Historical Context

The housing finance situation in South Africa is largely determined by two interwoven factors:

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

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

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

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

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

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

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

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

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

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

In addition to the subsidy scheme, the new government established a number of new housing finance institutions in the attempt to mobilize private sector credit. These included the National Housing Finance Corporation (NHFC, http://www.nhfc.co.za/), a provider of wholesale credit to banks, non-bank lenders and housing associations;
Setting the Context: South Africa

South African Housing: Capital Subsidy Scheme

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

The main scheme is open to first-time home buyers with a household income of less than $500 per month and with dependents, and provides a one off capital sum of a maximum $3,000, usually through the developer; this subsidy takes different forms depending on the position of the recipient. More recently, recipients have also been required to produce a co-payment amount of approximately $400. A house bought with subsidy cannot be sold for eight years.

In addition, an institutional subsidy scheme provides a higher amount ($4,000) to housing institutions which offer units on a rental, lease or rent-to-own basis to eligible tenants, with the right of the tenant to buy after a minimum of four years.

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

- Introducing a higher income band subsidy for those earning between approx $500 and $1,000 per month, where effectively a grant as down payment on a mortgage loan will be provided
- The resale time limitation on subsidized houses is reduced to five years to facilitate a legal secondary market
- The institutional/rental subsidy is made more flexible

This new category is open to those with an annual household income of between $1,000 and $2,500 per month, and offers $4,500 to a household to buy its own home. The subsidy cannot be sold for eight years and the recipient is required to pay a co-payment amount of $400.

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

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

- Population growth continues, although at a declining rate in part due to AIDS; in addition, average household size has fallen from 4.5 people to 3.8, in part due to the success of housing delivery.

- HIV-AIDS: with national infection prevalence estimated at around 12%, the patterns of housing demand will change in unpredicted ways; for example, it is likely that there will be larger extended families and child headed households.

- Urbanization continues at a rapid pace of close to 3%, especially in secondary cities and metropolitan areas.

- Unemployment has risen to around 30% by official definition, stretching the ability to afford housing finance, let alone pay for basic municipal services.

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

### Table 1: Housing Demand Pyramid

<table>
<thead>
<tr>
<th>Annual income (in US$)</th>
<th>Income range (ppp)</th>
<th>Percent of households (ppp)</th>
<th>Geographic/Housing situation</th>
<th>Housing finance options</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt;$8,000</td>
<td>&gt;$35,000</td>
<td>32%</td>
<td>Urban/suburban</td>
<td>Standard housing finance product is a 20 year, variable rate annuitizing mortgage, provided predominantly through 4 large commercial banks</td>
</tr>
<tr>
<td>$3,001–$8,000</td>
<td>$10,001–$35,000</td>
<td>35%</td>
<td>Urban/peri-urban</td>
<td>Limited: mortgages hard to obtain in areas in price range of this group.</td>
</tr>
<tr>
<td>&lt;$3,000</td>
<td>&lt;$10,000</td>
<td>33%</td>
<td>Rural/peri-urban</td>
<td>Micro-loans used for home improvements/extensions by formally employed</td>
</tr>
</tbody>
</table>

### Table 2: Overall Housing Situation

<table>
<thead>
<tr>
<th>1996</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>% of households</td>
</tr>
<tr>
<td>House on separate stand</td>
<td>48.0%</td>
</tr>
<tr>
<td>Flat/apartment/cluster</td>
<td>10.0%</td>
</tr>
<tr>
<td>Backyard dwelling</td>
<td>10.0%</td>
</tr>
<tr>
<td>Informal dwelling not in backyard</td>
<td>11.5%</td>
</tr>
<tr>
<td>Traditional dwelling</td>
<td>18.0%</td>
</tr>
<tr>
<td>Other</td>
<td>2.5%</td>
</tr>
<tr>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

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

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

BIG HOUSING FINANCE CHALLENGES/ISSUES

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

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

The major housing finance challenge in SA today is closing the ‘credit gap.’ ¹ The credit gap is the area of the home loan market which is:

(i) below the size at which mortgage finance is easily available (typically $15-20,000)
(ii) above the size at which uncollaterized micro-loans are available (typically up to $1,500).

This gap between $1,500 and $15,000 is critical because:

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

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

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

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

¹ See for example, Ian Fife “Riches to be Had”, Cover Article on SA property market in Financial Mail, 2 July 2004 p.18-19 Available via www.financialmail.co.za.
Solving this question at scale in township areas for residents with informal as well as formal employment is the frontier issue for SA housing finance in the next decade of freedom 2004-2014.

INNOVATIONS/PILOTS OF NOTE

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

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

3. AIDS insurance: At the high level of infection experienced in SA, HIV-AIDS clearly has severe implications for housing in general—both the type and distribution of housing (for relevant research on this, go to http://www.hfrp.org.za/frame_publications.htm). The effect is very pronounced on the risk assumed by mortgage lenders and/or life insurers. Mortgage loans usually require credit life insurance to cover the life of the bond holder. Increasingly, life insurance companies exclude cover for death as a result of HIV-AIDS. This means that: (i) currently infected people are unable to obtain bonds; and (ii) among existing bond holders, a proportion is expected to fall ill in the terminal stages of the disease and be unable to work, and hence to service repayments on a bond. Therefore, the family would be likely to be foreclosed on at a very vulnerable juncture. Various products are being developed to cover this. One, by a housing NGO insurer (www.hlgc.co.za), provides for instalment cover enabling a borrower and dependents to remain in the bonded house even when unable to pay, provided the borrower is tested upfront, and if positive, enrols on anti-retroviral therapy and a wellness course to extend working life. The insurance industry is developing a proposal for a national re-insurance scheme which would remove the AIDS exclusion from life cover.

During meetings in SA, the following were added:

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

FURTHER GENERAL REFERENCES

Khan & Thring (2003) Housing Policy and Practice in post Apartheid South Africa, Heinemann, Sandton
Porteous & Hazelhurst (2004) Banking on Change Ch.6 Housing Finance

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

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

KEY QUESTIONS WHICH THE SA DELEGATION BROUGHT TO BELLACIO

From the Breaking New Ground policy statement:

- How to oversee state housing finance institutions (p.6)
- How to share risk with the private sector (without getting the short straw) (p.9)
## Data annex: South Africa

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

*Exchange rate used: 1 US$=6ZAR*