New Housing Delivery Model: The Presidential Job Summit Housing Pilot Project

by Mary R. Tomlinson

INTRODUCTION

Since the 1994 democratic election, labor has been consistently challenging the government on its macro-economic policy, which it argues has resulted in dramatic job shedding due to the restructuring of the economy. Labor used this worsening situation to urge the government to participate in a job summit at the end of 1998 in order to formulate strategies for job creation.

One of the demands set down by labor during the negotiations was to revisit the country's housing policy. The housing policy, as implemented since its inception in 1994, was mainly focused on the delivery of "progressive" housing for ownership. Unhappy with both the standard provided (a 250-square-meter site and a +20-square-meter house) and the form of tenure (i.e., ownership), labor used the job summit opportunity to put a demand for "social" (i.e., rental) housing on the table.

Mary R. Tomlinson is Chief of Party, South Africa Housing Finance Resource Program, The Urban Institute.

The resulting agreement between business, the community, government and labor for a Presidential Pilot Project on Housing aims to initiate a new form of housing delivery, including financing and tenure options that, if successful, could serve as a model for rental housing delivery.

The objective of the pilot project is to deliver between 50,000 and 150,000 units over a three-year period, of which 75% are to be for rental purposes. Moreover, unlike the previous housing delivery projects, the intention of this project is to ensure that infrastructure and amenities are delivered in a timely manner. That is, a more holistic approach to delivery is envisioned than what has occurred to date.

This article will describe:

- The negotiations and the vision behind the housing policy
- The "mass rental housing" debate
- Social housing delivery 1994-1999
- The job summit agreement
- The financial and institutional model developed to deliver rental housing

NEGOTIATIONS

In a 1992 multiparty body, the National Housing Forum (NHF) was established to negotiate an alternative to the then Nationalist government's racially-based housing policy (Rust et al, 1996).

Made up of representatives of "mass-based" political groupings, labor, the business community, the building industry, financial institutions, civic (community-based organizations) and development organizations, this body rigorously applied itself to formulating a consensus around a new non-racial housing policy.

One of the policy options the South African government had at its disposal to address the housing backlog was the delivery of subsidies. Under the previous government, subsidies had gone to better off, low- to moderate-income households—mainly white, colored and Indian—as a reduction of the interest rate on a mortgage bond. An initial task of the NHF was to agree to a restructuring of the subsidy policy to refocus it on the—mainly black—homeless poor.

In a nutshell, housing subsidies are allocated to qualifying beneficiaries to help them acquire a "housing option." The subsidy is a once-off capital grant, with the level of subsidy varying according to household income.

The subsidy levels have changed slightly over the years, but currently they are as follows:

Income	*Subsidy level*
Up to R800/month	R16,000[1]
R1,501 to R2,500	R9,500
R2,500 to R3,500	R5,000

The government's vision of a "nation housed in sustainable human settlements" was formally set out in the 1994 White Paper on Housing. The policy's goal is to:

- Deliver a permanent residential structure with secure tenure, ensuring privacy and providing adequate protection against the elements.
- Potable water, adequate sanitary facilities, including waste disposal and domestic electricity.

There are four main strands of subsidy: project-linked, consolidation, individual and institutional. In practice, most of the subsidies allocated to date have gone to the project-linked subsidy, whereby households are able to own a rudimentary structure, on a serviced site, delivered through a housing project (DOH, Annual Review, 1997, pp 14). These projects are delivered by a variety of developers, both public and private sector.

The government set itself the mammoth task of facilitating the construction of one million housing options[2] within five years. The new government immediately went to work redesigning and restructuring the housing delivery process. As the national housing policy framework was fleshed out, enabling legislation was passed, rationalization of existing housing departments was undertaken and new institutions were established.

Under extreme pressure to produce results, the government was nevertheless clear that refinements would have to be carried out to the policy as the lessons of delivery became apparent. Moreover, while the initial focus was on the ownership strand of delivery, effort would have to be devoted to developing other forms of tenure (DOH Overview, p. 22).

As of the end of 1999, the housing subsidy scheme had resulted in:

- Approval of 1,169,354 housing subsidies.
- Completion of ongoing construction of 920,891 housing options.
- Expenditure of R12 billion on housing delivery (DOH, Overview, p. 47).

RENTAL HOUSING DEBATE

The NHF negotiations were characterized by fierce debates as to whether housing should be delivered by the market or the state, and if the standard provided should be a completed "four-room house" or "progressive"—i.e., incremental—housing.

This debate gathered even more momentum after the 1994 election as it became apparent that the consensus reached at the NHF was weak at best.

The left—and particularly the newly elected African National Congress representatives in national and provincial legislatures—began openly challenging the "progressive" nature of the policy on the grounds that it was not able to deliver "proper" four-room houses. This view was given greater weight by the government's election promise to "build one million houses in its first five years of office."

During this same period, the first beneficiaries of a "housing option" began expressing dissatisfaction with the products they received, for a variety of reasons, including size, quality and cost. Whether they had been consulted was also of prime significance.

Hence, many stakeholders on the left, particularly in labor, began—shortly after the first units appeared—strongly advocating a shift to a mass social housing program. One of the arguments for such a policy shift was that the previous government had provided "four-room" houses for rent—the old township matchbox houses—that were of a much higher standard than what the capital subsidy was providing. If the previous apartheid government could supply such housing, surely a democratic government could do equally as well.

In fact, just this question had been examined in great detail by the NHF. Where there had been total agreement that a rapid rate of production of shelter was urgently required, the way to achieve this had only been finally resolved by "the numbers." The strategy of providing a four-room house for all those who did not have one had proven to be prohibitively expensive (Simkins, Oelofse and Gardner, p. 38) when the numbers were crunched.

Analysis had revealed that a total of R54 billion in capital subsidies would be required if:

- The state were to embark on a mass housing program in which the minimum acceptable standard of housing was a starter house costing R30,000;
- Each household spent 21% of its income on housing; and

- The state provided enough capital subsidy over five years to accommodate each household not able otherwise to afford it.

This would have resulted in more than 10 times the then current level of state spending on housing.

In the end, policy-makers at the NHF were driven by "the numbers," and an approach—"breadth over depth"—was adopted that would mobilize both state and private sector resources in a way that would be sustainable over time. Nevertheless, the demand for a mass rental housing program did not go away after the new government came to power.

In the meantime, effort was directed at providing a limited amount of social housing through one of the strands of the new subsidy policy, the "institutional subsidy."

SOCIAL HOUSING DELIVERY 1994–1999

While the bulk of subsidies allocated to date have ended up being used for "incremental" housing through the project-linked subsidy strand, there is a strand through which delivery of "rental" housing through "social" housing institutions can be accommodated. This strand is known as the "institutional" subsidy.

Institutional subsidies are available to social housing institutions to create affordable housing stock for eligible people to rent. On approval, an institution is entitled to receive R16,000 for each rental unit that will be occupied by qualifying beneficiaries.

The use of this subsidy has provided for the emergence of a small social housing sector in South Africa, through which a tiny amount of rental housing stock has been delivered through newly established social housing institutions, e.g., the Johannesburg Housing Company (JHC). This sector has responded primarily to the demand for inner-city housing on the basis of collective ownership (SHF, p. V).

While not targeted at the poorest of the poor (SHF, p. V), social housing is seen to be able to meet the needs of households earning moderate incomes of R1,500 to R3,500 a month, nearly 20% of South Africa's population.

However, since the institutional subsidy strand became available in November 1995, only a limited number of subsidies have been approved for delivery.

Some of the reasons for this slow start have included:

- An inadequate policy and regulatory framework.
- A lack of mechanisms to facilitate the need for extensive capacity building required in the early stages of social housing associations.
- A lack of long-term institutional (bank) finance.

One of the major hurdles in delivering social housing has been a lack of institutional finance. Banks, with their experience of nonperforming loans in the townships, have been unwilling to make development loans available to emerging social housing associations. With unproven track records as to their managerial abilities, and some evidence of cooperative housing projects that have failed, banks have shied away from this market.

The collection of rentals is one of the key risks for lenders. South Africa's growing culture of nonpayment, whether for rates and taxes, service provision, mortgage bonds or government-provided rental stock, makes this an abnormal lending environment at best.

As further evidence of this view, interviews conducted in 1998 with local government officials noted a keen desire to rid themselves of the onerous task of managing the rental housing delivered in the townships under the previous order. Nor were they keen to become directly involved in any new state-owned housing delivery. Their reasons included their inability to collect rents, difficulties in maintaining the stock and administrative justice problems in determining who qualifies for tenancy (Tomlinson, 1998, p. 19).

Moreover, as social housing associations are viewed as requiring wholesale finance—i.e., developmental capital—rather than retail finance, financial institutions require at minimum 35% up-front collateral in the project. This had been an onerous amount of money for young associations to provide.

Notwithstanding the above, as the demands for this type of housing delivery have steadily increased since the election, the job summit negotiations were able to move social housing squarely onto the housing delivery agenda and provided a platform for this thorny issue.

THE JOB SUMMIT AGREEMENT

The agreement signed by business, the community, government and labor at the end of 1998 stated that "all parties support the need for more effective housing delivery mechanisms to redress inherited housing backlogs. All parties are, therefore, committed to the principle of a National Presidential Lead Project (NPLP), which is used to pilot affordable mass housing delivery and alternative forms of tenure, specifically rental."

While there were a number of issues captured in the agreement, including delivery at scale, integrated housing development on well located land, affordability biased towards the low-income market, demonstration of best practices to achieve sustainable delivery, job creation, and so on, the financing of the project would become the key issue in determining whether the project would fly.

From the outset, there were three principles that would drive this process in terms of developing an approach that would serve as the model. Labor required affordability for its constituency, coupled with a demand for a relatively high standard in terms of what would be delivered.

From business' perspective, the marketability and rate of return of the financial instrument that would be offered to investors would determine whether it would bring the R1.3 billion in finance needed to fund the project to the party[3]. Sustainability drove government, in that whatever model was finally developed, it would have to have a fair chance of addressing the problem at scale once the pilot was completed.

FINANCING

As previously described, formal financial institutions have been loathe to venture any further into the low-income housing market than they had to date. In particular, the fact that there are currently 49,000 nonperforming loans on their books, of which they are unable to access their security for most, has made the financing of social housing a less than savory proposition. An innovative way of financing this type of housing would, therefore, have to be developed that would take these considerations into account.

The constituencies of the National Economic Development and Labor Council (Nedlac) agreed to jointly develop a financing mechanism that would fund, in the first phase, a project of 50,000 units.

The government agreed to make R750 million available as junior debt through its 1998-1999 and 1999-2000 budgets. Rather than continuing to allocate institutional subsidies individually, the government agreed to bulk up the subsidies to leverage senior debt from the private sector. Business agreed to provide R1.3 billion of senior debt through a market instrument. This debt issue was to be able to provide funding at a rate significantly below the mortgage rate.

The money raised through the debt issue would be loaned to the social housing associations to finance construction of the rental units. Lease agreements drawn up with each association would generate a defined cashflow (the rental streams) to repay the loans. Hence, long-term bonds would be issued in order to fund the loans of the social housing associations, rather than seeking conventional mortgage finance.

INSTITUTIONAL ARRANGEMENTS

In the original agreement, ownership and management of the rental stock was to be located in the public sector.

However, due to the utter failure of local authorities to manage their rental stock, combined with the fears raised by the nonpayment culture gripping the country, all the constituencies agreed that the key to successful rental housing would be to separate its management from the government and to ensure that it would be run along business principles.

However, within the country's social housing sector there is a strong view that engaging residents in the governance and management of their housing can enhance their experience in the market (SHF, p. V). This view has been widely debated, particularly as experience has tended to reveal that less, rather than more, tenant-based management results in success. Standard lease agreements would have to be drawn up with each tenant, which would allow eviction in the event of a defined rental default. Accordingly, strict "credit criteria" would have to be developed in order to provide clarity to the financial markets of the ability of the social housing associations to perform.

In addition to the individual housing associations, a Rental Housing Development Agency would need to be established, which would have two specific functions. First, it would carry out responsibility for managing the funding raised in the capital market. Second, it would oversee project management, ensuring that the individual projects met the criteria set down in the project.

The need for a new agency was keenly debated, as South Africa has established a number of housing parastatals since the new housing policy was adopted[4].

JOB CREATION

As the agreement on housing arose from a national job summit, one of the important objectives of the project is local employment and small business development.

Hence, projects are to employ labor-based construction methods wherever possible. The promotion of job creation is to occur on an equal opportunity basis while favoring the disadvantaged. Training and capacity building will, therefore, have to be provided to emerging contractors by the developed segment of the building industry.

CONFLICTS WITH THE PRESENT HOUSING SUBSIDY POLICY

At the time of the negotiations, many actors in the housing sector became concerned that what was being negotiated—without reference to their views—would end up destabilizing the current housing policy.

While acknowledging problems with quality and location, along with the need to kick-start rental housing, there was the possibility of a number of potential conflicts occurring with the current policy, depending on the form the social housing delivery would take.

Of major concern was the fact that setting up a parallel delivery system would result in a slowdown of actual delivery because housing sector capacity was already limited in the country. In addition, the new model would have to draw on existing capacity throughout both the public and private sectors.

Another concern was the fact that the housing budget had recently been slashed by R1 billion. The re-direction of resources into what would surely be a "depth over breadth" model of delivery could considerably slow delivery in the "ownership" strand.

Moreover, going for "depth over breadth" would be contrary to a fundamental principle set down in the White Paper on Housing, which refocused housing expenditure on the poorest of the poor. In order to service the rental for the social housing, one would most likely need to be formally employed. Hence, the beneficiaries of this model would truly be members of the labor movement, i.e., those lucky enough to have a job.

But the most important consideration was whether the standard provided through the job summit would not end up being much higher than what the capital subsidy currently provides. If so, potential beneficiaries would reject the ownership model and instead line up for what they perceived would be a much better unit at a negligible cost.

POST SUMMIT PROCESS

Formulation of the delivery/financing model took nearly two years. Through this process there were endless debates about, for example, the rate of return the business sector wanted on its money, the standard of housing and the rental to be charged for the unit, and how much additional funding would be required by the government to bridge the gaps that were widening, rather than narrowing, between the parties involved.

Project Selection

In September 1999, enough progress had been made to go to tender, and a country-wide call was made for projects that could fulfill the project criteria. Nearly 60 project proposals were received. In adjudicating among them, the project selectors were driven by the need to choose projects that met the aims of the project, as well as demonstrating "best practice."

Initially, three projects were chosen that would deliver 5,000 units each. Concern has been raised about the size of the projects chosen and the lack of experience in managing such large numbers of rental units. It is speculated that the scale of individual projects is too large and will produce estates, rather than integrating urban areas.

The Model

In a nutshell, in the first phase, the model provides for 15,000 rental units, costing approximately $41,000 per unit. The average rental will be R575 per month. Because the rentals are fairly low for the standard being delivered, as expected, additional subsidies will be required of the government.

For example, an additional R75 million from the government's Poverty Relief Fund has been earmarked to be combined with the R16,000 subsidy already earmarked for each individual unit. The two are to be combined into the junior debt required to gear the private sector's senior debt.

Another R75 million is being shifted over from one of the housing parastatals to subsidize operating costs of the units delivered, which tend to be quite high due to the need for costly security measures. The European Union has allocated R3.5 million to establish an institution for each of the projects chosen. Moreover, each of the three projects has itself gone out and sought additional funds to close the gaps arising from the mismatch between rent and standard being delivered.

In total, each unit is attracting nearly R10,000 more than is currently available through the institutional subsidy, set at R16,000.

CONCLUSION

As the social housing debate has evolved over the past few years, there seems to be a greater understanding that while social housing is not the answer to the government's promise to build one million houses, its role in broadening the range of options available to low-income households and diversifying the low-income housing output is important and recognized (SHF, p. V). This thinking is in line with the World Bank's estimates that, in order for a housing sector to function efficiently and effectively, nearly 30% of the housing stock should be for rent.

Notwithstanding the above, the job summit exercise clearly proved that social rental housing is a relatively expensive form of delivery and that the government must provide a much deeper subsidy than it has to date to ensure its delivery. As the ability to replicate the model is one of the agreed upon principles, the government will have to ensure that it can provide this additional subsidy on an ongoing basis.

Whatever restructuring the government is considering with respect to its housing policy, it has clearly chosen to go for "depth rather than breadth" in this proposed model.

NOTES

[1] One U.S. dollar equals eight rand.

[2] A "housing option" is used to describe a variety of delivery types, which may or may not include a house, e.g., a serviced site, a serviced site with a rudimentary structure, in situ upgrading, or a house or a flat.

[3] There was to be no coercion of the private sector to become investors in this instrument. Rather its success would depend on whether or not it was viewed as an attractive instrument in which to invest. In order to be viewed as attractive, it would have to provide a higher rate of return than the South African government's R150 long bond.

[4] The issue of an independent Rental Housing Development Agency has still not been resolved, as the Minister of Finance has not been convinced of the need for another housing agency.