Financial and Fiscal Commission

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For an Equitable Sharing of National Revenue

Challenges and opportunities in housing finance in South Africa

Table of Contents

1. Introduction

Section 26 (1) of the South African Constitution (Act No. 108 of 1996), as amended states that everyone has the right to have access to adequate housing. Sub-section (2) takes this further by stating that the state must take reasonable legislative and other measures, within its available resources, to achieve the progressive realization of this right. There have been various interpretations of this clause and the role it sets up for the state. In terms of the 1994 housing subsidy policy, set out in the Housing White Paper of that year, the State has promoted a supply-side approach which, in the past seventeen years, has seen the construction of upwards of three million subsidized housing units. In the 2004 housing policy, popularly known as "Breaking New Ground" (BNG), a shift from quantity (the number of units delivered), to quality (their location, structural integrity and spatial integration) was promoted, and the role of the State in facilitating market functioning was raised.[1] This "Comprehensive Plan for the Delivery of Sustainable Human Settlements" was approved by Cabinet in September 2004.

These policy adjustments, and the enormous delivery effort of the state aside, the housing backlog persists. Today, South Africa still sits with the same size backlog it estimated having had in 1994. In 2009, the National Department of Human Settlements undertook an exercise looking into the capacity of South Africa's housing finance framework to address its human settlements challenges. A short paper emerged from that exercise, which was presented at the National Department's Social Compact meeting in November 2009 (FinMark Trust, 2009). The paper suggested that the

[1] 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
- 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.
- Utilizing housing as an instrument for the development of sustainable human settlements, in support of spatial restructuring.

housing sector faced three main challenges: insufficient scale of delivery – whether in the subsidised or non-subsidised markets; limited housing affordability among those outside the subsidy band; and the non-sustainability of the housing subsidy regime, given the scale of demand and the costs involved in delivering the standard product. Since then, the debate has continued among practitioners both in the public and private sectors. A critical issue appears to be the extent to which the housing policy leverages, or crowds out, the participation and capacity of both households and lenders in the housing finance market, and the impact this has on the state's capacity to perform its mandate. How this relates to the current subsidy regime, the South African housing sector's capacity to address housing backlogs across the market, the spatial form of our cities, and the overall functioning of housing markets, are key questions to be explored.

In light of this brief introduction of challenges within the housing sector, this project intends to:

(i) develop a consensus position on the dimensions and drivers of the challenges in housing delivery and housing finance policy;
(ii) consider the capacity of South Africa's housing finance sector (including both public and private finance, as well as individual household finance) to address the challenges it faces; and
(iii) make detailed, recommendations on approaches to housing finance.

The Financial and Fiscal Commission's mandate is to make recommendations on issues pertaining to financial and fiscal matters across all three spheres of government. Objectives of this project intend to review challenges in the housing funding and delivery with an aim of making recommendations on issues relating to housing finance.

The following section sets out a broad problem statement as with an aim of stimulating debate and input from stakeholders in the housing and housing finance sectors.

2. Draft Problem Statement

South Africa has a solid and well-developed housing finance sector that provides long term finance to borrowers at reasonable rates, supporting a vibrant and healthy property market. At the end of 2009, residential mortgages 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). The thrust of this market is at the higher end, however, with mortgages among only the top 10-15% of income earners – those earning more than about R10 000 per month.[2]

While the government provides a comprehensive and substantial housing subsidy[3], its capacity to meet the growing backlog is seriously challenged, especially given reduced GDP growth rates and rising unemployment. Current estimates suggest that while the government has been delivering houses for the poor through housing subsidy scheme, the housing backlog remains on the increase as shown in table 1.

Table 1: Housing backlog from 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 2,1m units and rising annually.[4]

In research supported by the World Bank, Sing (2010, unpublished) provides the following diagram to illustrate the segments that comprise the current market.

[2] The Income and Expenditure Survey 2005/06 shows that mortgages become a feature of the market at monthly7 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).

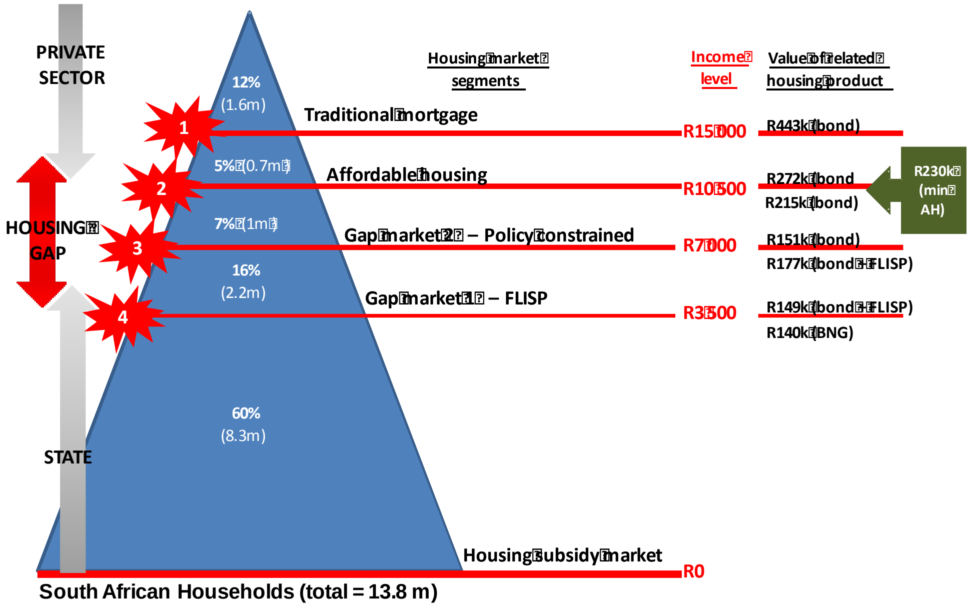
[3] The housing subsidy is currently valued at about R140 000, this includes the provision of a 40m^2 house on a 250m^2 plot of serviced land, entirely for free, to households earning less than R3500 per month.

[4] 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."

Diagram A

GAPS IN HOUSING FINANCE - POINTS OF INFLECTION

(Data Source: Melzer (2010); Concept: Sing (2010))



The Housing Subsidy Market

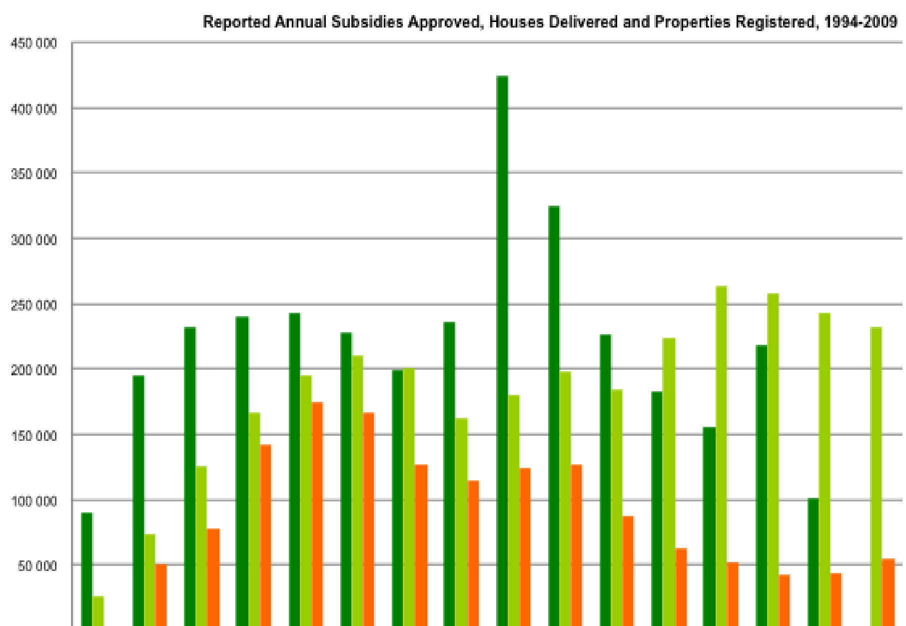
As illustrated above, 60% of households in South Africa are eligible to apply for a housing subsidy, which currently delivers them a house for a cost to the state of approximately R140 000 (estimates range from the R84 000 value of the individual subsidy through to R200 000). The Department of Human Settlements reports that since 1994, upwards of 3 million housing units have been delivered. Figure 2, below, shows how this has spread across the years (Shisaka, 2011). The figure shows three different data sets:

- Number of subsidies approved: this reflects data reported by the National Treasury and published regularly. While this data is only available until 2008, the National Department of Human Settlements database illustrates that since the initiation of the scheme in 1994 up until September 2010, about 3, 8 million individuals were approved to receive a housing subsidy.[5]

[5] This figure includes spouses, so 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.

- Number of houses completed or under construction: this is the figure reported by the National Department of Human Settlements to the National Treasury on an annual basis. It includes houses completed as well as those still under construction, as well as serviced stands. The Department of Human Settlements reports that between 1994 and 2009, a total of 2, 94 million housing units were completed or under construction.[6]

- Number of subsidy properties registered: this data arises from a process whereby the ID numbers of individuals approved for subsidies were fed into the deeds registry and matched with existing properties. Of the 2, 94 million subsidised properties built or under construction by 2009, 1, 44 million (51%) are registered on the Deeds Registry.



	1 994	1 995	1 996	1 997	1 998	1 999	2 000	2 001	2 002	2 003	2 004	2 005	2 006	2 007	2 008	2 009
Number of subsidies approved	90 107	195 232	232 025	240 079	242 808	228 467	198 838	236 470	424 843	324 882	225 865	182 664	155 012	217 848	100 826	
No of houses completed/under construction	26 502	73 321	126 147	166 218	194 705	210 821	200 058	162 226	179 465	197 604	184 613	223 145	263 865	257 798	243 260	231 543
Total number of subsidy properties registered		51 106	77 413	141 858	174 256	167 056	127 167	114 395	123 917	127 472	87 195	62 644	51 950	42 302	43 891	54 265

Data sources: National Treasury, 2007 and 2009 and Department of Human Settlements[7]; 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

[6] Because delivery figures are reported on a financial year basis, this has been annualized for the purposes of this 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.

[7] Delivery statistics, available at the department's website. www.dhs.gov.za

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 with an understanding of housing backlogs and the delivery goal the government has set for itself, to deliver at least 300 000 housing units per year (Knight, R 2001). However, the actual delivery of subsidised housing units has consistently fallen short of this target (for example in 2009/10 financial year the government has only delivered 161 854 housing and 64 362 serviced sites). Failure to achieve targets has been as a result of various factors including delays in township establishment processes, infrastructure constraints, and the limited availability of well-located and affordable land.

As worrying as the limited scale of delivery, is the decreasing rate of formal registrations. If we assume that all 2, 94 million houses have been built, the difference in delivery figures with deeds registry figures implies that a further 1,5 million subsidy beneficiaries received an asset that has not been registered in the Deeds Registry.[8] Up until 2004, the number of subsidy houses registered per year was more than 60% of those reported as delivered. From 2005, however, there is a consistent decrease in the percentage of subsidy houses registered, and this is continuing and becoming worse. By not receiving title to their houses, these beneficiaries are being denied a critical point of entry into the formal property market. Ultimately, this is an asset quality issue which must be addressed.

Lastly, the focus on the mass provision of fully-subsidised housing units has its own weaknesses including failure to leverage private finance and end-user contributions into housing delivery, and a lack of focus in resolving administrative problems associated with land release, tenure security and the subsidy waiting lists which leads to errors of both inclusion and exclusion due to the stepped nature of the income bands.

[8] 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' (commonly referred to as Breaking New Ground (2004) 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.

The demand for housing in South Africa remains high as it is currently estimated that 12.5 million people are in need for shelter and this translates into about 2.1 million housing units. The Minister of Human Settlements recently noted that the number of informal settlements across the country has gone up to more than 2 700 from 300 in 1994. A number of households especially in urban areas reside in shacks, backyard dwellings, squatter settlements and mobile homes. These forms of dwelling reduce the quality of life for households. Informal settlements are increasing due to a number of factors, most significant the failure of the current housing delivery system to deliver affordable housing at the scale required and, for informal settlement residents not eligible for a housing subsidy, the dynamics associated with the 'gap market' as explained below. The rate at which households move from informal to formal settlements is very low. It was only 10 percent between 1999 and 2004 (Lall et al, 2007). The demand for housing especially in urban areas of the country was estimated to have increased by 90% between 1995-2002 (Lall, et al, 2007).

The Gap Housing Market

The gap housing market , starts with households earning just outside the subsidy income threshold of R3501 household income per month, and extending to the household income required to purchase the cheapest, newly built house on the market – about R10 000 household income per month. This segment includes key public sector workers as well as entry-level workers in the private sector. The cost of the subsidy house delivered also defines the gap market, given that it is given away at no cost to households earning below R3500 per month. At about R140 000, a subsidy house if offered for sale would be affordable for a household earning about R5000 per month, just over the subsidy income threshold, to purchase with mortgage finance, which in principle could be available.[9] However, the R140 000 house is not available for sale, given developers' and financiers' fears of market risks, and borrowers' expectations for housing that is better than that available for free to the subsidy target market. As a result, two gap markets are created: Gap Market 1, in which a current, finance-linked subsidy is offered (however this, for a range of reasons, is inappropriate, insufficient and insignificant, not addressing the challenge at all), and Gap Market 2, where no state support is currently available. Other than resale stock (the supply of which is also constrained, given constraints in the primary market), there is no housing available in this market. 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. In the short term, however, 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).

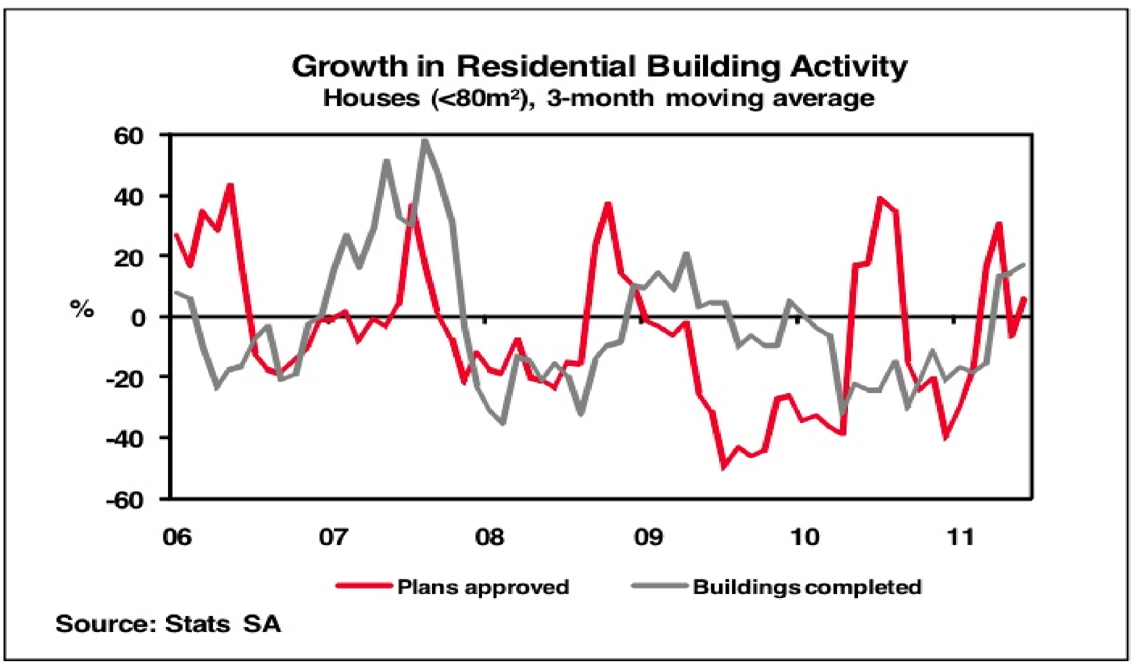
In the current environment, access to credit does exist. Households earning as little as R2000 per month can access a credit card, and the Financial Sector Charter sought to extend housing loans to households earning upwards from R1500 per month. However, in the absence of housing supply, access to credit 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 they can afford are encouraged to invest otherwise, often in consumption goods. Melzer (2010, unpublished) shows how 50% of households earning between R3500 and R7000 per month have formal credit (vehicle finance, credit from retail stores, bank overdraft facilities and loans), while only 3.4% in that income bracket have a mortgage. About one third of that population has liquid savings. When households spend their incomes

[9] There are, of course, problems with access to mortgage finance. However, lenders have offered such lower value mortgage loans to clients – in the FSC period, the average loan size was in the range of R100 000 – R120 000.

on other (often consumption) goods, their capacity to afford housing should it become available, diminishes. The National Credit Regulator has highlighted the dominance of consumption credit as an important financial sector stability issue.

The Affordable Housing Market

New housing delivery starts within the affordable market segment, although not yet at the scale required. The cheapest, newly built house in the current market is about R250 000, affordable to a household who earns about R10 000 per month. However, delivery in this segment of the market is far below the estimated demand. According to the Affordable Land + Housing Data Centre, only 6 252 new units priced between R250 000 – R500 000 were registered on the Deeds Registry in 2010. Houses in this segment of the market are generally smaller than 80m^2 (although 80m^2 houses can also be in the traditional mortgage market). According to Stats SA (2011), residential building activity for this segment of the market has been negative since about 2009 and is only recently moving again into the positive zone.



Of course, a critical issue facing this segment of the market also has to do with affordability for 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, of the 18.84 million credit active consumers, 53.3% were in good standing. The number of consumers with impaired records stood at 8.8 million. Only 39.1% of all consumers were current with their credit, and a further 14.2% were between one and two months in arrears. Eighteen and a half per cent were under in arrears of three or more months, and just under a third had adverse listings or were under judgement or administration orders. In the context of this level of debt, many households in the gap and affordable market segments find their affordability constrained even further, while some households even at the bottom of the traditional mortgage market may find their affordability has fallen into lower market segments.

The Traditional Mortgage Market

The Traditional Mortgage Market refers to the top 12% of the population, which earns sufficient income to afford housing that is generally available in the market, whether new build or resale. This market does not have housing backlog and quality challenge, and there is significant financial leveraging – this is the market with the highest proportion of mortgages, and loan to value ratios are lower in this market than in any other. The SA Reserve Bank has recently begun to track re-advances. The data indicates that re-advances accounted for 32% of all new mortgages and re-advances in 2009, suggesting that households are able to leverage their housing assets to access further finance, thereby contributing towards economic growth.

This market has not escaped the pressures of the recent economic downturn, however, and levels of default for this segment have risen with, and perhaps ahead of, the entire market.

Recent, preliminary research conducted by Eighty20 and XDS Credit Bureau for the FinMark Trust found that mortgage loans extended to Financial Sector Charter target market clients between 2004 and 2008 have performed slightly better than the market as a whole, with a lower percentage of non-performing loans (FinMark Trust 2011).

The Rental Market

South Africa's rental housing sector is significant, accounting for about one fifth of all households in South Africa (Melzer, 2008). A report commissioned by the Social Housing Foundation in 2008 found that the majority of renters were low-income earners – 55% earned less than R3500 and another 20% between R3500 – R7500. About 40% of tenants live in what would constitute slum conditions, however, 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 – they report an almost insatiable demand for rental. The different types of rental accommodation cater for different types of rental demand. At the very bottom end, backyard shack rentals offer their tenants cheap accommodation while also offering landlords an opportunity to earn an income. Their slum conditions could be addressed by municipal investment in infrastructure and support for water and sanitation delivery to these new housing opportunities. Inner city conversions, especially in Johannesburg, offer a more quality, 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.

Informal Settlement Upgrading

A policy response to the growth of informal settlements is found in the Upgrading of informal Settlements Programme (UISP), which itself responds to the Outcome 8 expectations for the upgrading of 400 000 units of accommodation within informal settlements. The UISP highlights the importance of assisting households living in informal settlements just where they are (in situ) and it states clearly that relocation should be the last resort and be undertaken only in exceptional circumstances on a voluntarily and co-operative basis. The UISP has the potential to offer important lessons to the government's wider approach towards subsidising housing. How it is integrated in the wider subsidy scheme entitlements is unclear, however.

Future of the housing subsidy programme

It might be possible to hope to subsidise our way out of the challenges raised above. Certainly the challenges with the gap market have led to discussions of a new subsidy, a larger FLISP or extended subsidy, on the existing programme. A critical issue, however, relates to *the sustainability of the current subsidy programme*. Within the current subsidy framework, a backlog of 2,2 million units would cost, at R140 000 per unit, over R300 billion– not remotely within the fiscal capacity of the state, and this is without any add-on that the additional market demands would suggest.[10] Assuming the projected delivery rate of 250 000 houses per year, the annual budgetary implication is R35 billion. Even if government were to combine the housing and infrastructure subsidies, and provide land for free, a budgetary shortfall would still exist. In the context of the current global economic environment, it is unlikely that revenue will increase sufficiently (if at all) to accommodate the budgetary growth that the current arrangements suggest is necessary. It is also unlikely that South Africa will be able to raise sufficient debt capital to subsidise housing on this basis.

Apart from the issue of sustainability, the actual *role of the state in the provision of housing* for the poor must be clarified. By promoting the state as the central provider of housing for sixty per cent of households, the current arrangements actively crowd out the participation by individuals and the private sector, whether in the subsidy market by creating an entitlement that is waited for, or outside the subsidy market by creating distortions that undermine participation. This means that the capacity of non-state sectors, including households and businesses, in contributing towards the nation's housing goals, is undermined.

[10] 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 figure, all in, given the breadth and depth of the housing policy in South Africa and the range of subsidy instruments involved, at R500 billion.

3. **Conclusions**

The challenges in the housing finance sector have come under close scrutiny by a wide array of stakeholders in recent months.[11] In all of these deliberations, it has been the housing subsidy that has come under the spotlight. But while all agree that a revision to the subsidy programme is a critical pre-condition for addressing the problems of scale, affordability and sustainability in the housing sector, none have articulated the parameters of a new arrangement. The bigger picture, however, distracts the debate: the non-financial interventions that are critically required, and the enormity of the infrastructure challenge. This breadth of issues and how they relate to our financial and fiscal framework for housing is the subject of the FFC Hearings in October 2011.

[11] 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 that the nation faces. FinMark Trust funded this work and a draft report was prepared for the National Department, and presented on behalf of the National Department of Human Settlements at its social contract meeting in November 2009. Work commissioned by the National Department of Human Settlements and the Western Cape Department of Local Government and Housing respectively has considered the market distorting impact of the housing subsidy and the cost of the subsidy to 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 towards 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 it is currently structured. The Informal Settlement Upgrading Programme as it is framed to support Outcome 8 of the Presidency offers very useful proposals for a more rational approach to improving housing circumstances.

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