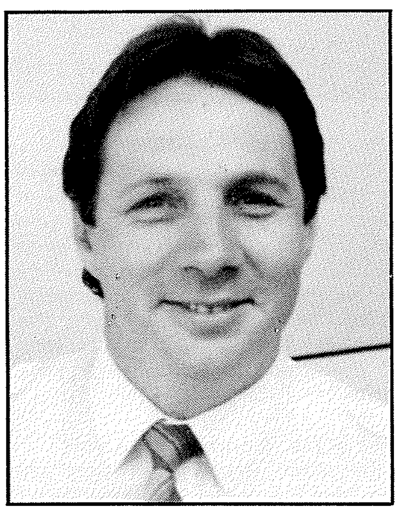
Building societies help the urban poor

Initiatives to provide housing finance for low-income families in South Africa are described by Matthew Nell and Jill Strelitz



ONE of the most fundamental development challenges facing South Africa today is the provision of housing for the urban poor. There is currently a backlog of need for housing units for this sector of the community in the order of 700,000. Furthermore, estimates of population growth between the years 1985 and 2000 indicate that the urban black population will more than triple in this period. Thus housing need for the urban poor will remain the dominant feature in housing in South Africa in both the short and long term.

The population growth translates into the need for an additional 2.1 million housing units to be provided for the poor over a 15-year period, exclusive of the units required to satisfy the backlog.

In addition to the scale of the housing requirements, it is relevant to note the income profile of the poor. Given current housing costs, and home loan interest rates of 12.5%, less than half of black families will afford the most modest formal house on an economic basis. Site and service schemes and the upgrading of informal settlements will be the only affordable form of housing delivery for many.

Constraints to housing supply

The enormous backlog in housing is a reflection of the fact that the formal housing supply process has not kept pace with need. In 1986 the total supply for this sector of the community was some 23,000 units, provided by the public and private sectors combined. This should be compared with the projected need of 140,000 units per annum.

There are numerous constraints to housing supply for the urban poor of South Africa. While many of these are typical for developing countries, they have been exacerbated by the policy of apartheid. Essentially the policy of influx control, which was abandoned as recently as 1986, has stimulated the need for houses in urban areas.

In addition, the absence until 1978 of land tenure rights for black people precluded private sector housing provision or lending in this sector. Consequently, the private sector — developers, building contractors and finance institutions — has only recently become fully involved in housing supply for this market and this has limited the generation of innovative approaches.

The role of the formal loan institutions, that is, the building societies and the banks, has to be understood within this context.

Formal finance for housing for the urban poor

The formal loan institutions have been financing the acquisition of housing by black families over the past five to seven years. The level of lending in this market currently constitutes about 10% of the total value of loans by these institutions.

It has generally been the top 10% to 15% bracket of black families that have benefited from this finance. In addition housing finance has been provided to government employees who are in receipt of substantial housing subsidies as part of their remuneration package.

While there has been an increase over the past seven years in the volume of lending to black families, the bias has continued to be in favour of upper income groups and those receiving subsidies, that is, those borrowers who present the least risk.

Clearly, the socio-economic realities of black urban families are such that a significant proportion will never qualify, in income terms, for a loan from a bank or building society. However, there is the potential for these institutions to provide finance for a greater proportion of black families than they currently serve. If they could provide finance for the top 40% income bracket they would be playing a significant role in housing the urban poor.

There are, however, constraints to this increased involvement. These are a result of lending practices which have been developed to service the formal middle income (white) housing market. These constraints fall into two categories, namely assessment of eligibility for loans and loan terms offered.

Assessment of eligibility for loans

Typically, potential borrowers are assessed in terms of the repayment amount not exceeding 25% to 30% of the *formal income* of the head of household.

This is totally incompatible with the socio-economic realities of the urban poor in South Africa where informal income, including room-letting or letting of backyard shacks, generates significant income for the household.

In addition, under the terms of the Building Societies Act, potential borrowers must provide 10% to 20% of the value of the house as a deposit. This, too, is incompatible with the circumstances of the South African poor where the accumulation of savings towards a deposit is generally a significant constraint, even where the household has sufficient income for the monthly loan repayments.

Finally, there is generally a very poor communication between the low income borrower and the lender which discourages loan applications and leads to defaulting. This defaulting increases the conservatism of the financial institutions and is reflected in their criteria for assessing eligibility for loans.

Loan terms

There is only one product offered by the loan institutions in South Africa, namely the straight line mortgage, whereby the loan amount is based on the value of the completed house. The interest rate is adjusted from time to time and amortisation periods are typically 20 to 30 years.

These terms are not appropriate for incremental building process where the house may be built over time and the value of the final product is not known when building is initiated.

In addition, there tends to be a lack of knowledge and understanding about housing loan terms among the poor which constrains their participation. Their only experience of loan finance is that offered by finance companies for durable goods, such as furniture, where amortisation periods are short — three to five years — and repayment amounts remain unchanged over the life of the loan.

Initiatives in housing the poor: the Family Housing Association

Notwithstanding the above circumstances, progress has been made in the building society movement in recent years in establishing new approaches to housing the poor. These initiatives have been undertaken in conjunction with private sector housing agencies, predominantly housing utility companies or associations.

One of the largest of these associations, the Family Housing Association, has been particularly active in facilitating increased private sector activity in the housing market serving black families.

The Family Housing Association (FHA) was established in 1983 by a major private sector structural reform agency, The Urban Foundation. Since its inception the FHA has grown from a relatively small annual turnover of R2.6 million, providing some 300 homes and 450 residential sites, to an anticipated R70 million turnover providing 2,000 homes and 6,000 residential sites during the current year.

The FHA's activities have been influenced by two fundamental beliefs:

- That the vast majority of housing will and should be supplied by the private sector, through both the formal and informal building industry. Consequently, the FHA seeks to stimulate and encourage the private sector home building industry through its projects. Moreover, the FHA believes the most effective way to supply the enormous demand for housing is on a commercially viable basis.
- That the involvement of individual families in the provision of housing is crucial. The family as home-owner, owner-builder, buyer or seller of housing is the pivot around which the private enterprise home building industry operates. The family's available resources will determine the quality and cost of housing to be supplied. Consequently, the FHA seeks to ensure that families participating in its programmes have access to home ownership.

While the FHA offers a wide range of housing services, two services in particular involve the building societies in innovative financing practice. These are the financing of supported owner-built (self-help) projects and starter housing schemes.

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Owner-builder projects

These projects provide owner-builders with access to building society building loans within the context of a support and supervisory programme which ensures home completion.

The support and supervisory programmes include the following:

HOUSE DESIGNS

Families are assisted by trained FHA staff in identifying their accommodation needs. Over 30 house plans are available ranging from a two-roomed 'starter home' of only 28 m^2 to an 80 m^2 three-bedroomed house. All houses are designed to allow for future expansion.

CONSTRUCTION SERVICES

In general, houses are built by informal contractors employed on a 'labour only' basis by the owner-builder. The FHA provides construction services for certain tasks where quality control is critical, such as the casting of foundations, manufacture of roof trusses, and the installation of the plumbing and electrical work.

MATERIAL SUPPLY

Owner-builders may obtain all the materials necessary to complete their home from the store located at the FHA's on-site project offices. The quantities required are worked out beforehand according to the house plan selected and are supplied to owner-builders on credit.

TECHNICAL ADVICE AND QUALITY CONTROL

FHA has full-time building inspectors who supply technical advice and exercise quality control throughout the home building process. Emphasis is placed on structural standards and quality must conform to standards set down by both the building societies and the local authorities.

In addition to the above, building society loans are arranged for the participants by the FHA. Loans cover the total cost of the serviced site, building materials, construction services and FHA management costs but do not include the labour costs. The owner-builder undertakes the building work himself or employs local informal contractors at his own cost to do this work.

The building society provides a 100% loan for all costs excluding labour. The only deposit required is that to the FHA which is about 5% of the value of the house and is refundable on successful completion of the house. The FHA is currently starting 200 new owner-built homes each month over three housing projects.

Starter homes

Starter homes were included in FHA owner-builder projects in order to enable lower income families entry on to the housing ladder, albeit on a very modest basis. In terms of this programme, very small, minimum standard homes were offered as part of the existing owner-builder projects. These starter homes could then be expanded and upgraded as the families' economic circumstances allowed.

The starter homes offered comprised two options: a core or a shell unit. The core unit consisted of a 28 m^2 two-roomed home, while the shell unit provided for 35 m^2 of internal space without any internal subdivisions. The minimum option for both starter homes provided for an outside toilet and shower and did not include ceilings or any internal floor or wall finishes.

However, for small additional investments, the inclusion of an internal bathroom and toilet as well as ceilings and improved finishes are optional. In both cases provision was made for these starter homes to expand into fully developed family houses with a minimum of alteration to the initial starter home.

The importance of the introduction of the starter home programme is that it significantly reduced the minimum standard of housing for which the building society movement was prepared to provide finance. The space standards were reduced to almost half those previously accepted and the level of finishes were also lowered significantly.

Affordability

As a result of these innovations, the building society movement, working together with organisations such as the Family Housing Association, has now expanded significantly the proportion of black families that can acquire homes on an economic basis. Through the owner-builder scheme families are able to acquire homes that range in price from R14,000 for a small starter unit to R26,500 for a three-bedroomed family home of 70 m^2. The down-payment or deposit ranges from R700 for the starter home to R1,325 for the larger family unit.

Conclusion

While the housing problem facing black families in South Africa is daunting, it is clear that significant inroads can be made into the problem through the provision of housing on a commercially viable basis. Such inroads depend on the degree to which the private home loan financial institutions adjust their lending practices so as to finance housing of a standard that is more affordable.

Currently, with the recent introduction of lending on both owner-builder and starter homes, the building society movement can increase substantially the proportion of families they are able to assist. ■

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