

Project Assignment: South Africa Housing Policy

1. Assignment

In the last two years I have been involved in housing and finance projects in Eritrea, South Africa and Palestine, all newly emerging countries -- Eritrea from 30 years of Civil War, South Africa from 50 years of apartheid policies, and Palestine from 30 years of occupation. Their status as emerging country provides opportunities and risks: opportunities because these countries can start the development of their institutions, legal system and regulatory environment from scratch, risks because the lack of continuity makes development unpredictable.

This quarter I expect the studio to focus on housing policies in South Africa. Specifically, the project for the class as a whole is to prepare **an implementation strategy** for South Africa's housing sector policy. South Africa has already in place the broad outlines of housing policy, see Annex 1 to this assignment. The policy consists of direct housing subsidies provided by the Central Government through the provincial housing boards for the country's poor (almost 80 percent of the population), and the establishment of an enabling environment (legal, institutional and regulatory) for the efficient operation of housing markets, including construction firms, developers, financial intermediaries, infrastructure companies, land owners, and others.

While the general housing strategy is given, its implementation is still under discussion. This is where the Studio Project comes in. I expect the class to divide (depending on class size) into three to five groups, with each group focusing on possible implementation strategies for one particular institution or one type of project. The following are six possible institutions or projects. Each student group will choose one of these institutions and projects, and develop a proposal for its operation. The elements of the proposals will vary but will generally include a business or investment plan, and a general analysis of the feasibility and sustainability. In most cases this will require some degree of modeling, including project or institutional accounts (income and expenditures, sources and uses of funds, balance sheet, and various sub-accounts), analysis of affordability, and other spreadsheet analysis. Specifically:

Municipal Government: The Government has re-organized formerly segregated municipalities, in the hope that the richer, formerly white municipalities will subsidize and improve the service level available to the poorer (formerly black) townships. The hopes of the poor are high that they will get instant improvements in their level of social and physical (water, sewer, electricity. etc.) services. However, the reality is that improvements will take a long time and are difficult to finance. The task for the group taking on this project is to make proposals for improving municipal services. This will include a discussion of all the options open to municipalities (including how to deal with persistent and continuing payment boycotts by the poorer population). It will also require developing a municipal model capable of projecting municipal taxes and user charges, and municipal operating and capital expenditures.

Municipal Service Companies: Many services, such as water and sewer services are provided by semi-private, so called trading companies. Instead of dealing with the complexities of the entire municipal government, it may be easier to focus on one particular service. Typically, at the municipal level this would be water, sewer, and solid waste disposal. Electricity in South Africa is in the hand of regional companies, and we may not have sufficient information to model them. Otherwise, the analysis is similar to that of the municipality, except of course, that trading companies have access only to various types of user charges, not taxes. However, they could be subsidized by municipalities.

Non-traditional Retail Lenders (NTRLs): Over the last 5-10 years South Africa has seen a boom in the development of NTRLs which provide loans to the poor for a variety of purposes, including housing, consumer durables and small enterprise lending. NTRLs are not banks, since by law they cannot collect savings. Hence, they depend on institutional investors or the Government's new wholesale bank for funding. Most NTRLs do not provide mortgage loans, since such lending carries high fixed cost that are not economical given the small loans the poor can afford. Instead, they provide loans backed by pension funds or employer payroll deductions (For more detail see the annex and literature). The Group taking on this subject must analyze the possible business strategies for a NTRL involved in housing. For example, how fast should the NTRL expand, how many branch offices should it have, how should loans be secured, how should rates be set, or how can risk be managed? This requires among other things preparing a projection model for the NTRL's accounts.

Housing Association and Companies: The Government's in its housing strategy so far has focused mainly on owner occupied housing. The however has not been as successful as hoped, and Government now wants to add rental housing to its concerns, in particular rental housing that is developed, owned and managed by housing associations or companies. These organization also could take over the public sector housing which Government has built in the past, and which now is being managed inadequately by the municipalities. Housing associations typically are owned by renters, whereas housing companies are owned by shareholders. In either case, there should be a professional management team in place to develop and manage housing stock. Funding of housing associations and companies may come from the National Housing Finance Company (NHFC), which is the Government's wholesale bank for the housing sector. The Group that takes on this subject must analyze possible business strategies for the housing associations (South Africa so far has little experience with these organizations). It will have to consider affordability issues, including what income groups can be reached through these organizations. It should also ask whether there are any advantages to housing associations relative to regular private landowners. As in the case of the other topics, a projection model needs to be developed, illustrating a development strategy for a typical housing association.

Wholesale Lending: The National Housing Finance Corporation (NHFC) has been set up by Government (with some private sector funds) to fund NTRLs and housing associations/companies, and to generally develop instruments that may improve funding for the low-income housing sector. This is the second attempt at developing such a wholesale lender (the first one started only in the early 1990s already failed). The Group taking on this subject will have to consider the business strategy and should prepare a fairly detailed model

Sites and Services/Upgrading Projects: Another way to analyze implementation issues is at the project level. I have been involved in a large urban development project (intended population about 200,000) called Cato Manor and located in Durban (Province of KwaZulu Natal). The Group considering this subject will have to prepare the usual project feasibility analysis. It could consider either a sites and services project, upgrading (including squatter upgrading) project, or both.

2. Project Hints

a. Outputs: I envision that each group works on its own, but that class discussions will make all groups aware of what everyone else is doing. Hopefully, this will establish some consistency between the different subjects and will make it possible to write joint recommendations at the end of the class. The individual group projects would be annexes to these recommendations.

b. Schedule: The schedule is as proposed as follows:

- Week 1: Read as much as you can about South Africa, get organized in groups, and choose the subject in which you want to work. Start distribution of assignments within each group.

- Week 2: Each group prepares a proposal for its papers, and describes individual's contributions to the Paper. The group outlines its own project, say in the form of terms of reference.
- Week 3: Each group makes a brief presentation of its goals.
- Week 3-7: Each group works on its own subject area. This includes preparation of the appropriate models to analyze the project type; analysis and use of the model; and drafting its annex report.
- Week 8: Each groups makes a 15 minute presentations of its findings.
- Week 9-10: Integration of results into a strategy paper. Obviously, this will work best, if the strategy paper can rely on sections from the annex reports.

c. Scope of Analysis: Throughout the focus is on the technical, economic and financial issues involved in low cost housing delivery and not on designing detailed land use plans. Nevertheless, physical planning aspects enter the analysis because feasibility and cost depend on the choice of technology and design standards, such as standards for infrastructure and subdivision design.

The analysis must be grounded in an understanding of the urban and housing problems facing South Africa. Each group report must include therefore, an outline of these problems as they relate to its choice of subject area, as well as strategies for solving them. Some of the strategic issues on which you may have to comment include:

- **Growth and Urbanization:** This defines the context of the housing problem and its solutions, including a sketch of the SA's economic development problems and strategy; recent and projected urbanization trends; income distribution; expected population and income growth; identification of poverty levels.
- **Institutions and Administrative Capacity:** This includes a summary description of the government institutions involved in the delivery of shelter and infrastructure, and an assessment of the problems these institutions face related to cost recovery, implementation capacity, maintenance and operation, skill and training needs.
- **Housing Delivery System:** This involves an assessment of all aspects of the housing delivery system, including land availability and cost; property rights and registry; housing typology; formal and informal construction methods; financial institutions; construction industry and construction methods; housing cost and housing affordability; infrastructure cost and recovery of that cost; government policies as they relate to low income housing provision.
- **Proposed Housing Strategy:** This identifies key components of the strategy including the choice of target groups requiring attention; investment emphasis (upgrading vs. new development; infrastructure vs. shelter, etc.); financial intermediation; housing technology; improvements in cost recovery and resource mobilization; project identification and justification; and the discussion of project replicability and policy conditionality issues.

In designing housing strategies, you must include a discussion of:

- the target population, its income and availability of funds for downpayment;
- a technical description of the project and its components; implementation details and schedules;
- calculation of project cost including foreign exchange components, physical and financial contingencies;
- cost recovery strategy, including consideration of subsidies and cross-subsidies;
- demonstration of housing affordability;
- description of administrative and organizational set-up of the government institutions responsible for project planning and implementation;
- demonstration of project financial feasibility;
- schedule of disbursements and repayment of loans and grants, cash flow analysis.

d. Annex Report: The following is the outline of a typical project appraisal report, but could also represent a starting point for an outline of the Annex Reports for each group.

1. Summary of Proposal
2. Objectives and Rationale
 - 2.1 Existing Situation
 - 2.2 Objectives
 - 2.3 Relation to National Development Policy
3. Strategic Concepts and Project Formulation
 - 3.1 Project Components and Expected Results
 - 3.1.1 Previous Measures
 - 3.1.2 Project Components and Expected Results
 - 3.2 Implementation
4. Administration
5. Cost and Finance
 - 5.1 Cost Summary
 - 5.2 Affordability
 - 5.3 Cost Recovery
6. Proposal Impacts and Risks
 - 6.1 Impacts
 - 6.1.1 Social Analysis
 - 6.1.2 Economic Analysis
 - 6.2 Appraisal of Relevant Open Questions
 - 6.3 Risks
 - 6.4 Replicability

e. Reference Materials: I have collected a fairly large amount of information regarding South Africa, see also the Bibliography below. One of the problems will be access to this material. I will make a copy of the most important material, but it will be impossible to copy all the material I own. Material of which I do not have a copy, you can borrow only for a short period of one or two hours.

Undoubtedly, the available information will not resolve all the questions you have. However, you must remember, that you are asked only for a preliminary analysis, and at any rate, planners never have full information. Where additional information is required and essential you should call for further study and come to preliminary conclusions based on assumptions. For example, if precise construction costs or land prices are not available, you may take some 'reasonable' guesstimates, and do a sensitivity analysis to demonstrate how your results would change with other assumptions.

I have available a number of spreadsheet models, including numerous models developed for countries other than South Africa. Also, you are welcome to look at some of the materials prepared by students in previous years for other countries.

I will familiarize you in class with some of the programs available to me at this time, including project, trading company, banking and affordability models. You may make use of existing programs or design your own, either by modifying existing programs or designing your own from scratch.

Remember that the emphasis of your report should be on a substantive analysis of the institution or project -- and not on programming or modeling tasks. If you design your own program, its documentation and discussion should be relegated to an Appendix. Only the analysis of your program results belongs into the main text of the analysis.

3. Bibliography

The following is a list of selected literature on South Africa housing, land and finance issues. I will make try to make available some of this material at the Engineering Library. Other material will be available from my office for short-term use

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Annex 1: South African Housing Issues and Policies

The following are excerpts (Section 2) of B. v. Rabenau et.al. *South Africa National Housing Finance Corporation: Report on the Project Appraisal* (October 1996)

2. Problem Analysis

2.1 Economic, Political and Social Situation of the Country

South Africa's apartheid policies strictly segregated the country's different ethnic groups and their access to land, housing, and jobs. Separate homelands established a distinct political, economic and social infrastructure including multiple administrative systems for education, health and services, and the black population in particular must often travel long distances between residence and work. Limited employment opportunities have contributed to income disparities that put the per capita income of the black population at less one tenths of its white counterpart. While the income level of the white minority would rank it in line with other industrialized nations,¹ the black majority is barely better off than the rest of sub-Saharan Africa. More than 50 percent of the black population has a household income of less than R800 per month.

Government policy aims to reverse the effect of past policies, and to raise the living standards of disadvantaged population groups by following a narrow path that attempts to balance the demand for rapid economic growth while satisfying the population's high expectations generated by pre-election promises that have included the provision of free housing, education and health for all, and the promise of rising incomes and full employment.

South Africa's GDP is about \$ 140 billion, with a little over 50 percent of total production coming from services and about 25 percent from manufacturing. Mining makes up 71 percent of export earnings. Over much of its history, South Africa has experienced rapid economic growth. For example, during the period 1960-69, GDP grew by an average 6 percent, followed by a decade of growth at 3 percent. However, during the 1980s economic growth no longer kept pace with population growth and per capita income fell, as a result of weak prices for gold and minerals, international sanctions, and the growing cost of enforcing the apartheid regime. A long recession starting during 1990 has cost numerous jobs, including 166,000 in gold mining alone.² As a result, the official unemployment rate in 1994 was as high as 33 percent while more than 50 percent of the working age population did not have formal sector jobs. The economy has also been hampered by oligopolistic and protected markets as a result of high tariff barriers that have discouraged productivity growth and reduced the quality of production. As an example, local car assembly hides behind tariffs of 115 percent, raising significantly the price of local automobile ownership, while reducing quality and competitiveness of the industry.

Nonetheless, there are a number of encouraging signs. Since 1994 the economy is growing, albeit by only 2-3 percent (3.3 percent in 1995), hence barely keeping pace with population growth. Inflation has declined to 9 percent (8.6 percent in 1995), the lowest in two decades. Private domestic investment has grown by 7 percent in 1994; and an excellent infrastructure and safe foreign investment laws are likely to attract foreign savings and investment in the future.

Significant economic growth is essential if the government is to satisfy the population's high expectations. Total public sector debt already stands at 55 percent of GDP, and the government's deficit for the budget

¹ As The Economist put it in "A Survey of South Africa" (May 20th, 1995), if the white 12 percent of the population were an own country, the United Nation's Human Development Report would rank it 24th in the world in terms of per capita income, just behind Spain; but Black South Africa would rank only 123rd, just above the Congo.

² See The Economist, op.cit.

year April 1995 to March 1996 has remained at 5.5 percent. Government hopes to decrease its budget deficits to 4.5 percent in five years, but also intends to raise spending on housing from 1 to 5 percent of GDP, and to equalize educational expenditures for black and white children within five years -- making success on the budgetary front unlikely. Foreign confidence in government policies is low, as shown by the loss in the value of the Rand by more than 30 percent since February 1996.

Setting priorities between competing types of social spending will become important in the future. Hence, while Government's immediate focus has been on housing, the need to improve the educational level of the black population is essential if affirmative action requirements are to be economically productive. The adult illiteracy rate is 46 percent for blacks compared to 1 percent for whites. Black pass rates for exit exams are only half those of whites (even though they were 80 percent in 1970); only 25 percent of black teachers possess minimum teaching qualifications, as compared to 100 percent of white teachers; and the backlog of classrooms may approach 50 percent of the existing stock for black children, while there is none for white children. Eliminating such differences is important, but requires a further rise in educational expenditures from an already high 7 percent of GDP. A program that encourages the mobilization of private sector resources for the housing sector would therefore be welcome, and will receive the active encouragement of Government.

2.2 Regional Analysis

Urbanization: South Africa's urbanization level is high despite her relatively low income and long history of discouraging black urbanization. The total population in mid-1996 is about 43.2 million³ of which an estimated 66 percent or 28.4 million live in urban areas, including the informal, peripheral and semi-urban areas surrounding the white and non-white townships.⁴ Of the total urban population about half is concentrated in just four urban regions, Johannesburg (6.9 million), Durban (3.7 million), Cape Town (2.6 million) and Port Elizabeth (1.2 million).⁵

As a result of the apartheid laws, urban areas suffer from inefficient land use patterns, excessive land consumption, excessive cross-hauling, and large disparities in the supply of infrastructure. Pass laws limiting black access to urban areas date back to 1937, and the Group Areas Act of 1950 led to the removal of existing black populations from white townships and the discontinuation of new migration into the largely white centers of employment. Without access to the urban centers, the non-white populations massed in its homelands, as close to the urban centers as possible, usually by-passing large amounts of vacant land, and almost always suffering from excessive and inefficiently organized commutes. Inevitably too, non-white townships lacked a strong tax base, had a limited human resource base, and could provide little infrastructure except as subsidized by the central government. In 1986 the pass laws were repealed leading to high migration into central white urban areas sometimes in the form of invasions of more centrally located land, and sometimes through the displacement of formerly white populations in central rental housing.

³ In the Census year of 1991, South Africa's total population was 31 million excluding homelands and approximately 37.8 million including the homelands (which prepared their own Census). As of mid-1993, the Central Statistical Service estimates the total population as "more than 39 million", and the Urban Foundation as 40.3 million (see SAIRR, p. 82). The mid-1996 estimate is based on an average annual growth rate of 2.27 percent.

⁴ Under the apartheid regime urban areas included only those settlements with a formal local authority. This definition led to a much lower urbanization rate. The newer definition is based on the functional relation of settlements with the core city, and counts peripheral informal settlements among urban areas if their commuting and job relations to the center are sufficiently strong.

⁵ Population figures extrapolated to 1996 based on 1992 base figures and an assumed average annual growth rate of 3 percent. All estimates are based on a functional definition of urban regions. Urban areas under the new Census will be redefined in terms of their new political boundaries, and population estimates may differ. Hence, in the case of Durban, the Durban Functional Region (DFR) has a population of 3.6 million, but the politically defined Durban Metropolitan Region (DMR) has a population of only 3.0 million

Much of this housing stock subsequently was subject to rent boycotts and has much deteriorated. The revitalization of central city areas and regularization of rental housing in possession are key functions of newly developing housing institutions, that have the strong support of DoH.

Provincial Administration: Following the end of apartheid, the number of provinces has been raised from four to nine, and provincial boundaries have been redrawn to integrate and absorb the patchwork of past provinces and homelands into a single system of provincial Governments. Provincial elections were held in 1994, and provincial governments were established in the same year. However, the efficiency of governments varies greatly, as many of them struggle to integrate up to five different administrations (one each for white, colored, Indian, and black urban and rural populations) into single cohesive units. In the area of housing in particular, Provincial Housing Boards in the "new" provinces lag behind more successful "old" provinces in their implementation of housing subsidy schemes by a factor of ten.

Local Authorities: Government policy aims to reduce the impact of past policies, by integrating white and non-white townships within new borders under new local governments, hoping that this will (i) result in the cross-subsidization of the poor, formerly black townships by richer formerly white townships; (ii) encourage changes in land use patterns through infill and population densification closer to the employment centers of metropolitan areas, and (iii) the efficient use of existing infrastructure that often has idle capacity.

Local elections were held in most of South Africa in November of 1995, and in KwaZulu Natal in June of 1996. Local governments now face the difficult task of restructuring their administration -- a process expected to take several years. Meanwhile, the **capacity to facilitate new housing development is severely limited**. The planning and administrative capacity in many municipalities has declined significantly, as a result of the ongoing restructuring and retirement of professional staff, and because of a lack of financial resources. The new national constitution agreed to in May 1996 remains silent on municipal fiscal issues and needed new taxes. At the same time, Central Government expects local governments to become self-sufficient in their operating budgets, and may well reduce capital subsidies which in the past subsidized all spending in the black townships.

Regional Disparities: One of the reasons for the restructuring of provincial and local governments has been the equalization of income, by combining higher income areas with traditionally poorer areas. Nonetheless, strong disparities remain, both in terms of income and administrative capacity. While there currently do not exist reliable provincial data, the large differences in urbanization rates are suggestive of income differences. Differences in administrative performance are also obvious from the implementation rates of Government's housing policy. For example, during the first three months of the current budget year the Northern Province, Eastern Cape, and KwaZulu Natal have disbursed at an annual rate of only 17.2, 18.8 and 40.0 percent of allocated funds, as compared to 192.8 percent, 140.8 percent and 135.2 percent respectively for the Northern Cape, Gauteng, and Western Cape.⁶

2.3 Sector Analysis

2.3.1 Housing Demand and Government Subsidy Schemes

Economic and social differences between the population groups are nowhere more visible than in the area of housing. The challenges for the Government's housing policy were identified by the Government's White Paper of December 1994:

⁶ This is based on Department of Housing statistics, which compare actual disbursements with available provincial funds for the year, see DoH, Report on Funds Allocation and Progressive Expenditure 1996/97 (June 28, 1996). Because expenditures have lagged behind allocations in the past, it is likely that provinces could spend more than their allocations for some time.

- **Housing Backlog:** There is an urban housing backlog of 1.5 million units, as identified by overcrowding, dilapidation, inadequate construction methods and materials, and a lack of access to infrastructure. More recent estimates have raised the backlog to 2.5 million.
- **New Housing Demand:** There is a need for the net addition of 150,000 housing units annually to the urban housing stock, based on an urban population of 27.4 million and a growth rate of 2.3 percent. Total household formation is an average 200,000 annually over the next five years.
- **Squatter Settlements:** As many as 1 million households live in squatter settlements, and the number of squatter households may be rising by as much as 150,000 annually (implying that 75 percent of all current population growth is housed in such settlements).
- **Sites and Service Schemes:** An estimated 720,000 sites and services plots in urban areas need upgrading. According to the National Housing Forum (NHF), an estimated 625,000 sites and services plots were implemented during the final decade of the apartheid regime, 27 percent with full service, 44 percent with intermediate service levels (electricity, water, roads), and 29 percent with only basic service (water and access).⁷ Acceptance of these plots has been limited, and the quality of housing erected on such schemes has been low.
- **Backyard Shacks:** As many as 400,000 households live in back-yard shacks, typically constructed of temporary materials, and with little protection against eviction.
- **Lack of Finance:** As much as half of all households in need of housing cannot rely on housing finance, and hence require state subsidies to supplement own housing resources.

The government has made the provision of housing, including shelter, infrastructure, and accessible sites a priority and cornerstone of its policy. The policy aims at eradicating the housing backlog of 1.5 million units over a period of 10 years while providing 150,000 units annually for the expected population growth. To achieve its aims the policy foresees raising housing subsidies over a five year period from 1 percent (1.4 billion Rand) to 5 percent of the national state budget, and to increase housing delivery on a sustainable basis to 350,000 units annually.

Government has established a subsidy scheme providing for income related lump sum subsidies of up to R 15,000 per household (with an option to rise another 15 percent in the presence of special cost). According to recent government figures⁸, the scheme would provide subsidies for up to 83 percent of all households as follows:

Household Income (R/month)	Percentage of all Households	Regular Subsidy (R)	Subsidy w/ 15% Premium (R)
less than R 800	47.9%	R 15,000	R 17,250
R 801-R 1,500	17.6%	12,500	14,375
R 1,501-R 2,500	12.0%	9,500	10,925
R2,501-R 3,500	5.6%	5,000	5,750
more than R 3,500	16.9%	0	0

⁷ This assumes the proportional distribution of 83,000 out of the 625,000 plots for which the improvement level is not known.

⁸ See DoH, **Housing the Nation**, which provides estimates of monthly household income for 1995, see also Annex 9.

Only 16.9 percent⁹ of all households (with incomes above R 3,500 per month) would not be eligible for some type of subsidy, though other conditions (no prior subsidies, not already a property owner) would further cut eligibility. There are four principal subsidy schemes:

1. Project-linked subsidies: These are subsidies given the developer of a project, usually in several drawdowns, with the final two payments conditional on property transfer and completion of the top structure of the dwelling.
2. Individual subsidies: These are given to individuals purchasing a home, either completed or under construction. While originally intended to be conditional on prior individual savings, this requirement appears to have been dropped.
3. Consolidation subsidies: These are topping-up subsidies that make up the difference between subsidies provided under earlier subsidy schemes (such as the R7,500 subsidy given under by the Independent Development Trust (IDT)) and the new subsidies. They are project linked, and given to a developer who upgrades a group of housing units previously developed as a serviced site with government funds.
4. Institutional subsidies: These are subsidies to a housing institution which purchases or develops housing units to sell or lease with option to sell, or which manages housing stock for rent or alternative tenure types. Subsidies must either be passed on at the time of sale, or they may be retained by the institution on condition that a new housing unit is being built, serving the same income group. So far few institutional subsidies have been given, though this is about to change as housing associations receive greater governmental priority.

Subsidy schemes are implemented by the Provincial Housing Board (and the Provincial Departments of Housing) which has broad discretion over implementing procedures and rules. Almost always however, subsidies are granted only for housing units that satisfy certain minimum standards, including access to water, sewer, electricity and streets, and legal proof of land ownership. The cost of a basic infrastructure package depends on local conditions, including the level of additional subsidies provided by local authorities (which often price land below market value) or utilities (which often set tariffs below cost recovery). Even a minimum infrastructure package however, will cost at least R8,000 to R12,000, even after having received additional local subsidies, leaving only R7,000 or less for the top infrastructure. Typically therefore, the top structure will consist only of an unfinished core or "starter" unit of 15m² or less. A complete 1-2 bedroom housing unit of 40m² will cost about R45,000 (without interior finish), or R65,000 including interior finish.

Despite the expectations by many of a complete, 40m² housing at no cost of their own, Government never intended to subsidize housing to this extent. Instead, much of its housing policy is based on the premise that the private sector has an essential role to play in the mobilization of housing resources, through credit from banks and/or through household savings and deposits used to supplement government subsidy funds. So far this has not happened yet. Only 12.7 percent of all project linked subsidies (and 33.7 percent of all individual subsidies) had a credit link. Virtually none required prior savings by the beneficiary. The subsidy policy therefore has not yet become an effective instrument for private sector resource mobilization -- though of course, this may change as households incrementally add to their housing units over time.

Implementation of the Government's subsidization policy has been slow of the starting block, and remains below its ambitious targets. Still, it should be considered a success nonetheless. Some of the continuing bottlenecks include:

- Bridge Finance: While the problem was thought to have been resolved in September 1995 by allowing developers to draw down the subsidy in line with project progress, the problem persists for the less

⁹ Others cite very different income distributions. For example, Van Gass (1991) suggests that 22.9 percent of all households have incomes above R 3,500 per months, and another 24.1 percent have incomes between R 1,500 and R 3,500 per month; 26.3 percent and 26.6 percent have incomes of R 600 to R 1,500 per month and less than R600 per month respectively. Still other income figures may be derived from SALDRU and AMPS surveys, see Annex 9.

established developers without equity funds who may find it hard even to secure minor bridge finance from commercial banks required to prepare the preparatory studies for the first withdrawal.

- **Lack of Guarantees:** Banks are usually unwilling to provide bridge funding for even the first project stage. The problem was thought to have been resolved with the establishment of NURCHA, but remains a serious constraint for smaller developers, in part because NURCHA provides guarantees for only up to 45 percent of capital at risk, leaving banks with a level of risk exposure they often are not willing to accept;
- **Community Behavior:** Developers remain at risk in part because of unacceptable community behavior, including invasions, lack of security, violence against property and people, conflicts of community leadership, and unwillingness to abide by prior agreements. The problem was to have been resolved by the social compact which must accompany all subsidy proposals. In practice however, it is difficult to hold a community to an agreement on which it has changed its mind, leading to project delays, interruption, or cancellation. In addition, associated risks reduce bank's willingness to lend, and developer's margins.
- **Conflicting Priorities:** Many PHBs have made one of their priorities the use of small and often inexperienced developers. However, there often is a price to be paid in terms of housing implemented, and PHBs may have to decide, whether it is housing delivery or developer training they want. There exist a number of larger developers with both the capital and experience to implement projects on time and to cost targets, while also using start-up construction firms.
- **PHB Approval Bottlenecks:** In a number of provinces project approval remains a problem. PHBs in the new provinces in particular suffer from a relatively inexperienced administration assembled from several homeland administrations;
- **Bulk Infrastructure Constraints:** Traditionally, many areas have had excess bulk capacity. However, with the growth in connected housing stock this excess capacity should run out quickly, while the creation of new capacity takes many years.
- **Local Financial Constraints:** Many local areas are said to be close to bankruptcy. First, traditionally, black townships have relied for both their operating and capital budget on central government transfers. These are not to be phased out, and may already have declined. Second, the regularization of utility and property tax payments in many formerly black townships continues to lag behind. Third, the Government's tax reform has not resulted in any additional local revenues in line with the greater responsibilities and decline in transfers. Hence, local authorities cannot certify the availability of infrastructure as required for PHB project approval.
- **Provincial Finance Constraints:** Provincial governments suffer from similar problems as local authorities, but are responsible for schools and most health facilities. For projects to be approved, they require provincial certification of services, which may not be possible. DBSA as the new development finance intermediary has the mandate to provide infrastructure funding to provincial and local authorities, but this in turn depends on capacity building and reforms that may take time to realize.

Despite these bottlenecks, implementation has recently picked up, and is now proceeding at an annual rate of at least 150,000 units. Actual completion in May 96 was almost 8,200 units, or about 100,000 units per year -- up from only 2,900 eight months earlier, during August of 95. While performance is uneven between the provinces and the different types of subsidies, it is nonetheless clear that there is a great deal of progress.

2.3.2 Housing Sector Institutional Environment

South Africa's housing institutional environment is undergoing an almost complete overhaul, designed to regularize the existing housing stock and to enable new development, construction, and lending. The following summarizes the principal elements of the enabling environment currently in various stages of implementation.

A. Legislation and Political Actions

Government laid out its housing strategy in a series of papers culminating in the White Paper of December 1994 that called for the stabilization of the housing environment, the mobilization of new savings and credit,

measures to strengthen the construction and materials sector, and government subsidies. Government enlisted the support of the private sector for its policies through its Record of Understanding with Mortgage Banks of October 1994 which led to the establishment of several new institutions to reduce political risks from lending, and contract risks from development and construction. Finally, in June 1996 it submitted the Draft Housing Bill designed to eliminate pre-existing housing legislation dating back to the apartheid years, and to establish a new and unified housing legislation.

Record of Understanding: Housing markets have been adversely affected by the non-payment of taxes, tariffs, and apartment rents; the boycott of loan payments to banks; land and property invasions; and a general failure of government to enforce existing laws. In a Record of Understanding of October 1994 agreement was reached between banks, building societies and government to re-establish a system of law and order, including repossession of housing units in case of default, eviction after illegal invasions, and the regularization of housing units in various stages of illegal use. The agreement has resulted in the establishment by Government of the Mortgage Indemnity Fund (MIF) against political mortgage risks, SERVCON to regularize properties in possession, and the Defect Warranty Scheme against building defects. Mortgage banks in return agreed to make an annual 50,000 loans to low-income borrowers in the first year (rising to 100,000 thereafter) and to establish a common "Code of Conduct" and "Technical and Mortgage Guidelines" to guide lending, in particular at the down-end of the housing market.¹⁰

The lending goals have not been reached, though according to the AML, this is the result of insufficient construction, not insufficient lending.¹¹ Also, subsidized housing starts have lagged much below Government expectations, and most project based subsidies have been to households with monthly incomes below R1,500 (and even below R800), which are generally thought not to be able to afford any loans (and certainly not mortgage loans).

Masakhane Campaign: The campaign by Government aims at restoring a culture of payments including payment of tariffs, fees and taxes to local authorities and utility companies; rent to housing owners; and loan repayments to banks. According to most observers, the Campaign has been largely unsuccessful, and indeed, according to some, recent months have seen a worsening of the situation, after initial improvements. For the future, many see hope in a "carrot and stick" approach. Specifically:

On the carrot side, it is argued that people are discouraged from paying their bills by inferior service (not unrelated to the payment boycotts), and that services should be improved before collecting payments, say a participatory in which beneficiaries agree in advance to payments in exchange for certain service improvements. Economic arguments and empirical evidence suggest this approach alone will not work.

¹⁰ For re-possessed yet occupied properties the following rules apply: If the current tenants are the previous owners of the property, they may re-purchase it with an interest subsidy (borne by the banks) and a new loan. If after 5 years tenants have paid regularly, they will be re-instated as property owners. If current occupants are not the original owners (i.e. the original owners have left, or the property was illegally occupied), they are permitted to purchase the property, though on terms less generous than for original owners. Similar rules apply for property in default but not yet re-possessed. The agreement also holds that "firm steps will be taken against occupants refusing to vacate or pay for occupation, while efforts by both the financier and State will continue to dispose of the property."

¹¹ According to the mortgage industry, in each of the calendar years 1994 through 1996 the private sector has been completing housing units at the annual rate of approximately 25,000 (about 6,100 in the months January through March in 1996), of which about 40 percent were smaller than 80m² (and hence, targeted to the low-income segment of the housing market). During the past year mortgage lenders are said to have financed 65,000 loans valued at R660 million secured by pension funds, and another 19,800 loans valued at R765 million secured by mortgages (though mostly to income groups other than the poor.).

Without enforcement people will take the existing (albeit low) level of service as their property right, and will agree to payments only for service improvements.^{1,2}

Greater hope for improvement may come from enforcement. After recent elections, the legitimacy and effectiveness of local authorities has been rising. Local Councils are now representative of the population at large and may be more willing to take unpopular actions in light of growing municipal debt and declining central government subsidies. Efficiency may also be rising, following the successful restructuring of local governments, and this should raise billing and collection efficiency.

Draft Housing Bill: DoH has recently introduced Draft legislation (Notice 885 of 12 July 1996) which will unify housing legislation and supersede all previous acts, dating back to the Housing Act of 1996. The new bill among others (i) provides a unified framework for the role and responsibilities of the central, provincial and local governments; (ii) provides for the finance of national housing programs; (iii) abolishes the National Housing Board and transfers Board assets (mainly rental housing) to local authorities; (iv) establishes a national housing data and information system; and (v) repeals racially based housing legislation.

Among the more important elements of the bill is the strengthening of the role of the public sector in housing delivery, and in particular the potentially much larger role of local government, which in the future may participate in the implementation of national housing programs by acting itself as a developer, or by establishing separate business entities to execute housing development projects. While this may not have been prohibited under the Housing Act and its Amendments in the past, the new Housing Bill appears to pro-actively encourage this extended role at the local level, and it clear that local authorities are already gearing up to this extended task. Whether it also is a harbinger of declining Government support for the private sector is unclear at this time.

Housing and Urbanization Information System: Despite the importance assigned the housing sector, ready information on the sector is still inadequate, particularly at the provincial and local level. The Draft Housing Bill establishes a *National Housing Data Bank and Information System* managed by the Director General of DoH, which will provide data at sufficient detail to follow implementation of the national housing policy at the local level. NHFC will supplement this system in the area of credit and retail lending, an effort that may receive some assistance from proposed GTZ-supported Project.

South African Housing Board (SAHB): Under the new Draft Housing Bill the National Housing Board (NHB) of the apartheid years will be abolished, to be replaced by the South African Housing Board (SAHB). While maintaining advisory functions to the Minister of Housing, other functions are either abolished or integrated into DoH. Assets managed by NHB will be transferred to the provincial housing boards, and debt owed to NHB for rental housing owned and managed by the municipalities will be forgiven. Monitoring and evaluation functions are moved into the portfolio of the Director General, DoH, with new extended responsibilities for the establishment of a *National Housing Data Bank and Information System*.

B. Mortgage Insurance and Guarantees

There are three type of insurance schemes available at the low end of the market. Of these, the Mortgage Indemnity Fund (MIF) insures against the political risk that repossession and default options are non-enforceable, because of the failure of the political system to use its police powers or to enforce existing court orders.

^{1,2} For the same reason, it almost always proves impossible to recover the market value of land and property from squatters, unless there is a real threat that non-payment will lead to eviction. Upgrading of such settlements will generate payments, but not for property rights already felt to be secure prior to the upgrading project.

Beyond the political risks, there are large credit risks which banks have been hesitant to assume. Lack of bridge-finance has stalled many housing projects, despite the fact that Provincial Housing Boards have significantly reduced financial needs by allowing for staged subsidy withdrawals. Lack of enduser finance may have been less of a problem, since at least so far most projects have been designed to available subsidies, and hence did not require enduser finance.

Mortgage insurance exists from two sources, the National Urban Reconstruction and Housing Agency (NURCHA) and the Home Loan Guarantee Company (HLGC). The two complement each other, in that NURCHA deals with much lower income groups than HLGC.

Indemnity Fund (MIF): MIF aims to provide mortgage lenders with guarantees against narrowly defined political risks. Specifically, the Mortgage Indemnity Scheme (MIS) pays lenders outstanding mortgage debt, provided (i) the borrower has defaulted, (ii) the lender has undertaken all steps to repossess and resell the property (as verified by MIF in a stringent review process) but was unable to do so,¹³ and (iii) the property lies in an MIF approved area. MIF has assessed 557 areas so far, and has approved 427 areas, deferred 72 areas, with 58 areas pending.

MIF guarantees are provided free of charge, but the pay-out process is cumbersome and time consuming, and pay-out values inadequate in the view of some banks.¹⁴ No payments have yet been made, and MIF's total risk exposure is unclear, though government has budgeted R50 million for 1995/96, and R105 million annually for the following four years. MIF shares office space and is administered for Government by NHFC.

NURCHA: The National Urban Reconstruction and Housing Agency was established in May 1995 as a non-profit company funded with R20 million from the RDP and R18.3 million by the Open Society (George Soros) with the objective to assist in the delivery of housing through (i) grants that assist communities to identify and plan housing projects, and (ii) guarantees for (a) bridge finance, and (b) enduser finance. In addition to its equity capital, NURCHA has a guarantee facility of up to \$50 million (R225 million) which must be combined with other guarantee facilities in a ratio of 3:1. According to NURCHA financial plans, the total loan volume unlocked through its guarantees may become as high as R5.5 billion over 5 years, with the actual amount depending on the share of bridge loans (which are short-term) in total loan guarantees, and the extent to which additional funding can be secured to access to the Open Society funds.

Guarantees are limited to up to 75 percent of working capital requirements in case of bridge finance and 45 percent of loan amount in case of enduser finance, the latter declining to zero after five years (with the expectation that beyond this time banks should assume the full credit risk). NURCHA is conceived as a solution to the immediate problem of perceived credit risks at the low-end of the credit market, a problem that NURCHA and others expect to no longer exist after 5 years. Hence, NURCHA expects to operate for only five years.

NURCHA loan guarantees differ from those of the Home Loan Guarantee Company, in that they address guarantee problems of a much poorer beneficiary group, where a lack of formal sector employment does not provide for payroll deductions or provident fund guarantees. Hence, NURCHA carries a much greater risk than HLGC.

Home Loan Guarantee Company (HLGC): HLGC was established in 1990 by the Urban Foundation and the Association of Mortgage Lenders and restructured in 1994 through the incorporation of the Home Finance

¹³ This may be the case because occupants are unwilling to vacate the property and local authorities do not enforce the court orders, or because banks cannot resell the property because of community sanctions against such resale.

¹⁴ Specifically, rules limit payments to the lesser of (i) R 100,000; (ii) fair market value; or (iii) lender's loan exposure including arrear interest capitalized for a maximum of 12 months and foreclosure expenses of up to R5,000. Yet the foreclosure process may easily extend over more than 12 months and cost more than R5,000.

Guarantors which HLGC previously managed. HLGC's objective is to provide guarantees to lenders to finance housing for low income persons, in addition to supplementary services related to borrower training, claims and risk assessment, and guarantee fund management. It currently sells two guarantee products:

- Mortgage Replacement Guarantees that permits lending institutions to top-up a mortgage loan to the full market value of a property. Lending institutions usually limit the loan/value ratio to 0.8. The HLGC guarantee is for an additional 20 percent of market value, for properties valued at between R25,000 and R80,000.
- Non-Mortgage Guarantees for payroll secured loans. The guarantee permits banks to increase the size of their loan by covering up to 25 percent of the risk on the unsecured portion of the loan. With the guarantee banks may lend up to 300 percent of provident fund security, or up to 400 percent of borrower savings and thus significantly raise the loan amount.¹⁵

HLGC has a capital base in excess of R120 million providing guarantees to 5-6 lenders on an institutional basis and to a handful of other lenders on a program specific basis. At the start of 1996 HLGC had facilitated more than 18,700 mortgage loans worth R570 billion on properties valued R650 billion; in addition, it had provided more than 7,200 non-mortgage guarantees worth R9.3 million, on loans worth R72.8 million. HLGC has an excellent profit record and has not experienced any use of its guarantees. It has narrowly limited the range of lenders to which it provides guarantees; it has narrowly circumscribed its guarantees and risks; and it has limited its down-market reach by narrowly extending credit to groups that are already being served by formal banks. It has however, considerable technical experience, and therefore is highly regarded, and undoubtedly will in the future be called upon by NHFC to enhance its lending through guarantees.

C. Regularization

Past payment boycotts have had a negative effect both on the existing housing stock and available credit for new housing. Government has promised to regularize housing stock in bank's possession that remains occupied illegally, and it has taken action to deal with rental housing managed by local authorities which is often is undermaintained and in urgent need for rehabilitation.

SERVCON: This is a joint venture company of the Government (51 percent) and the Association of Mortgage Lenders (49 percent) set up as a result of the Record of Understanding, with the mission to manage the portfolio of properties-in-possession which banks could not sell because of the breakdown of the law. Under the terms of the agreement, occupants of repossessed housing may:

- purchase their unit, provided the unit is affordable and they make their agreed-to payments for a period of five years;
- acquire alternative units (rightsizing) if they cannot afford the purchase of the units they currently occupy.

Unfortunately, of the approximately 20,000 units transferred to SERVCON less than 2,000 have been regularized so far, and the task has proven more difficult, time consuming, and dangerous than was anticipated. Another 20,000 are owned by the South African Housing Trust but are part of the total stock of PIP for which Government has assumed regularization responsibilities. Most households cannot afford the units they occupy; and alternative premises do not exist. A Task Force has been set up, which is considering new steps to deal with the problem.

¹⁵ Loans must be valued at R25,000 or less and not be backed by a mortgage; the risk must be shared, i.e. the HLGC guarantee is limited to 25 percent of loan value with banks and others assuming the remainder of the risk. Loans may be provident fund backed (so called relationship backed loans in the parlance of HLGC) or backed by borrower savings (in addition to payroll deductions). Banks typically lend only up to 80 percent of the payout value of the provident fund, but with the guarantee lend up to 300 percent. The savings backed guarantees remains experimental, with the borrower receiving a loan 3-4 times prior savings. In either case, employers (or an industry organization) has to take a retrenchment risk, i.e. has to guarantee against losses as a result of industry or employer staff reductions.

Government Rental Housing and Discount Benefit Scheme (DBS): Established in November 1992, DBS promotes home ownership for long-term tenants of government financed housing, by giving tenants the option to buy their housing unit, often at a price of between R4,500 and R7,000 for units that in good condition would have a market value of between R50,000 and R60,000. A total of 83,220 beneficiaries had already made use of the option by the end of May 1996. Under the Draft Housing Bill of 1996, however this scheme would be terminated. Stock owned by the National Housing Board (NHB) would be transferred to the Provincial Housing Boards and stock administered by local authorities would be forgiven its debt.

Already, many local governments are considering turning over their rental stock to newly established housing associations. These associations would require assistance to build an institutional capacity, and credit for stock rehabilitation -- with NHFC being the key in both endeavors.

D. Development and Construction

Several government actions are designed to mobilize and regulate the development and construction sector. Government has established a limited construction warranty scheme; it has established new and appropriate infrastructure and development standards in line with affordability; and it established housing support centers to mobilize self-help. Specifically:

Product Defect and Warranty Scheme (PDWS): Past government building schemes have often fallen in disrepute because of fraud and shoddy workmanship of unscrupulous developers and construction firms. To guard against this the building industry in 1994 established the National Home Builders Registration Council as a self-regulatory body to register and bond construction firms, set minimum home building standards, and warrant structural defects (for a period of 5 years, at a cost of 1.3 percent of structural cost charged to the enduser). While the warranty covers only structural defects (and hence omits mechanical systems and interior finish, such as plaster, painting, plumbing, wiring, doors and windows), NHBRC is able to blacklist developers found deficient in their supervisory functions, and this is said to encourage developers to correct even non-structural defects.

Housing Support Centers (HSC): The program supports the establishment of HSCs through a one-time government grants paid to organizations willing to operate such centers in areas accessible to populations in need of such support. The centers support incremental and self-help housing development by providing access to construction material, builders, developers, and credit facilities; and by providing endusers with information, training, and basic construction skills. Apparently, more than 30 such centers have already been established, though the extent to which they will be able to mobilize the necessary operating funds for long-term sustainability remains to be seen.

Housing Standards and the "Red Book": Traditional housing and land use standards are often inappropriate and unaffordable to lower income households. Through the National Housing Board (NHB) government has issued new standards, in the form of *Guidelines for the Provision of Engineering Services and Amenities in Residential Township Development*, commonly referred to the "Red Book". While not binding, these standards provide guidelines commonly accepted by provincial housing boards and local governments. The development of new standards is mandated by the *Draft Housing Bill* of July 1996, and will eventually lead to the establishment of a *National Housing Code* to be published by DoH.

2.3.3 Housing Credit Sector

South Africa banking system is highly developed, but traditionally has served mainly the country's upper income groups. Government has encouraged lending to lower income groups through a "second tier" of institutions,¹⁶ including subsidized development corporations operating in each homeland with

¹⁶ see Dr. David Porteous, "Tears for the Unbanked, Tiers for the Unbanked", paper contributed to the Seminar on Informal Financing, Reserve Bank of South Africa (August 1996).

government support, the South African Housing Trust established in the mid-1980s, and non-traditional retail lenders supported initially with NGO and donor support and since 1991 by the Government's Independent Development Trust (IDT). Falling outside the Banking Act, these institutions were not licensed to accept deposits, and as a result have suffered from higher cost of funds and occasional liquidity constraints. Still, much of the experience that now exists with down market credit operations is the result of the success and failure of these institutions, and the innovations they have initiated in providing loans for consumer goods, housing, and small, medium and micro enterprises (SMME).

A "third tier" of institutions also exists that because of special exemptions is permitted to collect savings. These include stokvels, credit unions, and village banks usually operating on a small scale with common bond membership. However, this tier does provide housing loans, though it could in cooperation with second tier institutions serve a role collecting contract savings for savings-led housing loans. The remainder looks at each of the three tiers and their potential in providing low income households with access to housing credit.

A. Formal Banking Sector

The formal banking sector consists of the South African Reserve Bank (SARB), and the banks and mutual banks regulated by the SARB. The SARB was established in 1920 and today is regulated by the SARB Act of 1989 which identifies as SARB objectives the protection of the Rand and safeguarding of the banking system by protecting depositors. Banking supervision was formerly with the Ministry of Finance but became an SARB function under the Office for Banks in 1987.

Bank Act/Mutual Bank Act: Banks and Mutual Banks are regulated under the Banks Act of 1990 and the Mutual Banks Act of 1993.¹⁷ Under this legislation banks/mutual banks must meet the following conditions:

- meet capital adequacy requirements, including minimum equity capital of R50 million in the case of commercial banks, and R10 million in the case of mutual banks, with a risk exposure not to exceed 8 percent of equity capital;
- maintain a minimum reserve balance with the SARB equal to 5 percent of short term liabilities and hold liquid assets on not less than 20 percent of short term liabilities;
- inform SARB of large exposure, and give detailed monthly and quarterly reports.

Compliance with regulations gives banks and mutual banks the right to accept deposits, a right that none of the other financial institutions has. Exception have however been granted to the Land Bank, the Development Bank of South Africa (DBSA), the Post Office Savings Bank, and the Industrial Development Corporation (IDC), all of which may to some degree, accept deposits. KwaZulu Finance Corporation (KFC) was given the right to accept savings deposits, but must reapply annually, and is expected to eventually restructure as a Mutual Bank. The National Housing Finance Corporation (NHFC) also has applied for an exemption with the aim to accept wholesale deposits, and current indications are that an exemption will be granted, aging subject to restrictions and conditions.

Under a 1994 amendment certain institutions with a common bond membership also may accept deposits, and this is currently being used by stokvels, savings and credit unions, and village banks to justify their savings operations. Total deposits must be less than R9.99 million, and the institutions must have registered with a regulator and be a member of a recognized umbrella organization. In the case of stokvels, however, a weak umbrella organization does little to protect depositors; and in the case of savings and credit unions or village banks, the common bond of depositors is weak indeed, and would not protect from the loss of deposits. Hence, changes in the current regulatory system are now being discussed.¹⁸

Except for the above, other institutions cannot accept deposits. This includes in particular non-traditional retail lenders (NTRLs) including provincial development corporations (PDCs). If strictly enforced, this would cut them off from a major source of funds, including wholesale deposits by pension funds and insurance companies. As importantly, it means that their ability for relationship based credit may be impaired. One way in which a bank may establish the creditworthiness of a customer is by observing his ability to make regular savings deposits. While NTRLs could still ask for savings as a pre-condition for credit, the savings would have to be deposited to a commercial or mutual bank, and this may encourage relationships to the competitor rather than the NTRL.

¹⁷ An interesting albeit temporary problem is that under the current constitution many of the banking laws and amendments may not apply to former homeland territories. Homelands made use as they saw fit of their right to legislate and enact laws that had been enacted by Parliament. The Strauss Commission reports that the Banks Act of 1990 and its subsequent amendments never became law in the Transkei, and that therefore legislation enacted prior to Transkei 'independence' is still in force. Similar problems appear to exist for other homelands.

¹⁸ op. cit.

The existing regulatory system for the informal financial sector, including NTRLs is in urgent need of an overhaul.¹⁹ Many NTRLs have already accepted institutional deposits, usually with the silent acceptance of SARB. Other NTRLs are known to accept regular savings and still others use "security deposits" as part of their credit transaction in a manner that may not be entirely legal.

Usury Act: The Usury Act as amended in 1992 has the dual purpose to protect consumers by legislating disclosure requirements in lending, and by limiting interest rates. At present the maximum rates are 29 percent for loans of over R6,000 and 31 percent for certain loans under R6,000.

The Usury Act is highly complex, and provides exemptions in its interest ceilings for loans under R6,000, provided certain conditions are fulfilled. This exemption is used by virtually all NTRLs to justify their charging substantially higher interest rates. Unfortunately, the exemption is now under review, and the Ministry of Trade and Industry in 1994 published its intention to withdraw the exemption. Current discussions suggest that the exemption may remain in place, but limited to SMME loans.

Interest rate limits would seriously limit access to credit markets by lower income households. NTRLs often provide non-collateralized loans and there is general agreement that high administrative cost and loss rates make credit lines not viable at interest rates below 60 percent or more. A repeal (or at least substantial re-writing including the lifting of interest ceilings) of the usury act is universally being advocated by all aiming to provide low income households with access to financial services.²⁰

The usury act is being administered by the Ministry of Industry and Trade, though enforcement has a low priority. A 2-staff department is responsible for all inquiries and enforcement action, and in the past year determined 20 cases that violated disclosure requirements, almost all involving major banks. Violations by NTRLs may well be numerous, but given the small size of most NTRLs generally affect only a small number of customers, and hence have received a low priority.

Banks and Mutual Banks: South Africa's banking system is highly concentrated. Of the 42 equity banks and 3 mutual banks just four banks have a combined market share of 80 percent of total assets -- the Amalgamated Banks of SA (ABSA, also known as Volkskas, Trust Bank, United Bank or Allied Bank) with a market share of more than 30 percent, Standard Bank (20 percent), First National Bank (18 percent) and Nedcor (16 percent). With over 3,500 branches and a total staff of 100,000 however, efficiency is low and margins high, with real interest rates among the highest in the world. The branch system is duplicative and concentrated in urban areas while despite major improvements over the last five years, rural areas and some of the poorer settlements in the metropolitan regions have limited or no access to formal banking services.

Over the last several years the major banks have made a number of efforts to become more inclusive in customer targeting, and to begin serving lower income groups. There are at least three types of efforts.

1. First, the major banks have established new banks to serve the emerging niche markets: Standard Bank set-up EBank; ABSA established Nu-Bank, First National Bank the Future Bank and Nedcor the People's Bank. An informed review however, suggests that despite the considerable financial strength and backing of these new institutions, the number of low-income borrowers served by them remains below that of the NTRLs.²¹
2. Second, the major banks are experimenting with a number of new loan products, some of them similar to those of the NTRLs. These include mortgages to the affordable housing sector (often of smaller size than traditional mortgages, or with guarantee enhancements provided by the Home Loan Guarantee Company); provident fund backed loans; employer based loans with payroll deductions; and on an experimental basis, relationship based loans based on a customer's savings history, see Section ___.

¹⁹ op. cit.

²⁰ see various writings by NHFC, Khula Enterprise, and the Strauss Commission recommendations.

²¹ see "Reaching the 'unbanked', in Banking in Southern Africa, Supplement to Business Day (August 1996)

While NTRLs do much of the experimentation, it is clear that the traditional banks observe closely the success of these experiments, and are ready on short notice to copy those that are successful.

3. Third, banks appear to have taken a diverse range of methods to better reach and serve their emerging customers. Their staff has become more diversified; branches are located closer to emerging markets; new technologies are introduced appropriate to the customer base (smart cards to register savings and loan payment at the counter of the average supermarket); there are experiments with linkage banking through new village banks; and computing and reporting power is being used with growing efficiency to evaluate potential clients and to monitor on a daily basis customer payments.

Mutual banks represent still another means by which the banking industry hoped to reach the lower income sector. The Mutual Bank Act was established only in 1993, based on the idea that a successful banking relationship in the emerging low-income market required a new institutional approach to banking, one that instilled in the community a sense of ownership in its bank and allowed for a participatory approach between bank and community so as to overcome years of distrust and payment boycotts. The first bank established on this basis was the Community Bank, and it indeed was successful in developing a (mostly mortgage based) housing loan portfolio with low arrears. However, excessive branch expansion and high overheads have pushed it into receivership, and its fate remains uncertain at this time. Cash Bank is another Mutual Bank, also with significant housing loan portfolio; and KwaZulu Finance Corporation is considering converting to Mutual Bank status. Hence while the Mutual Bank concept has not proven to be the success it was anticipated to be, its uses are still evolving.

B. Second Tier Lenders

For the last ten years an increasing number of institutions have experimented with lending in the low-income market. Niche market lenders providing housing loans may be broadly divided into three groups: (i) Banks and mutual banks regulated under the banking act; (ii) parastatal provincial development corporations (PDC) and the South African Housing Trust established under the apartheid regime to serve homelands with credit, or in case of the SAHT, serve the medium and low-income population with housing credit country-wide; and (iii) non-traditional retail lenders (NTRLs), mainly non-government organizations, though often established at least in part with government funds. The latter two are "second tier lenders". All three groups together are called niche market lenders, to the extent that they address the needs of the low-income segment of the housing market.

The three groups differ in terms of their sources of funds and credit products. Banks and Mutual Banks have access to deposits, while NTRLs and PDCs do not (the sole exception being KFC). Banks, Mutual Banks, and PDC offer mortgage loans while NTRLs virtually never do. Instead NTRLs focus on employer backed (payroll deduction) loans with or without provident fund collateral and unsecured loans, either savings-led or group-based to reduce transaction costs and loss rates. Banks and PDCs make loans that are rarely less than R10,000, and in the case of mortgages average R40-50,000, while NTRL loans are almost always small, usually below R6,000, so that usury interest rate ceilings do not apply. The loan purpose varies among lenders and with credit product. By law, pension fund secured loans cannot be applied to anything but housing, though many suspect that such loans are often used for purposes other than housing.

Sources of Funds: NTRLs and PDCs have no access to savings deposits, and hence depend for funding on loans or equity participation. Equity funding is difficult to come by, and loans can be expensive. Recognizing the problem, the Government supported Independent Development Trust (IDT) in 1991 established Altfin as a wholesaler, to provide loans and equity funding to NTRLs. Since then the activities of IDT have largely wound down, and Altfin liquidated much of its wholesale business in 1994, when it became clear that many of its retail lenders were experiencing serious difficulties and Government declared its intent to create a new wholesale organization, the NHFC.

Government under the Ministry of Finance is currently establishing a system of five specialized wholesale institutions:

- National Housing Finance Corporation (NHFC) associated and supervised by DoH, to provide liquidity to the housing sector;
- Development Bank of South Africa (DBSA) which in the future will provide (local and bulk) infrastructure funding, mostly to utilities and provincial/local authorities, but in the past has also provided funding for NTRLs;
- Khula Enterprise, associated and supervised by the Department of Trade and Industry (DOTI), to provide liquidity to NMLs for SMME loans, and to undertake training and capacity building activities through Khula Development Trust;
- Industrial Development Corporation (IDC) under DOTI to provide loans directly to large enterprises;
- Land Bank of South Africa, an agricultural bank established by the Land Bank Act, and associated with the Department of Agriculture, which in the past has mainly lent to large farming operations. If the recommendations of the Strauss Commission are heeded, it will be restructured under the oversight of the Ministry of Finance as the so called "Rural Bank" to serve the rural population (not just farmers), with a broad mandate to support and provide liquidity to rural areas for all type of financial service needs.

Of the DFIs, Khula Enterprise and NHFC (and possibly the future Land/Rural Bank) serve an overlapping clientele, since many NTRLs and PDCs make both housing loans and loans directed at SMMEs. Hence, it is essential that the two cooperate, and plans exist for the Chief Executive Officer of each institution to serve on the Board of the other. There is also a need to coordinate training and capacity building activities including course material and content.

Housing Related Loan Products: Housing loan products fall broadly into four categories: mortgage loans, pension fund secured loans, employer-backed loans (payroll deduction), and the remainder -- mostly savings-led loans and group loans, neither of which appear to be available on anything but an experimental basis, see also Annex 6.

(1) Mortgage Lending: Mortgage loans are the exclusive domain of banks, mutual banks, development corporations, and SAHT. In line with the Record of Understanding, AML institutions have agreed to lending guidelines that are standard in international practice (payment burden not to exceed 25 percent of gross income or 80 percent of so-called "disposable income", a loan value ratio not higher than 0.8, and full insurance coverage) but by setting the minimum loan size to at least R25,000 nonetheless effectively limits loans to households with a gross monthly income of at least R1,500,²² though most loans are to households with more than R2,500. Banks typically explain that loans below R20,000 are not feasible because of high and fixed administrative cost,²³ though a more appropriate reasoning would compare the cost of a mortgage loan to that of an unsecured loans -- which usually carries interest rates twice those of mortgage loans. Whether on that basis mortgage loans are not preferable, even if they carry a much higher interest rate than currently being charged, would be worth investigating.

Mortgage loans in the traditional market (loans greater than R65,000) carry a variable home loan (H/L) interest rate of 19.25 percent²⁴ (or 18.25 percent with past relationship) and a term of 20 to 30 years. Instead, interest rates in the non-traditional, so called "affordable housing market" (loan amounts less than R65,000) are higher, at 2.5 percentage points above H/L for loans up to R25,000, 1.5 percentage

²² Assuming a 20 year term, a rate of 22.5 percent, and an affordable payment burden of 25 percent of gross household income, a loan of R25,000 would require a monthly income of about R1,900. However, with a price level adjusted payment plan at say, 12 percent real interest rate, one could reach to a monthly income of R1,100 -- though the higher default risks of such a plan should not be overlooked.

²³ The bank's administrative cost of mortgage origination is often estimated at between R1,000 and R2,000 per loan, including a large fixed cost element. However, fees charged to the borrower are proportional to loan value (an initiation fee of 0.2 percent of loan value up to a maximum of R850, and a property assessment fee of 0.5 percent of loan value up to a maximum of R1,250), and hence result in losses for small mortgages.

²⁴ as compared to a Reserve Bank Rate of 16 percent, and a prime rate of 19.5 percent.

points above H/L for loans of R25-R50,000, and 1.0 percentage points above H/L for loans of R50-65,000. Still, these rates are much below those charged by NTRLs for unsecured loans.

Because interest rates are variable and usually do not carry a cap, borrowers are subject to large rate risks and banks to higher default risk.²⁵ Banks therefore are starting to experiment with fixed interest 10-year loans (rate of 22.5 percent for loan below R25,000, declining to 21.75 percent for loans of R25-50,000 and 20.5 percent for loans of R50-65,000) for households with income below R3,500 per month. In addition, certain short-term 2-year fixed interest loans appear to have become available at rates as low as 17.50 percent -- though the extent to which such loans are accessible to the average borrower is difficult to determine.

- (2) **Pension Fund Backed Lending:** Under the Pensions Funds Act 24 of 1956, a pension or provident fund may directly lend to its members, or provide a bank guarantee of up to 80 percent of the withdrawal benefit of the policy, provided the loan is for housing purposes. Both banks and NTRLs make use of this opportunity by establishing a relationship with an employer who agrees to payroll deductions and electronic transfer of installment payments, thus minimizing administrative cost to the lender. Loss rates are minimal, and can be further lowered through life and disability insurance. Even when the employee is laid off the lender has the right to the loan guarantee. Enhancement products by the Home Loan Guarantee Fund can further raise the loan amount, and may provide employer guarantees against retrenchment. The size of these loans varies and can be well above R6,000, with the interest rate about 21 percent.²⁶
- (3) **Employer Backed Lending:** As in the case of pension fund backed loans, the lender establishes a relationship with the employer, who agrees to payroll deductions. However, in this case there do not exist pension fund guarantees, because the employee is not enrolled, does not have the required job tenure, or for other reasons. The loans are provided mostly (though not exclusively) by NTRLs with Altfin a good example of a lender operating nationwide, and apparently highly profitable, with equity funds from large institutional investors, see Annex 6.

Loans typically are for R2,000 to R4,000, and to avoid usury restrictions, are always less than R6,000. There is no restriction on the use of funds, though housing related uses may be as high as 50 percent of total usage. The interest is nominally at least 31 percent, but various other fees (for example an initiation fee of R200 in the case of Altfin) plus deposit requirements (with limited or no interest) will bring total yield to at least 38 percent. When well managed, arrears can be held to less than 2 percent, and loss rates can be even smaller -- despite the fact that recovery efforts are limited.

- (4) **Savings Backed Relationship Lending:** The Community Bank as well as others have experimented with savings backed loans. It requires individuals to save for a period of 6-12 month at least 10 percent of income, which would then make them eligible for a loan three or four times cumulative savings. Savings will usually not receive interest, and will be returned only after the loan has been repaid. Interest charged on such loans is at least 60 percent, and may be higher, though statements to beneficiaries rates are disclosed with reference to specific repayment periods, and this makes it difficult to calculate effective rates. Terms for SMME loans will be short, often only a month with a maximum of 12 months. None of the NTRLs appear currently do provide such loans for housing purposes -- which would require a term of at least two to five years. However, several municipalities are negotiating lending schemes with the leading banks which in part may be savings backed, but would also carry municipal guarantees that would make them relatively risk free to the banks.

²⁵ A household that in 1991 borrowed R50,000 at a variable interest rate of 12 percent may now pay 22 percent. If the mortgage had a 30 year term, his payments would have risen from R517 to about R900 (approximate amount, depending on intermittent rates and amortization).

²⁶ The high interest rate, relative to mortgage loans, is likely because mortgage loans alone count only at 50 percent of their value against capital adequacy requirements.

- (5) **Group Lending:** This is the preferred type of credit for SMME loans. It also was used by the Group Credit Bank for housing loans -- though this experience turned out largely negative. Apparently, groups were too large, loans too big, and terms too long, and the Group Credit Bank suffered large losses, forcing it to restructure as the Cash Bank (that no longer provides such loans). While some believe that such loans could work in the South African context with the right conditions (see Annex 6), this remains to be verified by actual experience.

C. Third Tier Financial Institutions

Third Tier financial institutions operate largely unregulated in local markets, but accept savings from small depositors. They include stokvels, village banks, and savings and credit cooperatives. None of these so far play a significant role in the housing market (and none are currently intended NHFC customers). However, they provide valuable lessons on savings mobilization, the effectiveness of umbrella organizations, transaction costs in rural and low income markets, and the effectiveness of self-help. Hence, they deserve attention and in some cases could be partners for second tier organizations.

Because third tier institutions accept savings, their regulatory requirements differ from those of second tier niche market lenders. Village banks and savings cooperatives in particular, have emphasized savings over credit operations, and hence provide useful examples of a savings-first strategy in the provision of credit. Savings mobilization generally takes a long time, and as a result, the credit operations of these institutions has expanded much more slowly than those of second tier institutions, which have expanded on the basis of external funding.

- (1) **Savings and Credit Cooperatives:** Cooperative movements have a considerable following in South Africa, particularly in the agricultural sector where the Agricultural Co-operative Business Chamber represents 132,000 active members in 160 agricultural cooperatives operating more than 250 enterprises. Credit cooperatives remain small however. The **Savings and Credit Co-operative League (SACCOL)** was established only in 1992, though a predecessor organization, the Cape Credit Union League was established as early as 1981. SACCOL is a self-regulatory umbrella or apex organization with 10 mainly parish based local SACCOs (reduced after consolidation to eliminate uneconomic cooperatives), a total membership of 2,751, and total assets of about US\$ 3.1 million (status February 1996). SACCOL sees workplace based SACCOs as its main growth sector, and hopes to increase its membership more than tenfold in the coming four years.

SACCOL supervises and monitors its member SACCOs through regular audits and aims to assure that prudential standards and financial discipline are observed by its member organizations in the management of savings. It provides training and educational support to its members, and through its past performance has shown that it is able to deal with problem situations by preserving individual savings. SACCOL is finding it difficult however, to survive in a competitive environment. It clearly needs to grow to defray operating cost (donor contributions to operating cost are expected to run out in a year) and is trying to build new alliances with formal sector banks. This may in the future pave the way for formal banks to recognize the savings record of SACCO members as a basis for lending, or to use SACCOs as a means to reduce the administrative cost of savings.

- (2) **Stokvels:** Stokvels are rotating savings and credit clubs. They usually have a membership of between 5 and 20 individual which meet regularly to pool and distribute their savings according to some pre-agreed principle. Savings may be used for mutual benefit to hold a party, to pay for burials, or to provide self-help funds.

According to the **National Stokvel Association of South Africa (NASASA)**²⁷ there exist in South Africa as many as 500,000 stokvels, of which 3 percent are organized in NASASA. About 26 percent of the black population is said to be a member of some form of stokvel, and the total stokvel cash flow is said to be R200 million per month. NASASA acts as a lobbying group for stokvels which often engage in illegal activities (such as brewing or the unlicensed resale of alcohol), but it does not effectively regulate or audit the activities of its members. Hence, despite the broad acceptance of stokvels at the grassroots level, and the financial discipline of its members in regularly contributing to the group cash pool, it is unclear to what extent they represent a potential vehicle to mobilize housing funds or to channel credit to the housing sector. However, the similarity of stokvels to group lending schemes used by non-traditional retail lenders, particularly in the context of SMME lending suggests this may be possible.

- (3) **Village Banks:** Village banks are community supported banks with a link to formal banks, designed to offer small rural communities the opportunity to (i) save or deposit funds for safe keeping (important for pensioners), (ii) provide access to electronic fund transfer (important for remittances), and (iii) receive credit. Three such banks have been established on a pilot basis, each supported by a one-time grant of R25,000 (for a cash safe, and first year operating funds) in addition to community support in the form of a building and other necessities. It is expected that the concept will find wider application in the near future, possibly in numerous other villages. The pilot schemes suggest that a bank is sustainable if it attracts savings of R100,000 -- an amount that should be reached within a year.

None of the pilot banks so far have been involved in credit activities, and it is difficult to see, how village banks could attract the expertise necessary to make housing loans.

- (4) **Postal Bank:** The Post Office Savings Bank dates back to 1883, and for some of the rural population continues to be the only source of financial services. Exempted from the Bank Act it is permitted to accept savings and in 1995 had about 2.4 million accounts with total savings of R1.1 billion (including book based accounts, card based accounts and savings certificates). Its main attraction is the income tax exemption of its interest, and the ready access of 2,365 outlets which provide it with better coverage than the commercial banks, particularly in rural areas. Post Banks do not provide credit, but could have relevance to housing delivery for the transfer and savings services it offers, which may provide non-traditional retail lenders opportunities to establish a savings relationship with clients without involving competing banks. The operating cost for its savings deposits has been estimated as 7 percent, which would be low -- the Community Bank estimates its cost as 15 percent. The Post Bank is currently considering options for restructuring, including an expansion of service quality and access, and a reduction of cost.²⁸

D. Conclusions

A well functioning system of housing finance is critical to any housing delivery system. The World Bank and others argue, that in principle at least, South Africa has plenty of institutional and financial capacity. The current failure of the system of financial intermediation is at the retail level, where the system of apartheid and resulting payment boycotts have led to the abandonment of the lower end of the retail market.

While the traditional sector has only recently begun to re-enter the lower income market, there has been plenty of private, donor, and government support and institutional experimentation, particularly at the second and third tier. While South Africans joke that they will establish at least three institutions for each problem, this is not without its benefits. At a minimum, it provides for plenty of experimentation, from which it

²⁷ See S. Japp, The Role of Stokvels and Representative Bodies in the R.S.A., paper contributed to the Seminar on Informal Financing, Reserve Bank of South Africa (August 1996)

²⁸ see Interim Report of the Commission of Inquiry into the Provision of Rural Financial Services (Strauss Commission), March 1996.

should be possible to pick successes and discard failures. The early signs are that this is already happening. Second tier institutions in particular provide a rich case study history, which is only now being analyzed. In an ongoing joint study between DBSA and Khula, the two institutions will look in detail at the experience of more than 30 lenders that have received DBSA support since 1986.

Despite rising lending volumes to the low-end of the market, and the expectation of continued growth in the future, there are nonetheless several problems that must be addressed:

First, there is the issue of down-market extension of housing credit. By most accounts, households with incomes below R800 cannot be served by almost any lender, though there is likely very little lending to households with incomes less than R1,500. Examples from retail and furniture retailers illustrates that these groups can afford credit, and will repay it, but feasible lending models for the housing sector remain to be developed.

Second, there is the problem of deepening services to the income groups that already have access to financial services, particularly to households without pension fund security and with incomes below R2,500. Current credit products (almost all of them in amount of less than R6,000) are suitable for limited home improvements, but cover less than 10 percent of the cost of a regular housing unit.

Third, the cost of financial services is high, and ways must be found to bring it down. Operating costs alone require a spread of 15 percentage points for efficient NTRLs with payroll deduction plans, and up to 50 percent or more for others. Even the most efficient NTRLs provide unsecured loans with effective interests rates (including add-on charges) of 40 percent, see Annex 6. This means that a term of more than 5 years adds little to housing affordability, and a term of 10 years yields only twice the loan amount of a term of two years.

Fourth, there currently does not exist a NTRL enabling environment, including a capacity to monitor and evaluate niche market lender performance, particularly in the housing sector, to provide liquidity, or to monitor and supervise NTRL performance. Experience in other countries suggests the importance of strong and powerful umbrella organizations that provide credibility to their members and assurances to private investors. There is also a great deal of uncertainty regarding possible changes in government policy, particularly as they relate to changes in usury laws, the successful regularization of existing stock, the enforcement of existing default and foreclosure rulings, and Government's willingness to stay the course in relying on private sector markets for housing delivery.

Fifth, there is an almost universal conviction among niche market lenders, particularly those more successful, that credit demand is huge and that it goes much beyond the current size and scope of the market. What is missing is the required liquidity at what lenders regard at reasonable rates. Though the NHFC has yet to make its first loans, the cost of NHFC loans is uniformly regarded as high, and eventually some ways may have to be sought to make NHFC lending more attractive through equity participation (at lower expected yields) or through other means. Most importantly, the sustainability of NHFC depends on making few mistakes, particularly during the early stages of its lending. This in turn requires a capacity to monitor, and where necessary strengthen its customers.

Sixth, though a formal review of NTRLs and PDCs was not possible, it is clear that many suffer from institutional capacity deficits that make their operations not viable to institutional investors. The most successful NTRLs appear to focus on a small range of products, almost always limit credit risks through careful (but efficient and automated) beneficiary screening, reduce transaction costs in all phases of loan disbursement and recovery (payroll deductions), and have in a place well designed cost accounting, information and decision system that allow for the close monitoring of individual accounts, branch offices, and departments. They also invariably charge high interest rates and limit the term and amount of loans to levels that at best allow for incremental construction. Yet for many others one or more of these elements are missing, making them dependent on continued but non-sustainable donor subsidies.

Seventh, traditional banks continue to limit their involvement at the low end of the market, in part because of uncertain credit risks not covered by MIF. The solution here is time, and the development of a good credit history by non-traditional lenders that can be imitated by others.

3.3.4 Housing Institutions (Associations and Companies)

Most of Government's attention so far has been directed to owner occupied housing. However, subsidies are also open to institutions, and in the future DoH will pay greater attention to alternative tenure models, including rental housing. Housing institutions can have a variety of functions. They may develop, own and manage rental housing in the tradition of the classical Northern European model of housing associations; they may develop housing and eventually sell it to their tenants, similar to a land development company; or they may mainly manage stock for others.

South Africa so far has little experience with housing institutions, and there have not yet developed clear and distinct models for others to follow. While historically there have been associations that have owned and managed housing stock for middle income white tenants (Communaire in Cape Town in particular), the recent down market experience appears not to build on this experience. Instead it follows the varied and ad hoc demands of small community groups and the opportunities provided by non-government organizations and foreign donors. As a result, there are now underway a great variety of experiments, most of them in the early stages of development. The few experiments close to completion are rarely replicable however, particularly at the scale demanded by NHFC financial plans.

The following deals mainly with housing institutions that develop and manage housing stock. These institutions may be grouped into (i) member-based **housing associations**, and (ii) capital-based **housing companies**. In case of the former, members (usually current residents and possibly those waitlisted) elect the board and determine the Association's broad policy. Day-to-day operations and administration is left to a professional management team. In case of the latter, shareholders through their capital equity participation determine the board and the policies of the company.

A. Recent Experience

Virtually all housing institutions have developed over the last five years, usually with foreign donor assistance. Most of them are member based associations, and of these a large number have involved existing apartment buildings which had undergone rental boycotts, but eventually were purchased by tenant organizations from their previous owner with the purpose to regularize and rehabilitate the building. In addition however, there has been at least one member-based association that has developed new housing, and one capital-based company that builds, rehabilitates and manages rental stock. Specifically:

- The Wattville Housing Association in Johannesburg has been supported by French financial assistance, and more recently by Dutch technical assistance. Yet total housing construction during the last six years was only 46 units (with 9 units to be added in the coming year), rental non-payment remains as high as 30 percent (though down from 70 percent at the start of 1996), and social strife has interrupted institutional development.
- Several housing associations have been formed as Section 21 companies in Johannesburg (Seven Buildings HA, Angus Mansion HA, Navarone Court HA) in an effort to regularize rental properties in possession. The associations are member-based and vary in size from 35 to 446 members, see Annex 7. In most cases government subsidies have been sufficient to purchase the property from its previous owner, but commercial banks have denied request for refurbishment loans. Rental income could be used to self-finance refurbishment, though indications are that rates have not been set to levels required for maintenance and operations. While some associations voted to keep the property in rental form, others have decided to eventually own their property individually, with the association holding only common property.
- The Johannesburg Housing Company (JHC) was established in 1996 with local and international donor funds as a capital based housing institution. Its mandate is to develop up to 2000 rental housing stock within five years, through new construction and refurbishment of existing units. The Company is

professionally run, with a heavy emphasis on detailed financial analysis for project selection, clear guidelines for tenant selection and management, and a speedy and detailed information systems. However, it has yet to rent a unit. As all associations, it will benefit from Government institutional subsidies, but despite these subsidies will not be able to rent a 1-2 bedroom apartment below R550 per month (cold). Even this makes optimistic assumptions about rental loss rates, and hence, its target households would have incomes exceeding R2,000 per month.

- The Badiri Housing Association was created by the hotel and allied industry for the benefit of its employees. Little is known about the institutional set-up, including whether it is capital based or member based with housing finance secured from employee pension funds. It does however, suggest the potential for a more active role of employers and unions in providing housing for their employees.
- Several local authorities are considering ways to transfer their existing housing stock to housing associations. In line with the new Draft Housing Bill, they are also considering to set up housing institutions that will develop and manage housing stock. No models yet exist for such institutions, and hence, a broad range of options are possible. In the case of Durban Metropolitan Council (DMC) several financing models have been discussed with commercial banks (see Annex 7) which suggest that DMC would like to target its housing at the very poor who cannot afford a loan of more than R6,000. Commercial banks have made financing and loan management proposals, but demand full municipal guarantees, and suggest a package of charges that will yield 40 percent or more per year.

Even this limited review (further detailed in Annex 7) suggests some preliminary conclusions. Specifically:

1. First, member-based. NGO guided associations have generally lacked professional management and sound financial planning. NGOs themselves have had little experience, and implementation has been marred by many years of endless and wearing struggles with members to come to agreement on development and operating policies. The association involved in property regularization all received technical assistance for five or more years, yet are only now starting the transfer of ownership and refurbishment of apartments. The Wattville Housing Association has needed several years to implement 46 housing units, yet currently is involved in an intensive internal struggle over power that has temporarily stopped development and already cost two lives.
2. Second, the involvement of foreign donors, both through financial and technical assistance, has not encouraged a business like, realistic, and replicable approach to problems. In Wattville, rents have been based on a 10 percent interest rate, and Dutch assistance is currently attempting to mobilize international sources of funds on the assumption that these are cheaper than domestic sources. Yet foreign funds carry huge foreign exchange rate risks, and can be cheaper only if subsidized at their foreign source. In short, the solutions sought with foreign assistance illustrate, how problems may be solved when funds are ample and cheap. But the problem is that funds are tight and costly. Technical assistance also is treated as if without opportunity cost. Dutch assistance estimates that it will take at least two years to establish a housing association, and COPE has accompanied its housing associations for 5-6 years before buildings were fully regularized. While this may be shortened in the future, it is clear, that a more hard-nosed approach is needed, that clearly establishes the limits and cost of decision making and community participation.
3. Third, arrears and non-payment continues to be a problem. In the case of Wattville, non-payment was a particular problem, despite subsidized payments based on a concessionary fixed interest rate of 10 percent. While the non-payment rate has recently been reduced to 30 percent, these are not rates that attract private capital. The non-payment rate for a Malaysian housing project in Durban is also 25 percent. Non payment rates for the associations involved in property regularization are lower but rental levels are about half the market rate.
4. Fourth, with one possible exception, none of the member-based housing associations have succeeded in attracting private sector funds. The associations involved in property regularization in particular require refurbishment loans that exceed the cost of building acquisition.
5. Fifth, experienced NGOs themselves do not believe in the possible commercial success of their products, and usually will argue the need for increased subsidies rather than seeking to reign in cost. One of the most experienced NGOs (COPE) suggests the following list of conditions to make housing associations successful: (i) regular institutional subsidies; (ii) refurbishment grants in addition to the regular institutional subsidies; (iii) subsidized interest rates; (iv) municipal subsidies on tariffs and

taxes; (v) loan guarantees; (vi) and education and training grants to set-up associations. This is a menu of subsidies that likely would succeed in bankrupting both central government and local authorities.

6. Capital-based companies appear to take a more business like approach. They have available clear business plans and because they do not behold to members, can take a much tougher line in setting cost recovery rents, and establishing buildings codes and rules of acceptable conduct for their tenants.
7. Capital based companies have a more public minded agenda. Specifically, they do not limit size to existing membership, but usually want to expand their size so as to reach an efficient operating size. Instead, most member based associations appear to have no ambition to build new housing units, and many have no mechanisms that would allow them to do so. In this way, they are close to American condominium societies which typically come into existence after an area has developed, and seek no role and have no incentive to expand beyond.
8. There is a need for experimentation. While most experts would suggest that housing associations should be large and at least have 2,000 housing units, some South African experience suggests the need to keep institutions small, so as to make member participation manageable. Economies of scale are possible even for small associations, if they outsource their maintenance and administrative tasks to specialized service companies. Similarly, despite the inefficiencies of most member-based associations, it may be to early to limit institutional models.

B. Role of Public Sector Housing Associations

Local authorities will likely become a major source of demand for NHFC lending. There are several reasons to think so:

1. The new Draft Housing Bill of July 1996 gives local authorities a much expanded role in the direct development of housing expanding the public sector role from facilitator to developer.
2. Local authorities already hold a large number of rental units. When enacted, the new Draft Bill will forgive NHB debt, and according to DoH officials permits the transfer of municipal stock to private housing associations. The current stock is badly managed: Tenant roles are incomplete; apartments are in disrepair and require refurbishment; rental rates are low and may even not cover operating cost; and the incidence of non-payment of rent and tariffs remains high. The existing discount scheme (which has already transferred 83,220 housing units to private ownership over the last four years) will terminate, and the re-development of this stock would require large infusions of cash.
3. A large number of officials feel that the private sector has been given a chance, but has been moving too slowly in delivering housing stock. They point to the large capacity for housing delivery developed in the public sector during apartheid years, a capacity that now seems idle. Many officials are convinced that it can be re-mobilized.
4. DoH is considering providing funding out of its 1997/98 budget to assist in setting-up housing associations. Preliminary figures of R220 million have been mentioned, which would be used as equity capital to reduce the average cost of capital to housing associations. This capital would be in addition to regular institutional subsidies, and if permitted to yield a return lower than borrowed funds, would represent an additional subsidy over and above that given to other types of housing. While this funding will likely not be limited to public sector associations, public authorities would likely be in a better position to access it, given their simultaneous control over land and infrastructure.
5. Local authorities appear to be willing to back housing institutions with payment guarantees, see Annex 7. While the quality of this backing is not obvious, private sector institutions could not compete, particularly since rental housing requires much greater up-front investments than owner occupied housing which can be built incrementally.

It is likely that institutions set-up by local authorities will become a major source of credit demand for the NHFC. There do not exist however yet, appropriate institutional and financial models for the implementation of this strategy, and it should be obvious that it carries large risks. Given a continuing culture of non-payment combined with a lack of management capacity -- despite years of experience -- local authorities should:

- clarify their objectives, in particular the extent to which they believe that such schemes can benefit the lowest income groups with incomes below R1,500 or R800; in general, housing associations are not a

good way to provide housing to the very poor, unless the level of subsidies is very high; and then they may be much more expensive than the alternative, including incremental, owner occupied housing;

- professionalize management and not allow the wholesale transfer of staff to privatized housing associations;
- not burden new associations with non-performing beneficiaries;
- not burden housing associations with the subsidy and welfare functions of local authorities; if local authorities require housing associations to house the indigent (who cannot recover cost even after institutional subsidies), these additional subsidies must be paid from the public sector budget;
- first regularize existing accounts to make their claim believable that new ventures will receive regular payments from beneficiaries;
- limit own guarantees, and instead insist that all involved, including beneficiaries, share in non-payment risk (beneficiaries for example, through deposits);
- establish innovative incentive schemes, even for rental housing, to mobilize group pressure towards payments; for example, beneficiaries could be asked to make payments into a non-payment account, with rebates based on community/group performance (which may prove particularly effective if the groups are small);
- submit to regular outside performance audits and monitoring.

The above list is unlikely to be complete, and only includes some suggestions of the kind of issues that must be addressed, before public sector housing institutions should receive either equity capital or loans from NHFC.

C. Housing Institutions and the Very Poor

Several local authorities are currently considering establishing housing associations to assist the very poor. The question is whether housing associations are an appropriate vehicle in this case. The answer is that in general, rental housing may not be the best means to do so, unless special conditions apply.

Regular 1-2 bedroom apartments of minimum standards cannot be provided for rents below R450-R550, even after R15,000 in subsidies. This puts such housing units outside the reach of the very poor, at least if they are to recover cost. Also, rental housing is subject to rental externalities. Individual behavior results in costs that must be socialized and shared equally by all tenants. This in turn reduces individual's incentives to behave efficiently. While the problem exists for all rental housing, it is usually far greater at the low end of the market, where inefficiencies are large relative to the value of housing services provided. Perhaps more importantly, incremental and self-help housing are key means, by which owner-occupants provide themselves with housing over time. Yet this option seems difficult to implement if a housing association is to own and manage its stock to constant standards.

Of course, there are exceptions. Local authorities may be willing to provide housing institutions with the needed subsidies -- though this does not seem likely given the state of finance of most local government. Alternatively, the previous owners of apartment buildings may be willing to provide the necessary subsidies, as is the case with apartments buildings that have undergone payment boycotts and are now in possession. Given Government's inefficiency in regularizing such housing and in evicting non-paying tenants, the rightful owners may eventually be willing to write-off such property, and to accept the sale of their property to tenants at much below replacement cost. In this case, the very poor may well be able to afford such housing, and a housing association may be a viable option to manage such property.

Another case would be housing associations that do not own the stock they manage, but that limit themselves to the provision of certain services, such as certain maintenance, training, or lobbying functions. Such arrangements may qualify for project-linked or institutional subsidies. For example, it is possible for an institution to receive a housing subsidy, but to transfer housing to its tenants after some period of time while continuing to provide minimum management services.

D. Conclusions

Government policy calls for the support of housing institutions and the development of alternative tenure solutions. It has already made a large financial commitment to the NHFC which is mandated to support housing institutions with housing credit. At the same time, the new Draft Housing Bill foresees a much expanded role of local authorities in providing housing, possibly by setting up housing companies or housing associations.

Yet, there is so far little experience with such companies, and what experience exists is often discouraging. The cost and time involved in establishing member based housing associations can be extraordinary, yet despite this effort, none has yet succeeded in attracting commercial loans. There are a variety of reasons for the many problems, including the relative inexperience of NGOs; the difficulties in achieving agreement among community groups; the lack of institutional models and laws addressing cooperative issues in the housing sector; and continuing problems with payment boycotts and low payment morale. However, the greatest problem is likely a lack of professionalism, a lack of institutional capacity, and a lack of human resources. NHFC will have to insist on establishing this capacity before it lends.

2.4 Problem Analysis Related to Target Groups

The target group of GTZ technical assistance are the low income, mostly African households without adequate housing. The key problem facing this group is a lack of housing at affordable and appropriate standards. Housing often lacks basic services, is of substandard size and quality, and is located in former homelands far from most urban jobs. The reasons for the current situation are at least in part the result of past apartheid policies that have limited training and education, have tightly circumscribed residential areas the black population, and have limited access or lowered the performance of most segments of the formal housing industry, including finance, insurance, and construction, and municipal services.

The Government has made the improvement of the housing situation a centerpiece of its housing policy. Whether it succeeds however, will depend less on the level of its housing subsidies but on its success in mobilizing private sector resources to the housing sector. One of the key problems therefore is to stimulate the self-help efforts of the low income population, and to provide them with access to housing finance. The tasks is twofold, (i) to deepen available credit to those who already qualify for credit, both in terms of the number of households actually receiving credit and the quality of credit provided; and (ii) to broaden and expand credit access to include at least some of the more than 50 percent of the population that currently do not qualify for credit. The former group includes households with formal sector employment and monthly incomes above R1,200, while the latter include the remainder, including most rural households. Rural credit access in particular, will prove difficult, but requires particular attention in light of the KfW/RHLF commitment to fund rural housing.

2.5 Summary of Problems

South Africa has a dual economy -- a highly developed economy for its upper and middle income, largely white population, and an underserved, informal economy for its lower income population where access to many markets remains restricted. The challenge of the Government's housing policy has been to bring the capacity of its formal sector to bear on the low income segment of the market. To do so it has followed a market oriented approach and has established a broad range of institutional and regulatory instruments to deal with the diverse aspects of the housing delivery problem. It has not however done one thing that is essential for the various institutions to work in harmony. It has not allowed it time. For an institutional system to work well, the different actors must learn to work together, they must know and trust each other, and there must be a record of past behavior under a broad range of conditions on which to judge risks and likely outcomes. This is nowhere more important than in the area of housing finance.

The key problem facing low income household is a lack of housing at appropriate and affordable standards. While government has implemented a generous program of housing subsidies, these subsidies can provide only housing of minimum standards. To improve standards, subsidies must be augmented by household

savings and access to financial markets. This has not yet happened. There have been few savings linked subsidies, in part because current subsidization schemes do not require savings, and may even substitute for them. There have been few credit linked subsidies, either because of a lack of demand for credit, or more likely, because of a lack of access to housing finance particularly among the poorest households with incomes below R1,500.

The lack of access has several roots. First, there are few loan products appropriate to low-income households. Mortgage loans start at R20,000 and are inaccessible to the truly poor; group loans have been tried but default rates proved excessive; and pension secured loans and loans with automatic payment reduction require job security and formal sector employment. Even when loans are available, their short term and high rates limit the loan amount. Hence, loans typically are sufficient only for home-improvements and incremental construction.

Second, even non-traditional retail lenders remain reluctant to lend to the lowest segments of the markets because of the small size of affordable loans, high transaction costs, uncertainty regarding usury exemptions, difficulties in assessing credit risks, and the general perception of continued low payment moral.

Third, where NTRLs have been successful, they nonetheless face constraints on credit expansion. Having relied on operating subsidies and funds at concessionary rates, their operations and management may require major retooling to meet the stricter standards of institutional investors and the NHFC. Weaknesses include a lack of institutional capacity including data and information systems, cost accounting, and reporting practices; a lack of experience in risk management and control; inexperienced staff and low staff productivity; insufficient Board control; and limited policy making capacity.

Fourth, NTRLs face liquidity constraints where their products are successful. In the past most funds were at concessionary rates. NTRLs are not yet fully prepared for the transition to market based lending. Do not have sufficient capacity, do not have in place risk management tools, do not always manage their loan generation properly, are not sufficiently productive. There is slowly developing a body of knowledge as to acceptable standards but much remains new.

Problems also exist for housing institutions offering alternative tenure forms. A legal, financial and institutional format for such institutions remains to be developed, both for member based housing associations and capital based housing companies. There exist virtually no working examples of such institutions, and without a track record, access to financial markets will be difficult. The few examples of housing institutions that do exist have been developed with heavy subsidies, and would ordinarily not qualify for loans under standard banking criteria. Key problems for such institutions is to develop a capacity for project development (both the rehabilitation and new construction of rental housing), tenant selection and management, stock maintenance and operations, and financial management. Only when the requisite institutional capacity and trained staff exists, is there any hope of gaining access to financial resources, including loans from the NHFC.