Setting the Context: South Africa

More Than Shelter:
Housing as an Instrument of Economic and Social Development
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HISTORICAL CONTEXT

The housing finance situation in South Africa is largely determined by two inter-woven factors:

1. Income distribution; and
2. Historic legacy of apartheid, which enforced racial separation of residential areas and differentiated ownership rights according to race and area.

Prior to the 1980's, land tenure for black South Africans was essentially restricted to rural areas. This was a deliberate government strategy: a conscious component of apartheid intended to disenfranchise blacks from ownership, mobility, and wealth accumulation. In the urban areas, black South Africans lived as tenants in sprawling urban fringe townships built by the state in the 1950's and 1960's. The townships served as dormitory towns to the cities and white suburban areas in which people worked.

Housing thus emerged as a central plank in 'the struggle,' as black South Africans now refer to the decades-long fight to end apartheid and establish true democracy. To this day housing is a strong political issue and housing-related issues (e.g. access to housing, eviction, foreclosure) are often cast in human-rights and civil-rights terms.

As apartheid crumbled in the late 1980's, and specifically as tenure restrictions were lifted for urban areas, banks were relatively quick to grant mortgage loans to employed black buyers. The first flush of democracy (Mandela's 1990 release from prison, the 1994 elections) led to a vast volume of lending, almost exclusively for homeownership. In turn, a severe non-payment problem arose through a combination of factors:

- Loss of employment of borrowers due to a severe economic downturn in the late Eighties and early Nineties
- Interest rate increases which strained affordability
- Construction defects in rapidly built houses
- Inadequate financial literacy, especially as to mortgage bonds, among new homeowners

There shortly followed organized bond boycotts, linked to local service and tax boycotts, as a means of political protest in the dying years of the apartheid regime. By 1994 an estimated 20% of this new lending was non-performing, and banks had largely stopped lending there.

In 1994, the new democratic government inherited an environment in which there was not only a large and growing housing backlog in spatially dysfunctional urban areas, but also private sector finance was largely unavailable in the areas corresponding to the affordability of the majority of the population. Nevertheless, the new government set the ambitious goal of building a million new houses for new home owners.

This goal was largely achieved through the introduction of an individual capital subsidy scheme (see box below). At low income levels, the subsidy was intended to cover the cost of a small house with basic services; at intermediate levels, it was intended that the subsidy would be blended with private credit to produce larger, better housing outcomes.

In practice, the scheme ended up as a means of mass delivery of small (so called Reconstruction and Development Programme, RDP) houses to households, often with little or no income, by developers—at first private sector companies, but as inflation limited the value of the subsidies, increasingly by local authorities serving as developers. The numbers were nonetheless impressive: 1.6m houses were completed or under construction as a result of the programme within ten years, with a peak delivery rate of some 300 000 units p.a. in 1997/8 and more recently around 190 000 units p.a. being delivered (http://www.housing.gov.za/Stats/200403/20040324.gif). However, the average size of a subsidized house (20-60 m^2 on a 200m^2 lot) was small, which attracted popular attention; and very few of the subsidies were linked to credit in any form. In addition to new housing, 500 000 previously state owned housing units were transferred to their occupants.

The subsidy scheme has evolved over the decade, adding new categories (e.g. to encourage rental as well, and to allow for functional tenure in rural areas) and increasing in value, although below the rate of building cost inflation.

South African Housing: Capital Subsidy Scheme

The main instrument of housing subsidy in SA is the capital subsidy, provided by National Government through provincial housing departments.

The main scheme is open to first-time home buyers with a household income of less than $500 per month and with dependents, and provides a one off capital sum of a maximum $3000, usually through the developer; this subsidy takes different forms depending on the position of the recipient. More recently, recipients have also been required to produce a co-payment amount of approximately $400. A house bought with subsidy cannot be sold for 8 years.

In addition, an institutional subsidy scheme provides a higher amount ($4000) to housing institutions which offer units on a rental, lease or rent-to-own basis to eligible tenants, with the right of the tenant to buy after a minimum of four years.

The comprehensive housing delivery plan announced by the new Minister of Housing in September 2004 will lead to important changes in the subsidy policy:

- Introducing a higher income band subsidy for those earning between approx $500 and $1000 per month, where effectively a grant as down payment on a mortgage loan will be provided
- The resale time limitation on subsidized houses is reduced to five years to facilitate a legal secondary market
- The institutional/rental subsidy is made more flexible

In addition to the subsidy scheme, the new government established a number of new housing finance institutions in the attempt to mobilize private sector credit. These included the National Housing Finance Corporation (NHFC, http://www.nhfc.co.za/), a provider of wholesale credit to banks, non-bank lenders and housing associations; and NURCHA (http://www.nhfc.co.za/), which provides working capital guarantees for small contractors on subsidized housing projects.

It is worth noting that the new institutions were focussed on wholesale business or risk mitigation. No significant retail housing finance provider was established by the state; and the existing state-owned ones (which generally had a very poor performance record) were wound down early on, often with large losses under state guarantees.

Despite the efforts to facilitate private sector lending, frustrations mounted in the late Nineties over allegations of bank red lining, especially of black township areas. In 2000, government passed a Home Loan and Mortgage Disclosure Act (http://www.info.gov.za/aboutsa/housing.htm#legispolicy), modelled on US HMDA legislation, to provide hard data on lending patterns. In 2001 a Community Reinvestment Bill, also modelled on the US law, was introduced, which would compel all home lenders to undertake a certain percentage of their business at the low end of the market; but passage of the Bill was suspended.

The suspension was because the process was overtaken by a broader agreement (the Financial Services Charter, http://www.banking.org.za/documents/2003/OCTOBER/Charter_Final.pdf) between government and the financial sector about its role in transformation and development, including home lending prominently. The Charter was signed in October 2003 and is a voluntary industry code. In it, banks undertook to make a significant volume (a figure of some $7bn by 2008) of home loans to borrowers in the $250-$1100 per month income category, which were considered viable for housing finance. The banking industry has been working on proposals to government for risk sharing on new loans, in a way which would facilitate reaching the target, and is due to develop proposals to government under the title Project Sizwe in January 2005.

Finally, in September 2004 the new Housing Minister, Dr Lindiwe Sisulu (http://www.housing.gov.za/Content/min_of_housing/Resume.htm), announced a new comprehensive plan for housing delivery in the new administration entitled “Breaking New Ground” (press release at http://www.pmg.org.za/docs/2004/appendices/040909release.htm). Key elements of the plan include:

- a move away from quantity of housing to promoting the health of human settlements;
- a focus on creating a single working residential property market; and
- eliminating informal settlements within 10 years.

CURRENT OVERVIEW

The current housing situation and housing finance options available to the different main groups in the population are summarized in Table 1 below.

Table 1: Housing Demand Pyramid

Annual income (in US$)	Income range (ppp)	Percent of households (ppp)	Geographic/ Housing situation	Housing finance options
>$8,000	>$35,000	32%	Urban/suburban Formal structure (mainly brick)	Standard housing finance product is a 20 year, variable rate annuitizing mortgage, provided predominantly through 4 large commercial banks
$3,001-$8,000	$10,001-$35,000	35%	Urban/peri-urban Mainly formal structure, but some informal/self built Mainly ownership/ claimed ownership but also rental	Limited: mortgages hard to obtain in areas in price range of this group. Micro-loans used for home improvements/extensions by formally employed
<$3,000	<$10,000	33%	Rural/peri-urban Traditional structure; self-build	Very limited: self build process, sometimes facilitated through informal savings associations

Sources: 2002: WRI and author; US$=6.2 ZAR

Some of the underlying changes in the housing situation of the country are reflected in Table 2 below. This shows that more households are living in their own formal houses, largely as a result of the government subsidy scheme for home-owners, but the proportion of people in informal housing has increased somewhat, largely as a result of in-migration. Furthermore, close to one in ten households live in varying formal/informal tenancy in back yards.

Table 2: Overall Housing Situation

	1996 *% of households*	*2001* *% of households*
House on separate stand	48.0%	55.0%
Flat/apartment/cluster	10.0%	8.0%
Backyard dwelling	10.0%	8.0%
Informal dwelling not in backyard	11.5%	12.3%
Traditional dwelling	18.0%	15.0%
Other	2.5%	1.2%
	100%	100%

Source: National Census 1996, 2001. Available via www.StatsSa.gov.za

South Africans are overwhelmingly a nation of home owners. In national surveys, as many as 80% of people claim to own their home. However, since the proportion of claimed ownership is even higher in traditional rural areas, where freehold tenure does not yet exist, this is clearly an indication of perceived security of tenure, more than all the other rights of ownership.

One in five South Africans rent. Aside from backyard/informal rental, which is the largest sub-category, demand for rented apartments in well located inner city areas has become an increasingly popular option in recent years. Although the first post-apartheid housing policy prioritized home ownership, the importance of rental has increasingly been recognized. Social housing institutions, modelled on European lines, have been promoted by government as a means to provide affordable rental in urban areas – especially medium to high density. However, many of the 30 or so social housing institutions all started since 1994 are undergoing substantial financial stress.

There are a number of enduring demand-side challenges for housing in SA:

- Population growth continues, although at a declining rate in part due to AIDs; in addition, average household size has fallen from 4.5 people to 3.8, in part due to the success of housing delivery.
- HIV-AIDS: with national infection prevalence estimated at around 12%, the patterns of housing demand will change in unpredicted ways; for example, it is likely that there will be larger extended families and child headed households.

- Urbanization continues at a rapid pace of close to 3%, especially in secondary cities and metropolitan areas.
- Unemployment has risen to around 30% by official definition, stretching the ability to afford housing finance, let alone pay for basic municipal services.

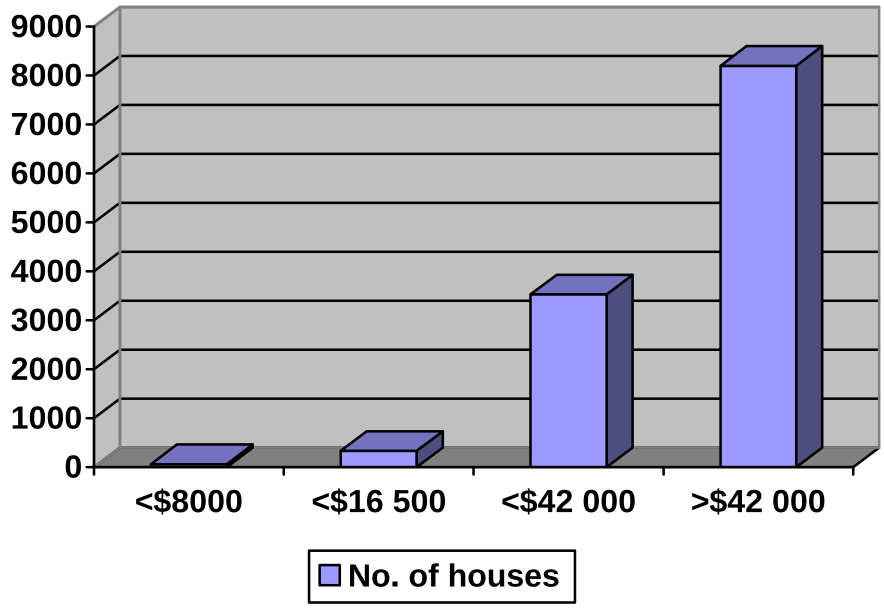
On the supply side, apart from the 190 000 houses delivered under the subsidy scheme, the figures for all new houses built in 2003 by price range are shown in Figure 1 below. These numbers come from the building quality regulator: the National Home Builders Registration Council, established since 1994, and would not include informal building or multi-unit dwellings.

The Figure clearly shows that formal production of new housing below $16 500 is almost negligible, as private developers have withdrawn from this section of the market. One of the main reasons given by them is that the uncertainty of a buyer receiving end user finance has made the lower end of the market too risky, given the small absolute margins earned there.

In addition, urban land is increasingly expensive—in fact, suburban housing markets in most cities have witnessed a price boom in recent years. [1]

[1] See for example, Ian Fife "Riches to be Had", Cover Article on SA property market in *Financial Mail*, 2 July 2004 p.18-19 Available via www.financialmail.co.za.

Figure 1: New House Construction in SA in 2003



BIG HOUSING FINANCE CHALLENGES/ISSUES

The biggest housing *finance* challenge for South Africa undoubtedly lies in the fast growing urban areas. This is not to overlook the problems in rural areas, but (i) these are usually more related to poverty than to housing per se; and (ii) the rural demand is less for housing than for basic services such as potable water, electricity, etc. In addition, a majority of the population is now urban, and urban areas continue to grow at a faster rate due to migration.

Within the urban areas, the main problem relates to former township areas. These areas contain one in five SA households and are growing. Within these areas there is a diversity of housing types, from relatively new developer built housing to old, previously rental stock, and to site, service and informal housing. The Township Residential Property Markets Study (http://www.finmarktrust.org.za/themes/trpm/trpm.asp), a recent major study funded by inter alia, the SA National Treasury and NHFC, sought to understand the state of property markets there. The study found very low levels of housing stock turnover, leading to the conclusion that the secondary market in these areas was not functional. In the absence of a working secondary market asset based housing finance is much harder; also, residents in these areas do not get to benefit from their houses as investments over time.

The major housing finance challenge in SA today is closing the ‘credit gap.’ The credit gap is the area of the home loan market which is:

(i) below the size at which mortgage finance is easily available (typically $15-20 000)
(ii) above the size at which uncollaterized micro-loans are available (typically up to $1500).

This gap between $1500 and $15 000 is critical because:

(i) the price of a typical starter or basic home in urban areas is in this range
(ii) the affordability of a typical household wishing to improve their housing lies in this range—for a 10 year loan at current mortgage rates and an instalment of 25% of income, they could not afford more than $10 000 anyway.

Hence, the central question of SA housing finance has been phrased as:

How do you turn an instalment of $150 per month into a house of price $10 000?

Assuming a self-amortizing loan over 20 years (240 months), the resulting interest rate must be 15% or less. Until recently, rates available to this borrower group have been higher than this seemingly achievable standard – and as rates have fallen, house prices have risen.

Solving this question at scale in township areas for residents with informal as well as formal employment is the frontier issue for SA housing finance in the next decade of freedom 2004-2014.

INNOVATIONS/PILOTS OF NOTE

1. *Securitization*: during the past decade, SA has seen moves to securitize home loans at both the high end and low end of the market. SA Home Loans started in 1998 as a high end mortgage lender following Australian precedents using securitization to allow it to reduce mortgage interest rates and entice customers to switch from existing mortgage providers. To date, SAHL has pitched four successful issues of Mortgage Backed Securities, with the senior notes rated domestic AAA. The issue premium relative to SA government has also declined substantially over the four issues, as institutional investors warmed to this type of paper and as the corporate bond markets developed in general. The low end model of securitization, Gateway Home Loans, was piloted unsuccessfully between 1999-2001 (see case study for full details).

2. *Micro-finance for housing:* the past decade has also seen the development of commercial micro-lending mainly directed at salaried workers. Short term, uncollateralized loans were made available in large numbers. Many surveys of usage have suggested that around 30% of typical term micro-loans are in fact used for home improvement or extension. In addition, banks developed a housing loan secured by a guarantee from a worker's retirement fund as a means of offering larger loans at lower rates than the unsecured micro-loans. An estimated $2-3 billion of these loans is outstanding; and loan packages of this type have recently been securitized on capital markets.

3. *AIDs insurance:* At the high level of infection experienced in SA, HIV-AIDs clearly has severe implications for housing in general—both the type and distribution of housing (for relevant research on this, go to http://www.hfrp.org.za/frame_publications.htm). The effect is very pronounced on the risk assumed by mortgage lenders and/or life insurers. Mortgage loans usually require credit life insurance to cover the life of the bond holder. Increasingly, life insurance companies exclude cover for death as a result of HIV-AIDS. This means that: (i) currently infected people are unable to obtain bonds; and (ii) among existing bond holders, a proportion is expected to fall ill in the terminal stages of the disease and be unable to work, and hence to service repayments on a bond. Therefore, the family would be likely to be foreclosed on at a very vulnerable juncture. Various products are being developed to cover this. One, by a housing NGO insurer (www.hlgc.co.za), provides for instalment cover

enabling a borrower and dependents to remain in the bonded house even when unable to pay, provided the borrower is tested upfront, and if positive, enrols on anti-retroviral therapy and a wellness course to extend working life. The insurance industry is developing a proposal for a national re-insurance scheme which would remove the AIDs exclusion from life cover.

KEY QUESTIONS WHICH THE SA DELEGATION BRINGS TO BELLAGIO

From the *Breaking New Ground* policy statement:

- How to oversee state housing finance institutions? (p.6)
- How to share risk with the private sector (without getting the short straw)? (p.9)
- How to develop and provide alternative loan products to mortgages for the self employed?

During meetings in SA, the following were added:

- How to unlock the 'dead capital' in SA's bifurcated residential property market and make resale markets work?
- What are the real limits to bankability of a client for housing and how are these determined?

These will be added to by delegates during the build up to the conferences.

FURTHER GENERAL REFERENCES

Khan & Thring (2003) *Housing Policy and Practice in post Apartheid South Africa*, Heinamann, Sandton http://www.kalahari.net/VS/product.asp?toolbar=mweb&sku=27078299&format=detail

Porteous & Hazelhurst (2004) *Banking on Change* Ch.6 Housing Finance http://www.exclusivebooks.com/search/display.php?skuid=3236825&m=1&Tag=&CID=

Department of Housing website: www.housing.gov.za

Other recent research material on housing finance in SA: www.hfrp.org.za

DATA ANNEX: SOUTH AFRICA

	Figure	Year / source
Population	46.6m	2004; Stats SA mid year estimates
Rate of increase	-0.1%	2003; World Bank
No of households	11.2m	2001; Census; Stats SA
GNI per capita current US$	$4 500	2003; Stats SA revised GDP estimates and population 2004
GNI PPP	$10 800	2003; CIA website
Gini co-efficient	58	2001; World Bank
% of population urban	55%	2004; UNHabitat GAO
% Home ownership	72%	Census 2001
Mortgage finance/GDP	26%	2003; Calculated from SARB Quarterly Bulletin 4: 2003
Mortgage margin (average rate less bank cost of funding)	2.1-4% depending on size	
National housing budget	$766m	2003/4; SA Treasury Budget 2004
National housing budget/GDP %	3.6%	Stats SA revised GDP estimate
Average cost of low end formal residential construction/m2	$250	Development industry sources

Exchange rate used: 1 US$=6ZAR