of having a narrow focus on ownership only.
- (d) There needs to be commitment by all stakeholders to efficient delivery of human settlements. This should result in better costing of houses, which should include the value of the land over time. In addition, innovation should be encouraged such that it reduces costs.
- (e) Government funding should follow function, and this should result in there being no unfunded mandates.
- (f) Metros should be given full accreditation in terms of human settlements to enable them to take greater responsibility for their contribution towards national government's outcome targets. The role of provinces should be redefined in this regard.

### A3.2 Stakeholder perceptions of knowledge and data gaps

Research gaps identified by stakeholders included:

- (a) Understanding the shifting nature of demand for housing including migration patterns, household formation and mobility.

- (b) How a common database on housing could be established for the use of all stakeholders (e.g. National Treasury, Banks, South African Reserve Bank, Human Settlements departments).
- (c) Analysing scenarios for phasing out the current subsidy scheme and evaluating how the design in human settlements and infrastructure grants can be improved to enable greater coordination in delivery.
- (d) Regulatory impact assessment of all legislation impacting on housing and financing, including the implications of the new spatial planning legislation.
- (e) Understanding more about land acquisition and release and appropriate land use management options in South Africa.
- (f) How policies could decrease the holding and transaction costs for private, municipal and household developers.
- (g) Examining how to enable and facilitate incremental development and secondary markets of housing, along with mechanisms to gear government and private funding.

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