Submission to the FFC on “Challenges and Opportunities in Public Housing Finance in South Africa”

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1 Introduction

This submission has been prepared for the FFC Public Hearing on Housing Finance to be held in Ekurhuleni on 13-14 October 2011. The submission is based on work that has been undertaken by PDG in the housing sector, ranging from cost-benefit analyses of integrated housing projects, to national-scale modelling of municipal finance and the interaction of municipal housing programmes and the fiscal framework.

The submission will focus on housing finance policy in cities, defined as the metropolitan municipalities and the 19 largest local municipalities (A and B1 municipalities). Approximately 76% of the housing demand and state expenditure on housing is located in these cities.

2 How big is the challenge?

2.1 Defining the housing demand

Defining the housing demand accurately has been as problematic as finding solutions to address it. Numbers that are quoted typically refer to StatsSA data that classifies housing demand by those that have ‘inadequate’ types of shelter, including informal dwellings, backyard shack and traditional dwellings. In addition, the quoted demand figures are sometimes tempered by limiting them to those who qualify for the national housing subsidy, thereby ignoring those ‘non-qualifiers’ who continue to live in informal settlements, backyard shacks and overcrowded dwellings. A report produced by PDG (PDG, 2010) discusses flaws with both the statistical and ‘waiting list’ method of quantifying backlog. In addition, the structural problems in the ‘gap market’ referred to in the FFC Problem Statement, represent a different aspect of housing demand, which has a knock on effect on the low-income housing market through downward raiding.

Effective housing finance strategies require adequate budgets, which in turn depend of an adequate assessment of how housing demand is likely to change in future. The factors that need to be considered in projecting this future demand include the current housing context, demographic growth, economic growth and the change in housing supply given private and public sector housing provision.

2.2 The impact of economic growth on housing demand

A preliminary attempt has been made to model these dynamics at city- and national scales using the Municipal Service Financial Model (MSFM). The MSFM models housing supply through a user inputted housing delivery programme (including informal settlement upgrading) and matches this to housing demand as dictated by a pre-existing 'backlog'[1], demographic growth and economic growth. The result is an analysis of the funding required to achieve a certain target for housing and service provision, which is provided in PDG (2010). However, a flaw in the model is that it assumes a perfect secondary housing market – that as the economy grows, average household incomes increase, and so households will move out of low-income housing stock and into middle-income housing stock. But the reality is a critical shortage of housing stock in this market, and thus households do not move, or middle-income households 'downward raid' into housing stock intended for lower-income beneficiaries and these households are displaced to backyard shacks and informal settlements.

This flaw can be overcome by modelling what will happen to demand if low income average household incomes do not increase – what has been termed 'inequitable' economic growth. The result of this change in economic growth dynamic is that as low-income households increase, so the housing demand increases proportionately. The resulting housing supply that would be required in these two scenarios is presented in Table 1[2].

Table 1: Average number of housing units required per annum to remove over 10 years with 'equitable' and 'inequitable' economic growth

Housing category	Equitable economic growth	Inequitable economic growth
Single dwelling	82,646	205,135
Medium density	9,397	24,115
Incremental housing	11,363	27,994
Total subsidised	**103,407**[3]	**257,244**
Low income un-subsidised	23,523	52,349
Gap' housing	69,756	2,991
High income	126,864	16,398
Grand total	**323,549**	**328,981**

Overall the average number of housing units that is required per annum over 10 years does not increase significantly, but the number of subsidised housing units required per annum increases by 150%. The 'inequitable' economic growth scenario presented

[1] The MSFM does not define a 'backlog' but merely uses as a starting point the number of households accommodated in the various housing situations (i.e. formal housing, backyard shacks, traditional dwellings and informal settlements, etc.). In addition, the model calculates the level of overcrowding by subtracting the number of households from the number of dwellings and endeavours to eliminate overcrowding through allocating one household per dwelling.

[2] For a full explanation of the model parameters, see PDG (2010)

[3] The reason why the average number of units for low income households is less than the Base run figures still needs to be explained.

above is extreme, but it illustrates the point that housing demand pressures on state funding are heavily influenced by affordability, which is in turn dependent on economic growth and job creation.

2.3 A new approach to modelling housing demand

To date the emphasis on housing demand projections have been on the subsidised housing sector, and, to a lesser extent, the gap market. However, in analysing the sector it is important to look at housing need for all income categories and understand how shifts in income and related shifts in 'demand' for various housing products takes place. In order to do this it is important to understand the quantum of housing *stock*, in both rental and ownership forms, and the dynamics within this housing stock. Put simplistically: "Who is living where?", and a further question: "Is this considered adequate?".

Very little data exists that looks at the housing stock in all sectors of the market, or the dynamics between these markets. There is a glaring need to reconcile the national statistics (unfortunately still from Census 2001), the various databases of housing stock (ABSA Housing database, Affordable Land and Housing Data Centre, city shack counts, etc.) with more qualitative studies that indicate who lives in these units, why and how they move. An attempt has been made to account for this process through a separate modelling exercise undertaken as part of a research project for the FFC (PDG, 2011). The City Efficiency Costing Model (CECM) includes a housing module that projects housing stock and the allocation of this stock to households of varying income levels., essentially matching housing supply with housing demand (Figure 1).

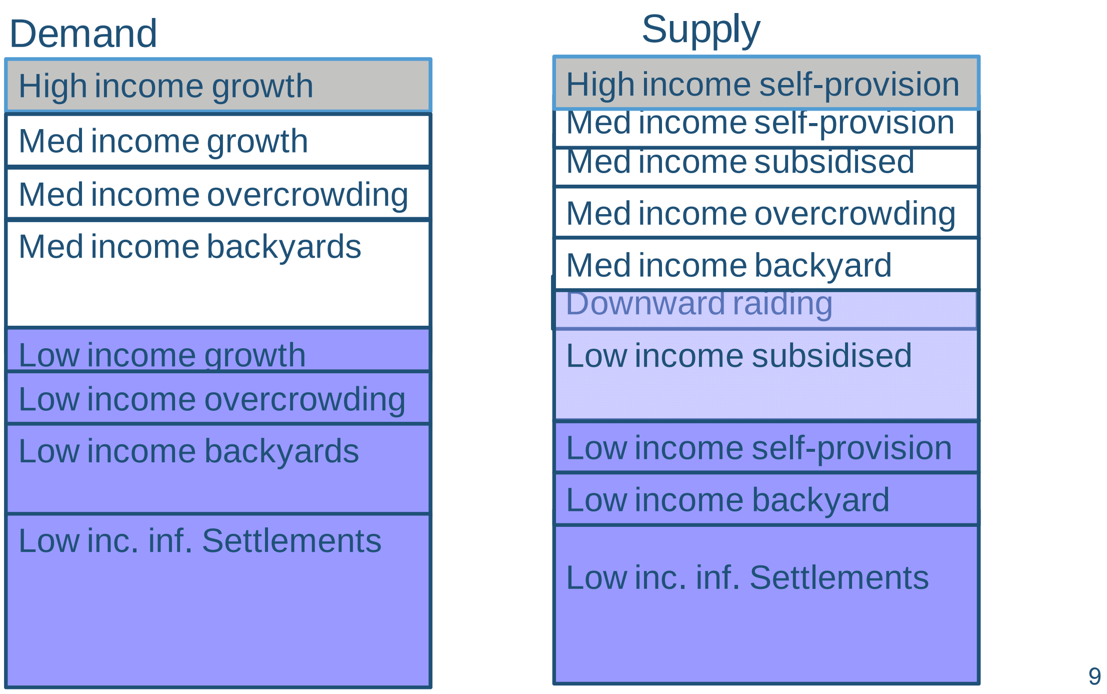

Figure 1: Housing demand and supply categories considered in the CECM

While the module is fairly basic, it does incorporate the principles that are needed to understand the interrelationships between housing supply and demand. The output of the housing module in the CECM is a forward projection of the housing context based on a user-inputted housing programme (Figure 2 and Figure 3), and the funding required to achieve a specified rate of housing delivery. This modelling approach is very useful in reconciling the impact of a chosen housing policy with the funding required to finance the programme.

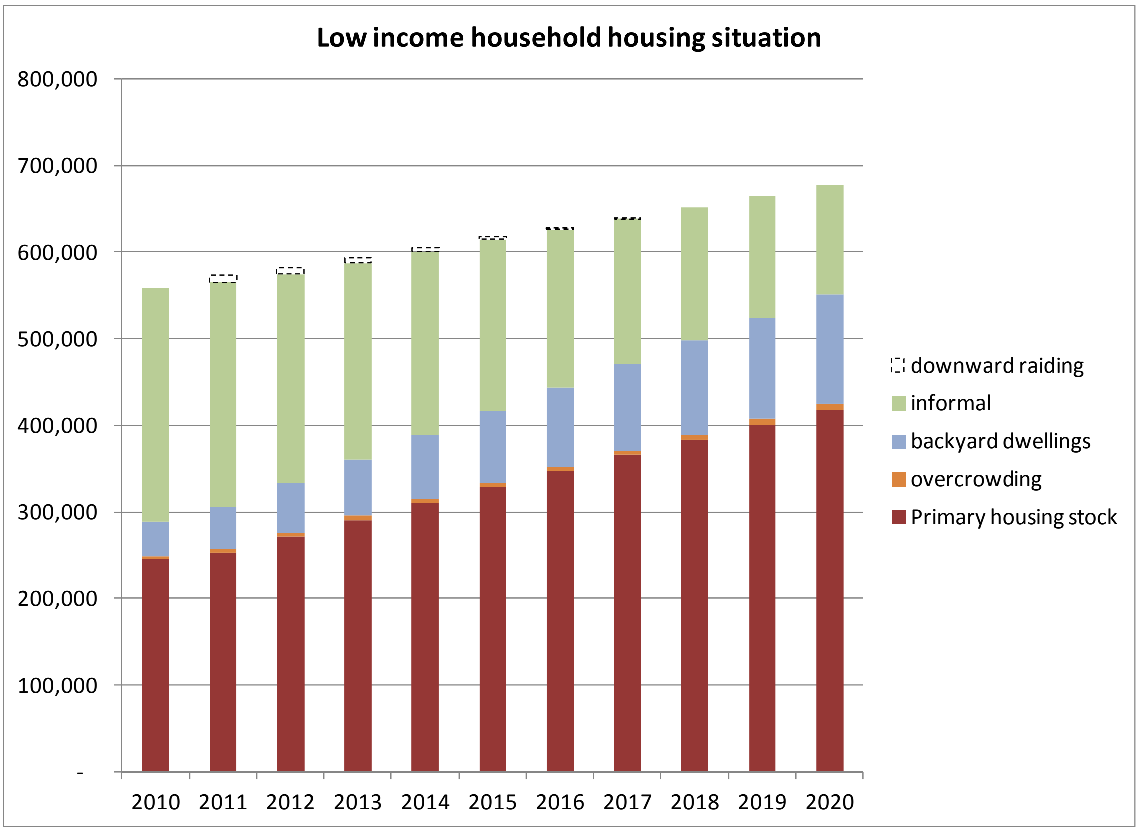

Figure 2: Forward projection of low income household housing context from the CECM

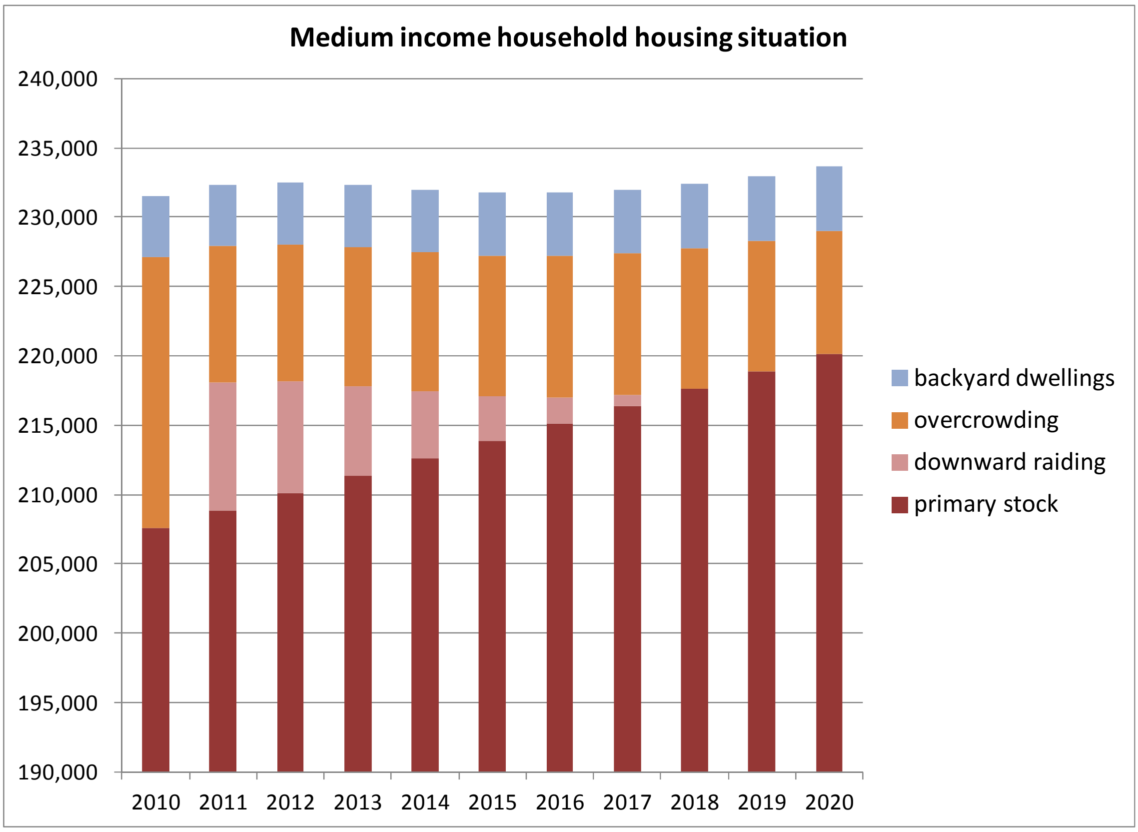

Figure 3: Forward projection of medium income household housing context from the CECM

3 Current policy and housing dynamics in the municipal sphere

3.1 Current policy shifts

Two important developments will have a significant impact on the way human settlements are finance in cities and the form that these interventions will take. The first is the accreditation of the municipalities to undertake the housing functions (according to graded levels of accreditation), and the second is the combination of the Integrated Housing and Human Settlements Grant (IHHSDG) and the Municipal Infrastructure Grant – Cities (MIG Cities) into the Urban Settlements Development Grant (USDG).

3.1.1 Housing accreditation

Five metros have recently been accredited to level two, while the two new metros, Mangaung and Buffalo City, will be accredited to level one. No municipality has been accredited to level three, which delegates full financial administration of the housing grant. The implication of level 3 accreditation is that cities will be able to manage the design and funding of their housing programmes independently of provincial government.

Accreditation therefore has the potential to have major influence on the form of housing interventions in cities. There is a realisation that land, project and beneficiary identification is most effectively done at a local level, and where the municipality has capacity to manage large projects and finance, the municipality should act as the developer. Cities that are granted Level 3 accreditation will have the flexibility to match the IHHSDG to their specific housing needs, and will not be forced to select certain types of projects to comply with provincial housing plans.

3.1.2 Impact of the Urban Settlements Development Grant (USDG)

In essence, the introduction of the USDG circumvents the need for the housing accreditation process. The provincial-led housing process has previously denied cities funding for land and services, through the emphasis on top structure, resulting in the use of large amounts of city internal funding for this, or the stalling of housing delivery. The USDG has deliberately provided funds for this purpose: the purchase and servicing of vacant land, or upgrading of existing settlements.

The USDG is a step in the right direction for creating *integrated* human settlements in that it provides a funding source for all components of settlement creation. Most importantly, it facilitates the more rapid release of serviced land. However, it being unconditional means that it will be used to respond to City priorities and not necessarily those of the National Department of Human Settlements. Even though the Macro Coordinating Framework for Human Settlements states that "Any project or programme which has a direct impact or a significantly indirect impact on a human settlement (existing or new) should be approved according to the National Development Plan for Sustainable Human Settlements and upon which funding is authorized"[4], this is unlikely to happen with cities gaining more funding and control.

The USDG essentially separates the funding for land and services from that of top-structures, which will still be provided thorough the IHHSDG. The portion of the IHHS DG that will be allocated to the Cities is not yet known, as this has to be determined by

[4] Macro Coordinating Framework for Sustainable Human Settlements. Pg. 26.

the provinces from their national allocations, which are now reduced because of the USDG.

For municipalities that do not have level three accreditation, this will mean a separation of funding for the provision of services from the provision of top structures. This then raises the likelihood, whether intentional or not, that services will be provided with top structures only being provided at a later time, or not at all. In some cases this will be a deliberate strategy by cities to prioritise service provision above housing provision, as it allows the spread of the available resources to benefit a greater number of households. This is a political decision that is fraught with conflict over expectation and the social mandate of the State, and that will have to be negotiated with communities. The Minister of Human Settlements has already raised the debate that the continued provision of fully subsidised housing is not sustainable during his comments made at the International Housing and Home Warranty Conference on 26 September 2011.

3.2 Housing delivery models

The FFC Problem Statement has highlighted the fact that the provision of fully subsidised housing is financially unsustainable. The reality is that the housing subsidy does not cover the entire costs of delivering a BNG house, and the balance is covered by hidden subsidies provided by the municipality in most cases. Where the housing subsidy is insufficient to cover the cost of services, MIG funding has been used by municipalities, although this is specifically excluded in the MIG policy in order to avoid 'double' subsidies. But it is seldom that MIG funding for internal services for low-income housing development is sufficient.. Most often if the municipality is topping up the cost of internal services to low-income households this is done from their own sources of capital, using either internal reserves or borrowing. Given the obvious financial challenges that are faced in the sector, the dominant interventions are likely to be those that combine the dedicated state funding sources with maximised contributions from households and the private sector.

3.2.1 Incremental upgrading and serviced sites

Incremental upgrading was always possible through UISP, but was hindered because of non-alignment with MIG funding for bulk infrastructure, and because Provincial targets for this subsidy type were in conflict with municipal intentions. The de-linking of infrastructure provision from that of top structures through the creation of the USDG is therefore likely to increase the rate of informal settlement upgrading and the provision of greenfield serviced sites. However, the latter strategy needs to be managed carefully to avoid the negative connotations associated with previous 'site-and-service' programmes. The provision of top structures subsequent to the settlement of serviced sites is likely to be administratively and politically challenging, requiring careful coordination between the Cities and the Provinces

This new policy thrust is also a deviation from the expectations created by the housing subsidy programme to date that the poor will be provided with a completed house.

3.2.2 Integrated housing developments

Integrated housing developments have been gaining in popularity an acclaim, with the success of projects such as Cosmo City and Pennyville, and a significant up-scaling of this type of housing intervention is planned in the major metros, such as those at Cornubia in eThekwini and Fleurhof in Johannesburg. In this delivery model, developers gain project approval based on an agreed amount of subsidised or partially-subsidised housing in the project. The developers have access to the IRDP subsidies for fully subsidised units or FLISP subsidies[5] for partially subsidised units, and recover full costs from the 'bonded' housing and commercial sites within the development. The flexibility introduced into the subsidy through changing the PLSP into the ISDP has meant that the subsidy can effectively be used as bridging capital for these developments that is recovered through the sale of non-subsidised and commercial sites.

However, studies by Urban LandMark have shown that because of the high standards of product required to make the remainder of the development attractive, cross subsidy from the other units is unavoidable. This is not a problem if the other units in the development are bonded housing catering for middle- and upper-income groups, but if the remainder of housing is low-income entry level housing, then the undesirable situation can arise whereby the poor subsidise the very poor. This is less of a problem where the range of housing types provided is highly varied and the scale of the project is large.

While integrated housing projects are desirable from a social perspective (integration of previously segregated communities, provision of amenities and generally good locations), the scope for this model of subsidised housing delivery is limited because viability for the developer depends on getting the mix of subsidised to non-subsidised housing right. While municipalities may have optimistic intentions for the numbers of subsidised units that can be included, this is seldom over 50% of the total units delivered. Developers have indicated that the ratio of bonded to subsidised needs to be over 60% to make these projects attractive. Given the housing demand in the low income market is approximately 60% of the total, up-scaling of integrated housing will only be effective until market saturation is achieved, without addressing the full extent of the demand.

3.2.3 Financial interventions in the 'gap' and 'affordable' markets

FLISP has not been adopted at scale because of reluctance of banks to lend to this market, and the unavailability of housing stock at this price. In 2010 the National Guarantee Fund, worth R1 billion was announced, specifically aimed at addressing access to housing finance for those in the 'gap' market segment. This is a form of Mortgage Default Insurance and was introduced to increase the willingness of banks to lend – it is to be available to banks in April 2012. The Minister of Human Settlements has committed to the improvement of property market, through one of the four outputs of Outcome 8, which translates to facilitation of access to 600 000 home loans/bonded units.

Through the National Guarantee Fund, the Department of Human Settlements seeks to work in partnership with banks to address the gap housing challenges which affects, amongst others, critical civil service workers such teachers, nurses and the police who generally fall within the relevant income categories (Department of Human Settlements in Parliamentary Monitoring Group 2010). The establishment of a National Guarantee Fund for South Africa is driven by a number of factors, including the following, identified by the Department of Human Settlements (PMG 2010):

- make 'Finance Linked Individual Subsidy Programme' (FLISP), currently under review, more responsive to the affordability challenges faced by the target market and

[5] While this is possible in theory, experience in Gauteng has shown that accessing the FLISP subsidy is extremely difficult given the reluctance of financial institutions to lend to qualifying households and the small amount of subsidy that is available.

- enable those who lend to access long term fixed-interest rate capital
- create opportunities for these households to purchase homes much sooner
- ensure improved risk management of high-ratio lending
- enhance the housing finance system
- increase the efficiency of the secondary markets and attract institutional investors into the housing finance market

The Department explains that this is intended to "facilitate(ed) access to affordable housing finance by offering protection against default risk to the lenders, thereby stimulating market confidence in the human settlement finance market. This affects the whole market mechanism and market players' response to the increased demand for homeownership" (Chainee quoted in PMG 2010). The Fund therefore offers a mechanism for credit risk mitigation for lenders (banks); in case borrowers are not able to make their mortgage repayments. The Fund could represent an important step towards risk sharing, to which banks are likely to respond to favourably.

3.2.4 Social Rental Housing

Three programmes—the Social Housing Programme, Institutional Subsidy Programme and Community Rental Units (CRU) Programme—are designed to work together to support the implementation of the national rental housing strategy. While social rental housing is gaining momentum in Johannesburg, it has not been implemented at scale. According to the Social Housing Regulatory Authority register of social housing institutions (SHIs)[6], there are 19 active SHIs that have produced 30 499 units to date. Anecdotal evidence suggests that there is an 'insatiable' demand for rental housing at the lower end of the market, and research by PDG for Urban Landmark has shown that social rental housing is a viable solution for addressing the demand in the gap market.
Municipalities have historically struggled to maintain council-owned rental stock, with the result that most municipalities have been trying to get rid of these units. The construction of new rental units using SHIs, and accessing the innovative financial products that are available to them, is a far more attractive solution. However, the scale of funding allocated to social rental housing needs to increase to address this latent demand.

4 Means to address the significant housing finance challenge

The discussion above leads to some preliminary conclusion around possible means to address the significant housing finance challenge. These points do not address the housing finance challenges as a whole, but merely note some of the lessons that have arisen out of the research that has been undertaken by PDG.

Firstly, it needs to be acknowledged that the housing crisis is underpinned by slow economic growth, unemployment and income distortions, resulting in low affordability for the housing products that are available on the open market. Given that the formal housing market functions very well in South Africa, structural improvements in the 'second economy' may do more to alleviate the housing 'demand' than any supply side interventions. However, this is a long-term issue that has no immediate solution.

[6] http://www.shf.org.za/images/stories/2011/pdfs/register_august2011.pdf accessed 04 October 2011

To address the shorter term problem of a shortage of housing stock, the whole housing sector needs to be analysed and the internal dynamics of the sector understood. A dynamic model of housing demand is required that takes into account demographic growth, economic growth, household fragmentation, previous interventions and housing stock provision. Recent models have attempted to fill this gap. These need to be refined and be ready for the release of the Census 2011 data which will radically improve the understanding of the supply side constraints.

The accreditation of metros and larger cities and the changing of the funding structure into the USDG will have a significant impact on the provision of serviced land, but not necessarily on top structure delivery. The scaling up of informal settlement upgrading and serviced land provision is a positive development in providing serviced, habitable settlements in the low income market, but will not address the problems related to the gap market. Accreditation needs to be completed and strategies to complete incremental processes with top structures need to be clearly defined.

In terms of financial interventions for the 'gap' and 'affordable' markets, the only programmatic solution is the mortgage default insurance, through the establishment of the National Guarantee Fund. This has the potential to increase the flow of funds into the housing market by increasing access to mortgage finance for this market segment. The design of the Fund however needs to be informed by a thorough analysis of market information and mortgage data to better understand affordability and housing demand as well as risk probabilities related to potential default. The Fund's success also hinges on the effective co-ordination of activities between relevant governmental and non-governmental stakeholders (such as banks). It is worth noting that while the Fund has the potential to improve the flow of finance into the market it does not address the issue of limited supply of affordable housing stock for the 'gap' market.

Social rental housing is not a strategy that has been aggressively pursued in the South African housing sector. However, research has shown that demand for this type of housing exists in the major urban centres and it has the potential to address some of the problems experienced in the gap and low-income markets.

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