

2018

PROVINCIAL PUBLIC RESIDENTIAL RENTAL STOCK

ADVISOR NAME: GAFEE VENGADAJELLUM

SECTOR: PUBLIC WORKS

PUBLIC EXPENDITURE AND POLICY

ANALYSIS (PEPA)

Disclaimer

All care has been taken in the preparation of this document and the information contained herein has been derived from sources believed to be accurate and reliable. Alcarí Consulting does not assume responsibility for any error, omission or opinion expressed, nor for any decisions based on this information.

Project team

Gafee Vengadajellum

Odette Crofton

Santhurie Naidoo

Adrian Di Lollo

Ilse Martin

Saloshna Shunmugam

Serena Shunmugam

Larry Hobson

Tinashe Guramatunhu

Kate Shand

Contact details

Alcarí Consulting

63 Himalaya Road, Braelyn, East London, 5209

Tel: +27 72 800 2983

Fax: 086 583 4352

Email: gvenga@lantic.net

Table of Contents

1	Introduction	1
2	Purpose of this study	1
3	Background to the provincial public works housing stock.....	1
4	Current legislative and regulatory framework.....	2
5	Profile of the stock.....	4
6	Institutional framework	5
6.1	Spheres of government and the inter-departmental matrix.....	5
6.2	Funding flows	6
7	Programme analysis.....	7
8	Expenditure analysis	11
8.1	Programme funding sources and flows	11
8.2	Income and expenses.....	13
8.2.1	Income	13
8.2.2	Expenses.....	13
8.2.3	Net operating losses	14
9	Benchmarking analysis.....	15
9.1	Cost-to-income ratios	15
9.2	Comparative analysis	15
9.3	Key findings	17
10	Financial modelling	18
10.1	Assumptions underlying different scenarios	18
10.2	Projected fiscal implications	20
10.3	Evaluation of the scenarios.....	21
11	Conclusions and recommendations.....	22
12	Appendices.....	25

Acronym	Definition
BAS	Basic accounting system
BCA	Building condition audit/assessment
GEHS	Government Employee Housing Scheme
GIAMA	Government Immovable Asset Management Act
GTAC	Government Technical Advisory Centre
PW	Public Works

List of figures

Figure 1: History and context of the stock

Figure 2: Policy overview

Figure 3: Institutional framework

Figure 4: Funding framework

Figure 5: Chain of delivery

Figure 6: Financial model design

List of tables

Table 1: National property portfolio

Table 2: Programme elements

Table 3: Programme challenges

Table 4: Provincial public works budget allocations

Table 5: Comparison of average monthly residential rentals

Table 6: Description of base case and scenarios

Table 7: Summary of fiscal projections per scenario

Table 8: Evaluation of scenarios

Table 9: Analysis of overall cost to government of existing employee accommodation

Table 10: Summary of conclusions and recommendations

List of maps

Map 1: Density map of the public works residential rental property portfolio

List of graphs

Graph 1: Expenditure as a % of immovable assets budget

Graph 2: Rental income as a % of immovable assets budget

Graph 3: Rental collections compared to rentals raised

Graph 4: Direct property expenditure items

Graph 5: Net position per unit of the properties per financial year

Graph 6: Overall net position of the properties per financial year

Graph 7: Cost-to-income ratio

Graph 8: Maintenance cost per unit

Graph 9: Total management costs per unit per month for 2015/16

Graph 10: Summary of equitable share required to cover losses per scenario

Graph 11: Annual surplus/deficit per scenario per financial year

1 Introduction

The Government Technical Advisory Centre (GTAC), an agency of the National Treasury, was established to support public financial management through the provision of professional advisory services, programme and project management and transaction support. GTAC promotes public-sector capacity building through partnerships with academic and research institutions, civil society and business organisations. Since mid-2013, GTAC has conducted a number of performance and expenditure reviews to address gaps and misalignment between planning, budgeting and monitoring of government programmes and functions. These have helped the National Treasury and affected departments to better understand the factors that raise the cost and constrain the delivery of various government functions and services. The reviews have led to policies and programmes being refined, aligned and changed. This performance and expenditure review focuses on provincial residential rental housing stock within the provincial departments of public works.

2 Purpose of this study

The purpose of this study was to obtain relevant data and analyse the costs and revenues associated with provincial government renting state-owned residential properties to private tenants in the period 2013/14 to 2015/16.

The **key objectives of the project** were to:

- Identify and quantify all costs and revenues associated with the management of state-owned residential rental properties by provincial governments.
- Assess the quality and comprehensiveness of available data on leases and rentals.
- Estimate the discrepancy between rentals charged and market-related rates that could be obtained for similar properties.
- Identify weaknesses in rent-collection systems and processes and make recommendations to address them.
- Make recommendations to improve the effectiveness and efficiency of property rental processes.

At the outset, the study focused on all provincially owned and managed residential rental stock within the provincial departments of human settlements and public works. After the policy and institutional analysis and the logical framework had been completed, it became clear that while many of the programme elements are the same, the focus and policy intention of the rental stock falling under the two national departments was quite different. As such, the analysis and reporting had to be done separately. This report focuses on the residential rental stock of the provincial public works departments and excludes the provincial residential properties that form part of the public works prestige properties.

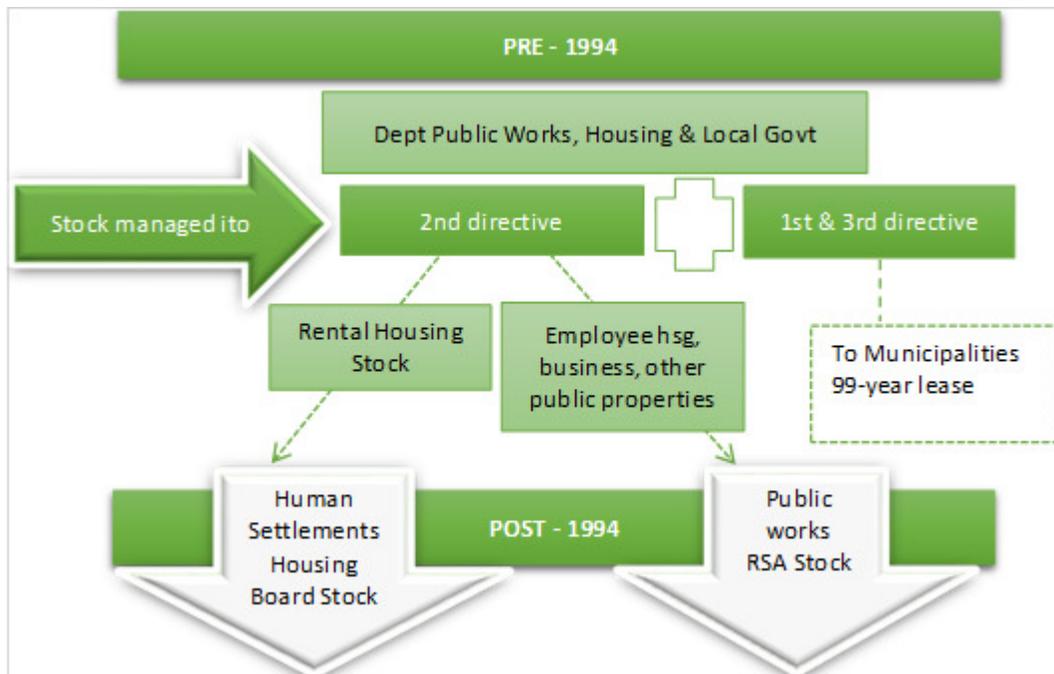
3 Background to the provincial public works housing stock

The analysis focused on provincially owned residential rental properties managed by provincial public works departments, which are the custodians of the properties. In terms of the guidelines set out in the Government Immovable Asset Management (GIAMA) (2007), the properties would be classified under “property category 6: general asset, custodian, provincial residential leasehold”. Provincial public works provides these properties to user departments for residential rental.

Typically, the residential rental housing properties are freestanding houses. There are, however, also “road camps”, temporary housing structures, rondawels and flats. The public works residential stock is

old; it was built between the 1950s and 1970s. At the time, Public Works was part of the housing and local government departments. When Public Works became a separate government department, employee housing and other public properties remained with Public Works (Figure 1).

Figure 1: History and context of the stock



Most provincial public works departments are still in the process of updating asset registers based on audits of the stock in the provinces that have been done in stages over the last few years as funding has become available. The occupants of the stock are a mixture of government employees, private tenants and illegal occupants. The provinces are regularising and resolving issues relating to existing occupants in phases.

The purpose of public works residential rental properties was to accommodate employees based in remote locations and provide for the housing needs of essential services. The provincial public works departments indicated that the provision and management of residential employee housing is not understood to be a core function of Public Works. The residential properties forming part of this study are not recorded or managed separately from other assets in the provinces, which makes the oversight, monitoring and management of this portfolio particularly difficult.

4 Current legislative and regulatory framework

After 1994 (see Figure 2), the development of a government immovable property management policy (2005) and strategy (2006) triggered the need to address the various issues relating to the management and maintenance of all public immovable assets. The strategy resulted in the development of GIAMA, which was aimed at ensuring competent management of immovable assets in national and provincial government.

GIAMA provides a uniform framework for managing an immovable asset that is held or used by a national or provincial department to ensure the use of the asset is aligned with the service delivery objectives of

that department. The act requires the issuing of guidelines and minimum standards in respect of immovable asset management by a national or provincial department. The National Treasury and national public works introduced guidelines, but they did not specifically separate the residential properties from other assets managed by the provinces.

GIAMA legislation was developed to detail the planning, management and disposal of government assets in each of the provinces. Provinces developed provincial policies or directives for managing residential housing properties. Among other things, these policies and directives covered operational management, roles and responsibilities, allocations criteria, rent setting, rental increases, payments and disposal of properties. The finalisation and approval of these policies took some time. Implementation of the guidelines was slow if not stalled completely by objections and issues raised by tenants, employees and unions in the provinces.

While the policy framework adequately covers all the key asset planning and management requirements, it does not specifically deal with residential property management challenges and the costs and funding implications of implementing and complying with legislation.

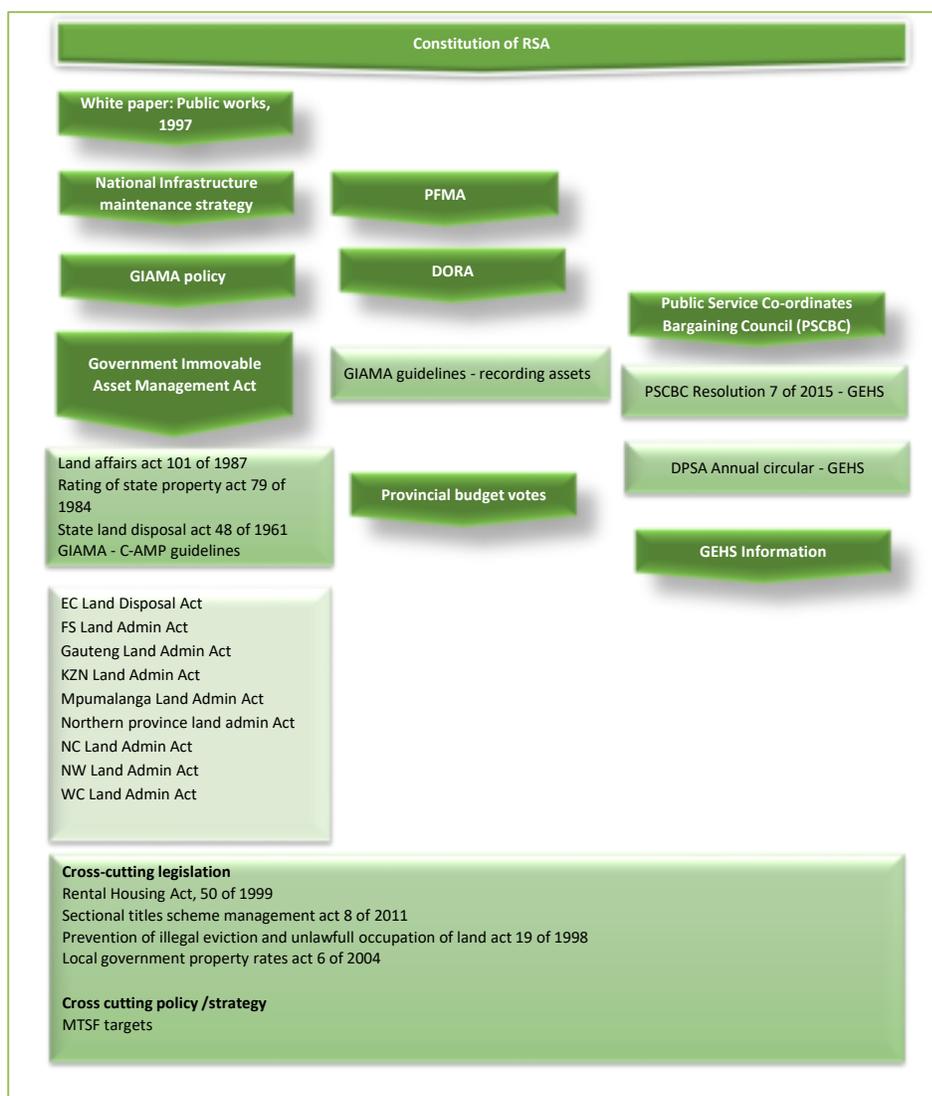
The Public Service Co-ordinating Bargaining Council resolution 7 of 2015 established the Government Employee Housing Scheme (GEHS). This resolution emphasised home ownership rather than rental accommodation, but also made provision for continued rental accommodation. It required the enrollment of all government employees with the GEHS to be able to access the housing allowance for either home ownership or rental from 2016. This ought to have provided a means to monitor which employees were accessing this type of rental accommodation and to identify employees who needed rental accommodation. However, the databases and information of the GEHS are not yet fully up to date or accessible.

The GEHS fixed the housing allowance (R900/month at the time) for existing employees renting government accommodation prior to 21 May 2015 and diverted any increase in the allowance to a savings scheme for future home-ownership purposes. Communicating and introducing this within the provinces created some confusion and resistance. It may also have led to an increased rate of rental defaults.

Provincial residential rental accommodation is also affected by the National Rental Housing Act (1999) and legislation relating to property and lease management, stock disposal and occupant evictions. Provinces that have pursued evictions of occupants have found the process to be very costly and are still left with the obligation to find alternative accommodation for the occupants once eviction is granted.

Given the sociopolitical issues and management challenges relating to the properties, and that their management is not a core provincial function, most provinces indicated a desire to dispose of the whole portfolio.

Figure 2: Policy overview



5 Profile of the stock

The various provincial public works departments have a residential rental portfolio of 6 627 units. As can be expected from the history of the stock, the more rural provinces of Limpopo, the Eastern Cape and Mpumalanga have the largest proportion of leases, as shown in Table 1.

Table 1: National property portfolio

Units	E Cape	F State	G'teng	KZN	W Cape	Limpopo	M'langa	N Cape	NW	Total
Properties	856	246	167	347	55	2 047	1 226	202	516	5 662
Units leased*	1 399	229	167	384	236	2 289	1 226	181	516	6 627
% of total	21%	3%	3%	6%	4%	35%	19%	3%	8%	100%

* In some cases, more than one unit is rented in a single property

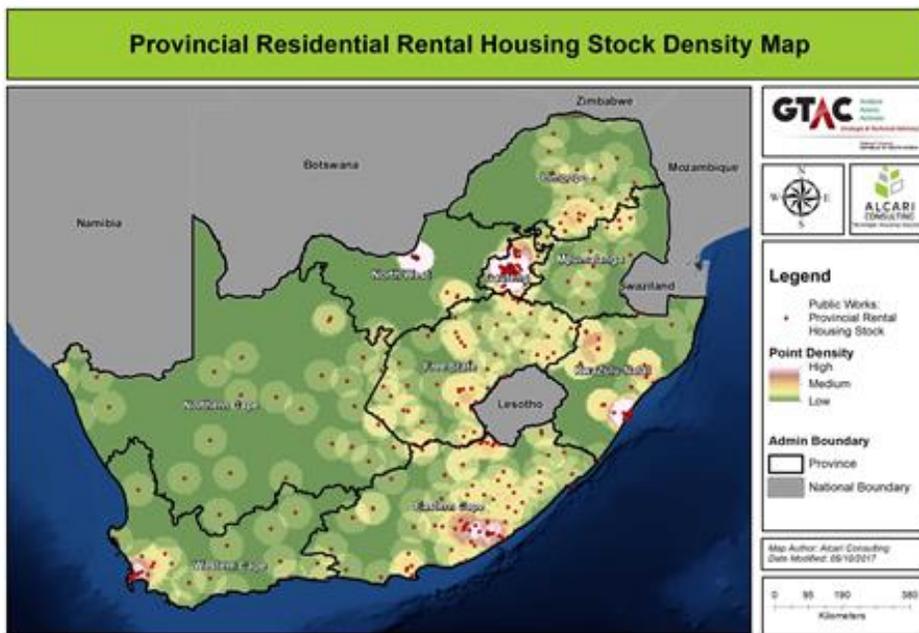
It should be noted that the asset registers for these properties are not complete, nor is the information on the type of unit per province. There is also no reconciliation between the asset and leasing registers. There is more than one lease for some properties as some of them are leased out on a per-room basis.

Average monthly rentals are R1 339 per month. Gauteng has the highest average rentals at R3 173 per month, while average rentals in KwaZulu-Natal, Limpopo and Mpumalanga are equal to government employees' rental housing allowance of R900 per month.

Some provinces were able to provide information on the departments and staff levels accessing the housing stock. Health, Transport and Education are the main users of the stock, but a wide variety of other departments access it too. The accommodation is used by all levels of staff, from heads of department to operational staff.

Map 1 shows that the accommodation is dispersed across the provinces, but the largest concentration is in urban areas, where the private rental housing markets could deal with the accommodation needs of employees. Provincial public works residential accommodation therefore does not appear to be provided and operated in terms of its purpose.

Map 1: Density map of the public works residential rental property portfolio



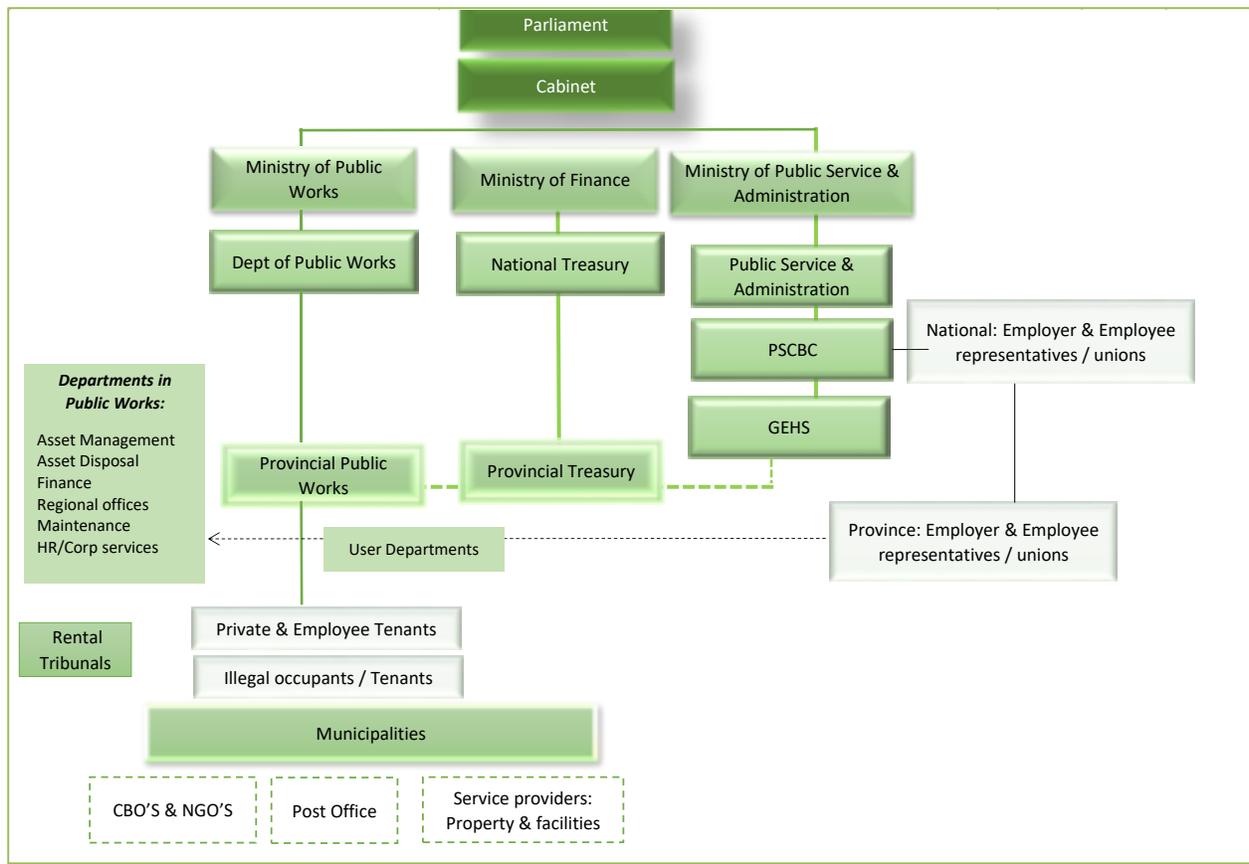
The distribution of the stock throughout the provinces may also make the property management function difficult and costly. Some provinces have regional offices that manage the properties and other assets in the area, while others manage the stock from a central location.

6 Institutional framework

6.1 Spheres of government and the inter-departmental matrix

Figure 3 outlines the relationships between different spheres of government.

Figure 3: Institutional framework

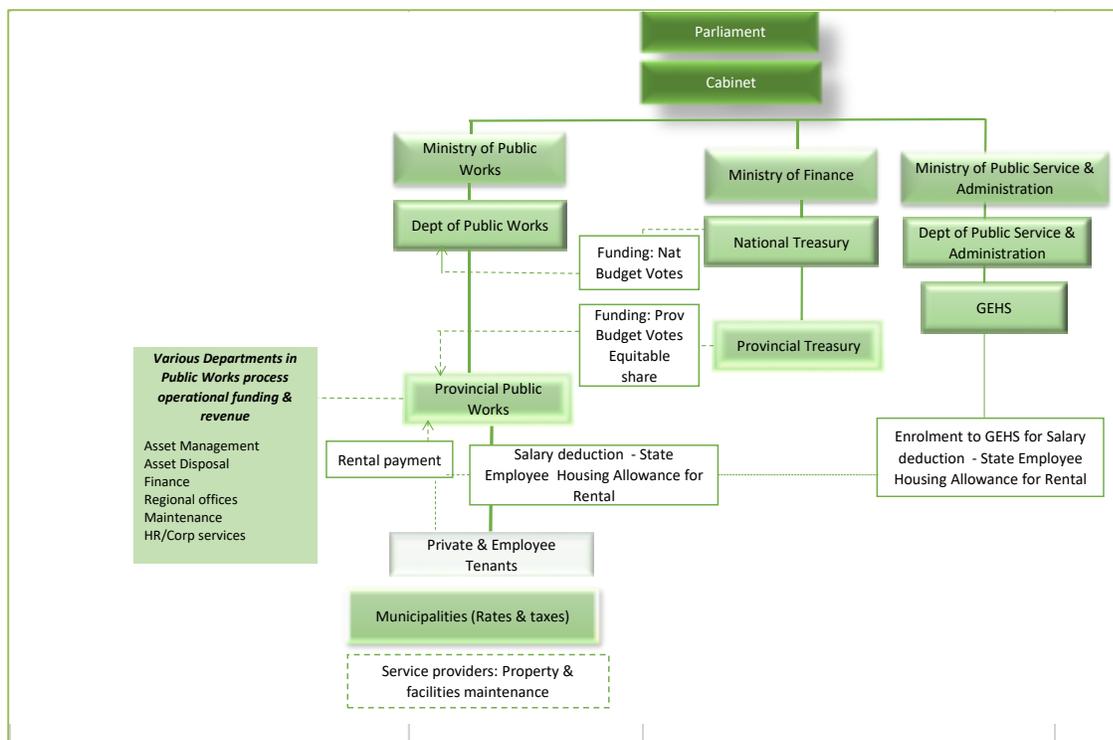


As a separate sphere of government, provinces can use their own systems and arrangements as long as they comply with GIAMA. National public works, which should provide advice and guidance, has introduced some systems to assist with property management (*iWorks*). But as this is not compulsory, a province may not choose to follow national directives or arrangements.

6.2 Funding flows

Funds for these properties are allocated over the three-year Medium-Term Expenditure Framework period from each provincial Treasury to the provincial Department of Public Works via an equitable share (Figure 4). This allocation is then apportioned to various budget components in provincial public works – typically, immovable asset management, maintenance and capital assets. The allocations do not distinguish residential properties from other immovable assets being managed by a province.

Figure 4: Funding framework



Asset planning and resultant funding allocations within provinces by provincial public works departments (as the custodian of such assets) should be done using a Custodian User Asset Management Plan. However, in most cases plans are a work in progress, as assets are audited and updated in phases as funding becomes available. Asset planning for the residential portfolio is therefore not adequately done.

Operating funding is allocated to urgent expenditure priorities, which may be in the residential portfolio or for other assets. Municipal rates and urgent maintenance are covered by operating funding. In some provinces, capital improvement and maintenance have also been done. Water and electricity charges are for the occupants' account, but the province must cover defaults and shortfalls.

Revenues from rentals received are paid directly to the province in the case of private tenants or via salary deduction in the case of government employees. The salary deduction from government employees is linked to the rental housing allowance as prescribed by the GEHS.

Each province has in-house staff (funded from the equitable share) who manage the properties and undertake urgent maintenance of these and other assets owned by the province. Some capital repairs and maintenance are outsourced, depending on their urgency and availability of funding. In KwaZulu-Natal, user departments are responsible for managing the properties, including maintenance and rent collection.

No separate monitoring and accounting of the residential properties is in place. Records and information are often lost within the province or among the different departments responsible for the stock. Manual reconciliations are then done between the finance system and various property management systems or Excel spreadsheets in the province.

7 Programme analysis

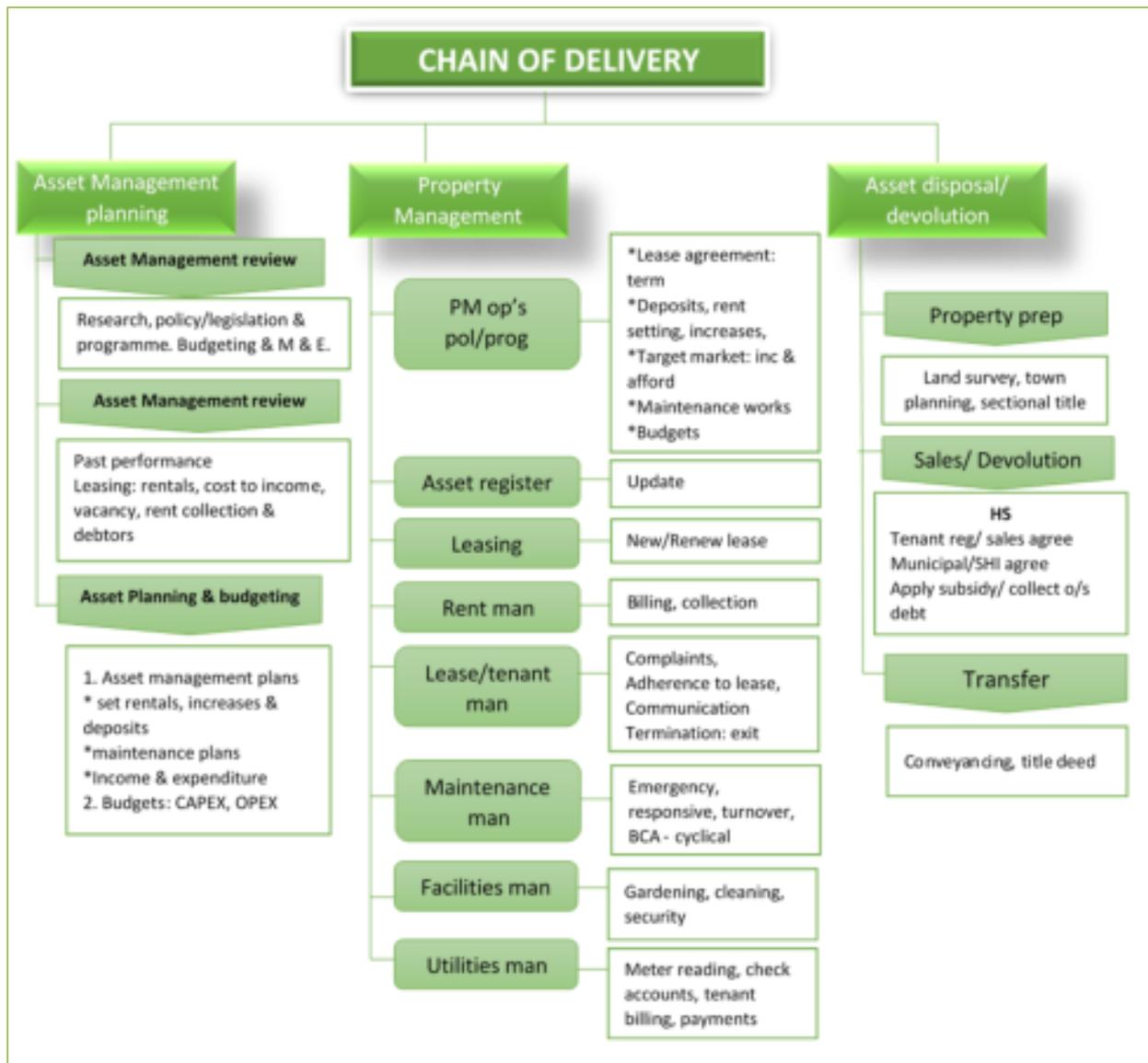
The provinces' role is to deliver property planning and management. Provincial public works is the custodian department responsible for implementing all the programme elements outlined in Table 2.

Table 2: Programme elements

Programme elements	Sub-elements
Asset planning	Research, policy/legislation and programme development
	Capital and operating funding
	Monitoring & evaluation
	Asset management review
	Asset management plans & budgets
Asset management	Leasing/letting management
	Rental management
	Lease/tenant management
	Maintenance management
	Facilities management
	Utilities management
Asset disposal	Disposal method
	Property preparation
	Funding the transaction
	Contracting
	Property transfer/conveyancing

Figure 5 shows the chain of delivery. It provides more detail on programme elements and shows the ideal property management arrangements and services required from the provinces.

Figure 5: Chain of delivery



The model (see Appendix 1) is structured in terms of the programme elements and its sub-elements in the chain of delivery. The outcomes relate to efficient and effective management of stock that is currently not well managed and disposal of stock that is surplus to the departments' needs. Key indicators are developed to enable the departments to measure and monitor performance of the stock. The risks and assumptions relate to poor planning, unsustainable rentals, low rent collection, and premature ageing of the property as a result of poor maintenance, which results in an increasing cost to government over the long term. The desired impact pertains to the original intention of the programme to provide accommodation to employees with scarce skills in remote locations where there is a market shortage of rental housing products.

Several issues make it difficult to properly manage the properties:

- Various departments or sections in provincial public works deal with various functions related to managing the properties. This makes it difficult to properly collect information and oversee, monitor and manage the portfolio.
- Government employees, tenants and the unions in the province have considerable influence in the rental management process. They are able to organise stopping rental payments, rental increases and any changes to the property, leasing, disposal and management arrangements.

Only two provinces have undertaken to dispose of these properties. National public works, together with the provinces, is currently developing general guidelines for the disposal of residential and other properties, drawing on the provinces' experience of disposing properties through the national GIAMA task team. Generally, properties should be disposed of at market rates, but in the case of Free State province, the residential properties were disposed to their occupants as a donation, given the condition of the properties and that the occupants were indigent. In Limpopo, the disposal of these properties was stopped as the process was seen as unfairly benefiting employees who could afford to purchase them.

A summary of the programme challenges is set out in Table 3.

Table 3: Programme challenges

Issues/Challenges/Problems	Consequence/s
Asset planning	
Asset register incomplete	Incomplete and no physical verification of assets. Planning and budgeting cannot be properly done.
Market assessment incomplete	No market assessments done as basis for rent setting. Rentals not aligned to market rentals.
Budgeting and planning incomplete	Baseline budget adjustment rather than real projection of operating and management costs.
Lack of maintenance and maintenance planning	Properties in poor state of repair. No planned maintenance, just emergency maintenance.
	Non-compliance with building and health and safety legislation.
	Premature ageing of the properties.
	No facilities management: gardening, cleaning, security.
Policy implementation difficult	Policies approved but cannot be fully implemented due to tenant or union interference.
Inadequate systems and staffing capacity	Provinces can decide on systems, staffing and processes for management, reporting and oversight of the properties. As the residential portfolio is not a core function, it competes with other core functions, capacity and funding required in the province.
Inefficient and ineffective property management services	Provinces can decide on systems, staffing and processes for management, reporting and oversight of the properties. Properties are managed on an ad hoc basis.
No political will to address unsustainability of the stock	Policies approved but cannot be fully implemented due to tenant or union interference. Historical sociopolitical issues relating to the stock make it challenging to address. Eviction is costly and still requires occupants to be housed by government.
Asset management	
Leasing criteria and requirements	Income and affordability not considered when leasing. Historical occupants in the stock.
Occupancy in some cases unknown	Asset and occupancy audits are done in phases and incomplete. It is not known if there is overcrowding or

Issues/Challenges/Problems	Consequence/s
	subletting and if the properties are not serving their target market.
Poor tenant behaviour: social problems	No relationship and engagement with tenants. Provincial management arrangements and staffing not set up to be responsive to tenant management.
Rent setting and adjustments not done	Non-viable rentals that are below cost recovery. Policies approved but cannot be fully implemented due to tenant or union interference. No rent increases linked to inflation to cover cost increases.
Poor rent collection and unable to evict occupants for non-payment	Bad behaviour from tenants. Policies approved but cannot be fully implemented due to tenant or union interference. Historical sociopolitical issues relating to the stock make these issues challenging to address. Eviction is costly and still requires occupants to be housed by government. Provincial management arrangements and staffing not set up to be responsive to tenant management.
Disposals	
Transfers are not taking place for all saleable properties due to the challenges above	Tenants do not pay anything now so do not want to take transfer as then they will have to pay for maintenance and municipal rates and services. Policies approved but cannot be fully implemented due to tenant or union interference. Historical sociopolitical issues relating to the stock that make it challenging to address. Eviction is costly and still requires occupants to be housed by government. Provincial management arrangements and staffing are not set up to be responsive to tenant management.
Long approval process for both policy and disposal process	Changes in costs and requirements means sales are not concluded and the process is restarted. Inability to manage unfair benefit to occupants or government employees.

8 Expenditure analysis

The expenditure analysis was conducted by analysing data and reports provided by provincial departments relating to their property portfolio, asset and leasing registers, and basic accounting system income and expenditure. Data sourced from the government affordable rental housing programmes and the private market via the Tenant Profile Network was used to develop benchmarks against which to measure the portfolio under review.

8.1 Programme funding sources and flows

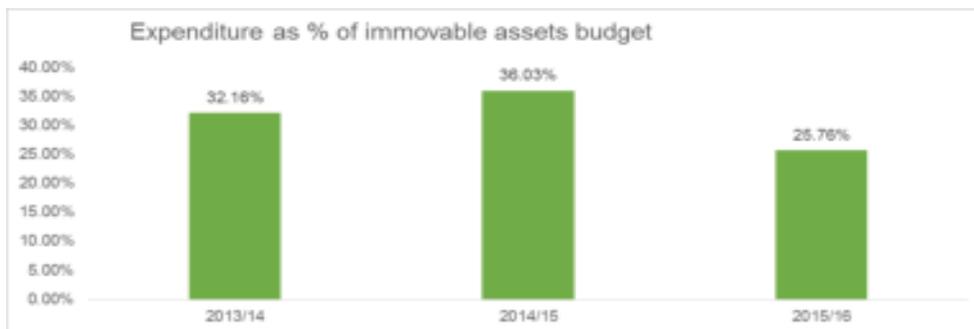
Public works receives an equitable share funding allocation annually. This equitable share is divided into portions to cover existing infrastructure, immovable assets and maintenance. The residential rental housing properties are funded (in most provinces) from their immovable assets budget allocation. The average of about 30% of the overall budget allocation to provincial public works departments, as set out in Table 4, is set aside for immovable assets.

Table 4: Provincial public works budget allocations

Provincial public works budget allocations	2013/14 Budget		2014/15 Budget		2015/16 Budget	
	Overall (R thousands)	Immovable assets (R thousands)	Overall (R thousands)	Immovable assets (R thousands)	Overall (R thousands)	Immovable assets (R thousands)
Eastern Cape (vote 5)	R2 494 472	R545 113	R2 440 883	R567 861	R3 360 235	R623 642
Free State (vote 9)	R830 243	R719 056	R866 286	R738 742	R893 674	R1 076 581
Gauteng (vote 15)	R1 529 044	R643 477	R1 880 117	R799 959	R2 404 609	R984 445
KwaZulu-Natal (vote 14)	R1 257 040	R467 064	R1 313,705	R512 586	R1 399 466	R538 832
Limpopo (vote 9)	R851 264	R535 100	R1 894 656	R531 284	R1 755 054	R581 214
Mpumalanga (Vote 8)	R1 975 200	R539 108	R2 081 000	R533 688	R2 135 144	R635 655
Northern Cape (vote 5)	R576 520	R64 690	R570 540	R69 095	R637 710	R109 791
North West (vote 11)	R1 934 034	R68 669	R2 283 253	R10 802	R1 804 664	R13 970
Western Cape (vote 10)	R2 249 842	R758 918	R2 208 490	R766 613	R3 365 523	R850 189
Total	R13 697 659	R4 341 195	R15 538 930	R4 530 630	R17 756 079	R5 414 319
%		31.7		29.2		30.5

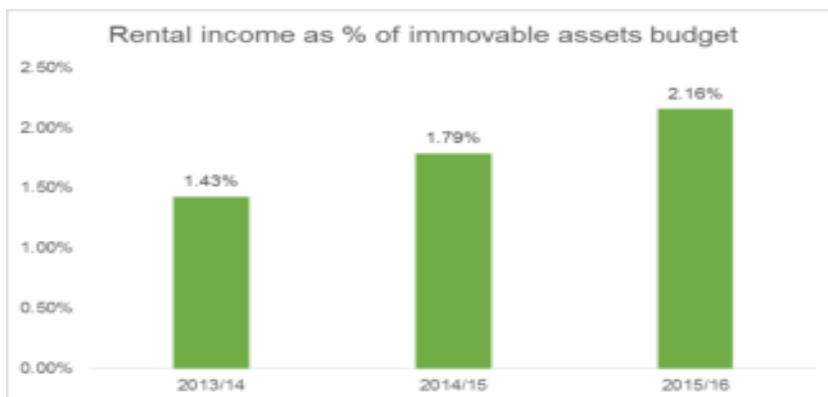
As can be seen from the graph below, the share of provincial public works immovable assets budget allocation spent on the housing stock ranges from about 26% to 36%.

Graph 1: Expenditure as a % of immovable assets budget



Rental income received from these properties forms part of the income of the provincial public works departments and amounts to between just 1.4% and 2.1% of their immovable assets budget.

Graph 2: Rental income as % of immovable assets budget



With income representing only 1–2% and expenses representing 25–35% of the budget allocation, one should expect the analysis of revenue and expenses to reveal big operating deficits. This indicates that the

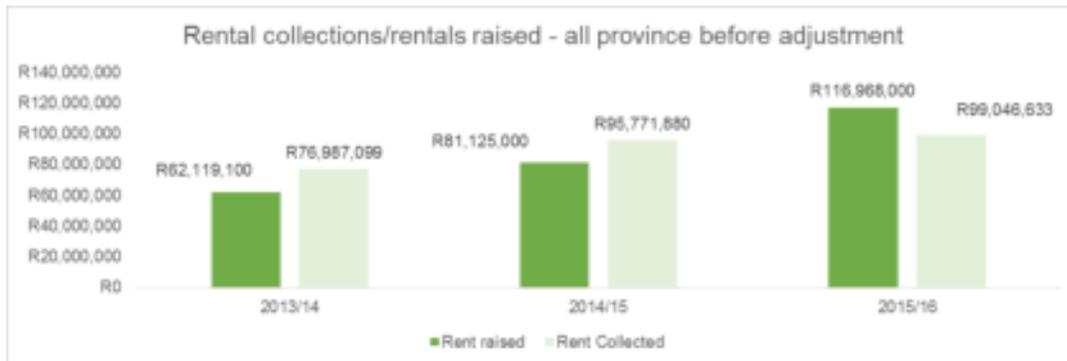
provincial budget allocation is being used to fund the operating deficit of the residential property portfolio.

8.2 Income and expenses

8.2.1 Income

Rent collected is less than budgeted, noting that adjustments had to be made in cases where provinces had not provided for rent raised and yet received rental income. In 2015/16 this difference was significantly less due to rental adjustments made in the provinces resulting in a reduced collection rate.

Graph 3: Rental collections compared to rentals raised



No income from sales could be identified. A reason for this is that where sales are taking place properties have been donated. Only two provinces provided disposal data – North West and Free State – and in both, properties were donated to the existing indigent occupants.

Debtors age analysis could not be obtained from all provinces. An analysis of debt is provided in the provincial analysis where this data was provided. Where data was provided, the age analysis tended to show long-term growing debt that was not being recovered by the provinces.

8.2.2 Expenses

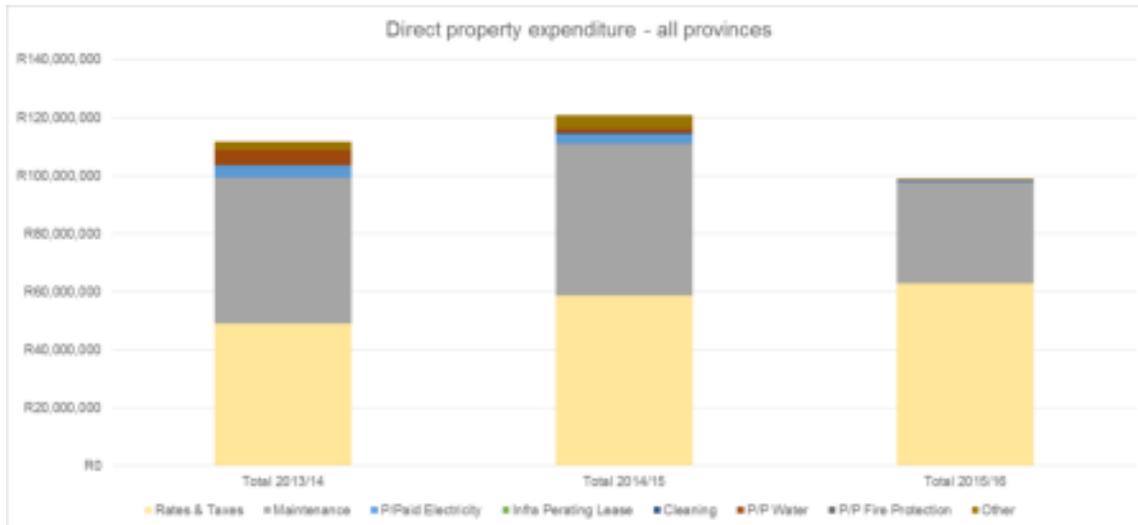
Maintenance and rates and taxes are the largest direct expenditure items relating to the residential rental housing properties.

Writing off debt owed to the state – The Public Finance Management Act and Treasury regulations make provision for writing off debt if:

- All reasonable steps have been taken to recover the debt.
- The recovery of the debt would be uneconomical, cause undue hardship to the debtor or would be to the advantage of the state to effect a settlement of its claim or to waive the claim.

In cases where public works properties are being rented to government employees, the requirements for the write off would not apply. In the case of private and/or illegal/historical occupants, this could be considered.

Graph 4: Direct property expenditure items



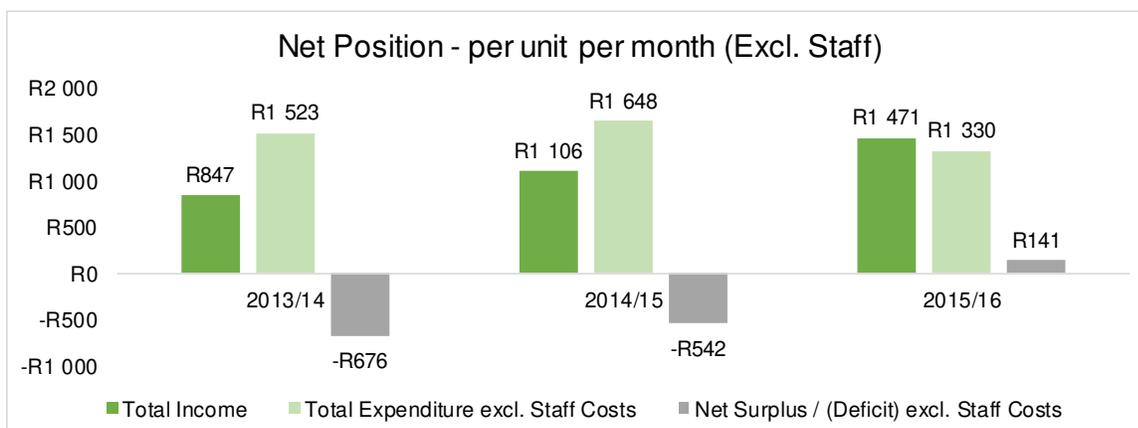
In terms of total expenditure, where staff costs are included they form the largest expenditure item. It should, however, be noted that staff in provincial public works departments do not just work with these residential properties. Not all provinces provided staff costs and it was therefore difficult to determine the staff resources and costs specifically allocated to these properties.

A formula with assumptions was used to calculate staff costs. Some assumptions were based on information from the provinces, but these would need further interrogation and testing, with considerably more support from provinces before they can be used as reliable estimates. Therefore, except where otherwise indicated, further analysis excludes staff costs and sets out direct expenditure. All results in this analysis should be read with this in mind.

8.2.3 Net operating losses

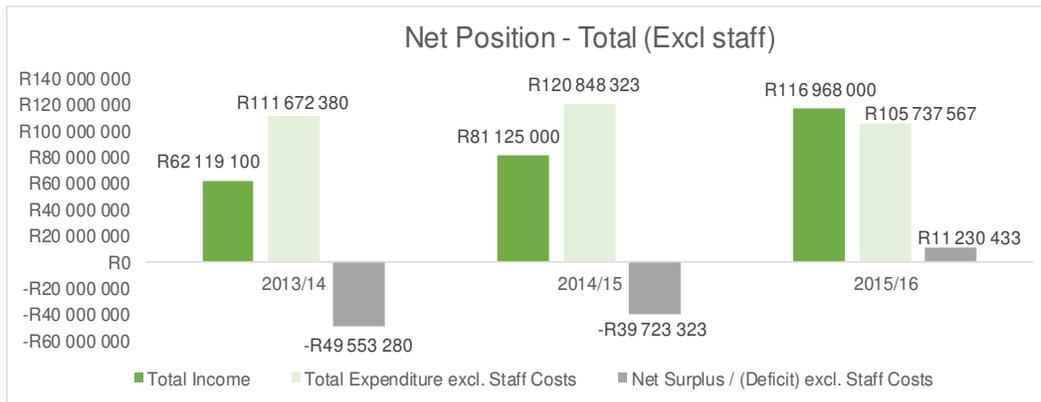
When spread across the total number of leases (6 111 in 2013/14 and 2014/15, and 6 627 in 2015/16), the operating deficit is R676 per unit per month in 2013/14 and R542 per unit per month in 2015/16. An operating surplus of R141 per unit per month was recorded in 2015/16 before a proportion of staff costs was deducted.

Graph 5: Net position per unit of the properties per financial year



Although there appears to be an improving trend in results over the three years under review, closer examination of costs indicates big fluctuations from one year to the next in individual cost components. Care must therefore be taken in interpreting operating surplus and deficit. In addition, the inclusion of a proportion of staff costs would increase deficits and turn the surplus in 2015/16 into a deficit.

Graph 6: Overall net position of the properties per financial year

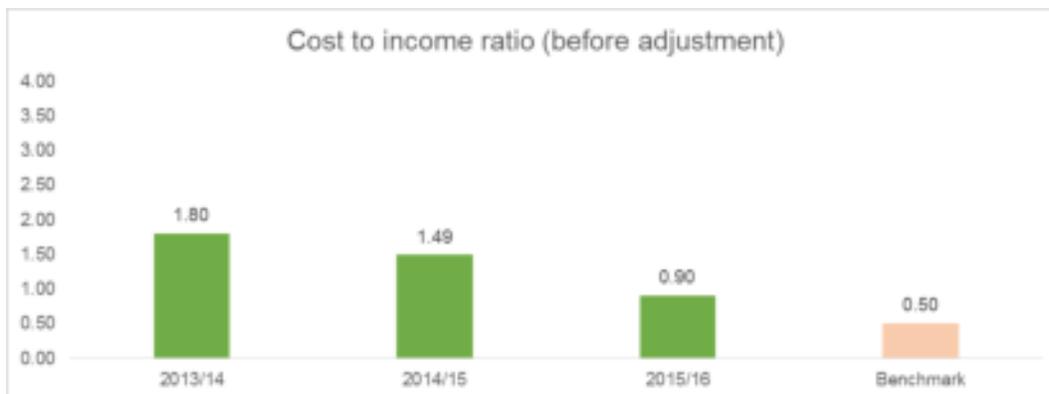


9 Benchmarking analysis

9.1 Cost-to-income ratios

The cost-to-income ratio (based on direct expenditure) indicates a ratio above the benchmark of 50% applied by financially sustainable landlords with financing obligations. Even allowing for the fact that the government would not have financing obligations on this portfolio, operating costs when the share of staff costs are included would still be less than the income generated via rentals. This indicates that this portfolio of properties is not financially sustainable.

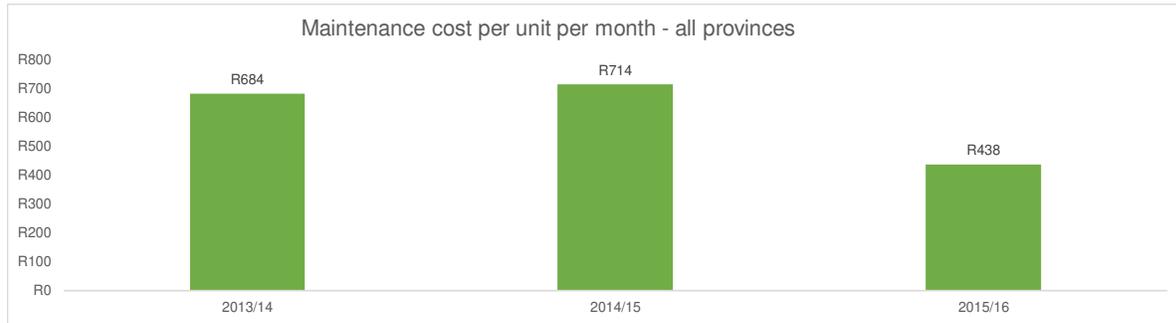
Graph 7: Cost-to-income ratio



9.2 Comparative analysis

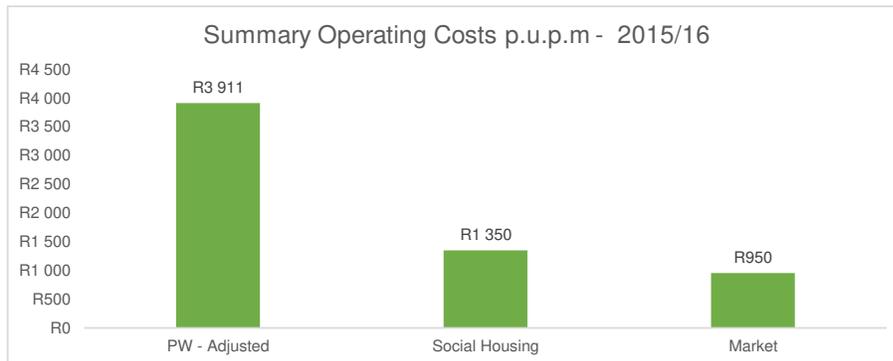
Maintenance cost per unit over the three financial years under review exceed the average rentals charged on the properties, as shown in Graph 8.

Graph 8: Maintenance cost per unit



Operating costs per unit per month far exceed the market averages as well as the affordable rental housing market costs, even when staff costs are excluded from the operating costs. If a fair allocation of Public Works staff costs are included in the total operating costs, the difference becomes even larger, as evident in Graph 9.

Graph 9: Total operating costs per unit per month for 2015/16



Average rentals charged by provincial public works departments are 75% lower than the going market rate. This serves as a benefit or subsidy to occupants of the properties. Even against average affordable rental housing or social housing rentals, public works rentals are 34% lower than affordable rental housing rentals. Again, this serves as an unintended benefit to the occupants. The benefit to the occupants of public works properties is set out in Table 5.

Table 5: Comparison of average monthly residential rentals

Average rentals compared	2015/16									
	Eastern Cape	Free State	Gauteng	KwaZulu-Natal	Western Cape	Limpopo	Mpumalanga	Northern Cape	North West	Total
PW average rental	R1 780	R1 352	R3 173	R900	R1 533	R800	R900	R1 832	R1 124	R1 488
Social housing average rental	R2 250	R2 250	R2 250	R2 250	R2 250	R2 250	R2 250	R2 250	R2 250	R2 250
Market average rental	R5 127	R4 790	R6 223	R5 914	R6 271	R6 020	R6 070	R7 432	R4 803	R5 850
PW unintended benefit compared to social housing	R470	R898	-R923	R1 350	R717	R1 450	R1 350	R418	R1 126	R762
PW unintended benefit compared to market	R3 347	R3 438	R3 050	R5 014	R4 738	R5 220	R5 170	R5 600	R3 679	R4 362
PW unintended benefit compared to social housing %	21%	40%	-41%	60%	32%	64%	60%	19%	50%	34%
PW unintended benefit compared to market %	65%	72%	49%	85%	76%	87%	85%	75%	77%	75%

9.3 Key findings

Provincial public works departments are providing rental accommodation at low monthly rentals for occupants who are also mostly government employees earning an income. The occupants therefore ought to be able to afford to pay for their accommodation on terms that are not highly subsidised. Moreover, government provides its employees with a housing allowance to cover the cost of the monthly rental accommodation.

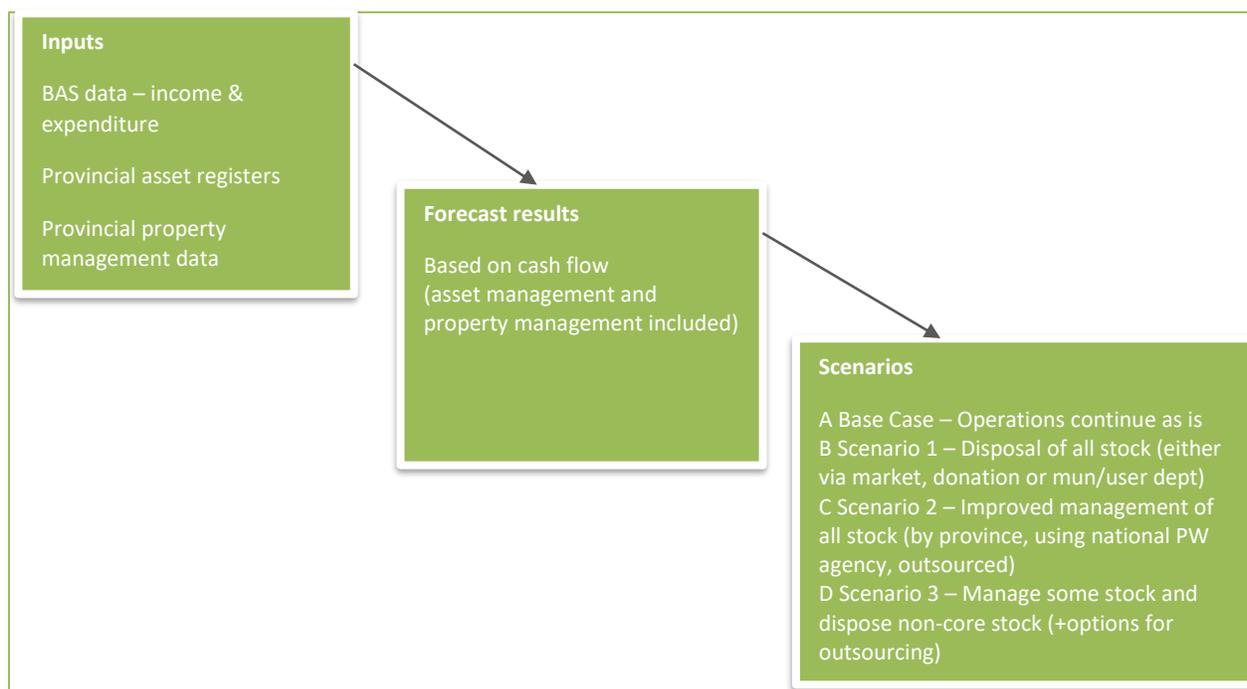
Operational shortfalls in the provincial public works portfolio are covered by provincial governments' budget allocations and represents a significant subsidy to the occupants. The occupants effectively enjoy a better arrangement than tenants in the affordable rental housing sector. The arrangement is not sustainable or equitable.

The provincial public works portfolio of properties is not considered a core component of these departments and they largely no longer fulfil their original purpose. The properties are highly subsidised by government in the form of operating costs and a housing allowance for employees who can afford to pay for the accommodation. However, any attempt to change these arrangements is met with opposition from government employees, placing provincial public works departments in a difficult position. The portfolio needs to be refocused to meet the intentions of government employee rental accommodation.

10 Financial modelling

The financial modelling set out below uses information collected about the properties forming part of this study. The base case or existing position projects the outcome should the current situation continue without further intervention. Three additional scenarios, using different assumptions, are modelled and their outcomes projected.

Figure 6: Financial model design



10.1 Assumptions underlying different scenarios

Table 6: Description of base case and scenarios

Scenario	Assumptions	Outcomes
Base case: Operations continue as is	<ul style="list-style-type: none"> No disposal Low rentals No rent increases Existing low rent collection 	<ul style="list-style-type: none"> Increasing debt High cost Funded from equitable share of province Model shows cost to government/province of continuing to manage the stock as is over time/per year and the related deficit and unintended subsidy vs market and affordable rental market
Scenario 1: Disposal of all stock (either via market, donation or mun/user dept)	<ul style="list-style-type: none"> Existing rental income during disposal process Disposal of all stock (100% non-core): 1/3 donated to indigent occupants; 1/3 to middle-income occupants/employees at sale below market value; and 1/3 to high-income occupants/employees at market value 	<ul style="list-style-type: none"> Disposal costs: conveyancing and related costs Rental debtors remain the same; new debt will continue to accumulate. No sales debtors. Reducing in-house management cost and overhead linked to unit disposal

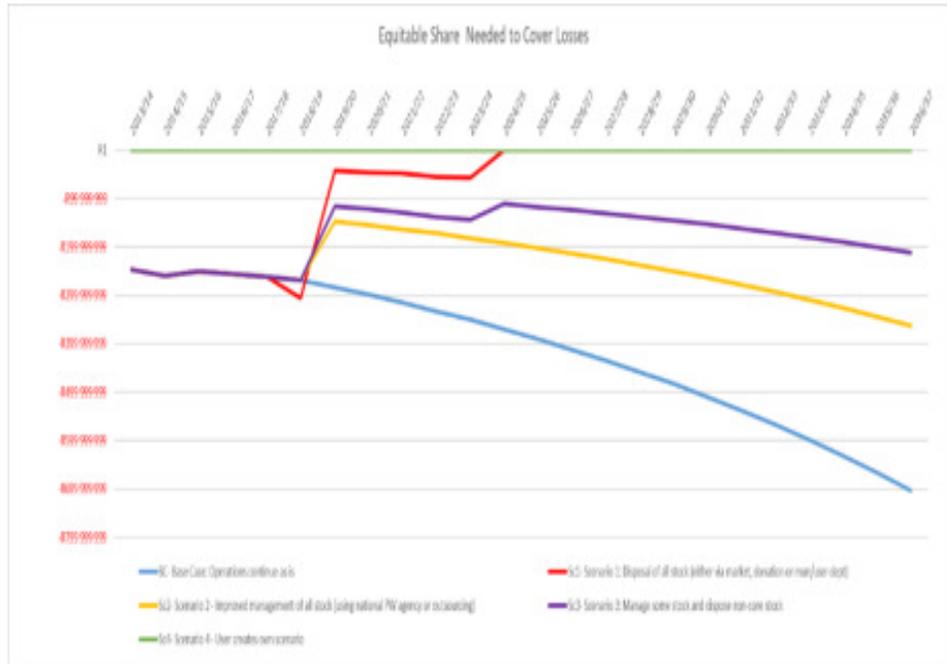
<p>Scenario 2: Improved management of all stock (by province, using national PW agency, outsource)</p>	<ul style="list-style-type: none"> • Increased rentals: staggered over 5 years on the basis of tenant incomes • Rental increases: 1/3 for low-income earners at the inflation rate, 1/3 for middle-income earners to recover operating costs, and 1/3 for high-income earners to reach market rentals • Increased rent collection rates: staggered using the base rate adjusted upwards progressively 	<ul style="list-style-type: none"> • Rental debtors remain the same; new debt will continue to accumulate. No sales debtors • Reduced management costs: outsourced/national property management agency • Phase out staff costs: over 5 years, staff to be transferred • Improved/reduced management/overhead cost, reduced/no debt, improved rent collection, rent increases linked to market
<p>Scenario 3: Manage some stock and dispose non-core stock</p>	<ul style="list-style-type: none"> • Disposal of non-core stock (70%): 1/3 donations to indigent occupants, 1/3 to middle-income occupants/employees at sale below market value, and 1/3 to high-income occupants/employees at market value • Rental increases for core stock (30%): 1/3 for low-income earners at the inflation rate, 1/3 for middle-income earners to recover operating costs, and 1/3 for high-income earners to reach market rentals 	<ul style="list-style-type: none"> • Rental debtors remain the same; new debt will continue to accumulate. No sales debtors • Disposal costs: conveyancing and related costs • Reduced management costs: outsourced/national property management agency • Phase out staff costs: over 5 years, staff to be transferred • Ratio/percentage of core vs non-core to be disposed per province. Improved management required

10.2 Projected fiscal implications

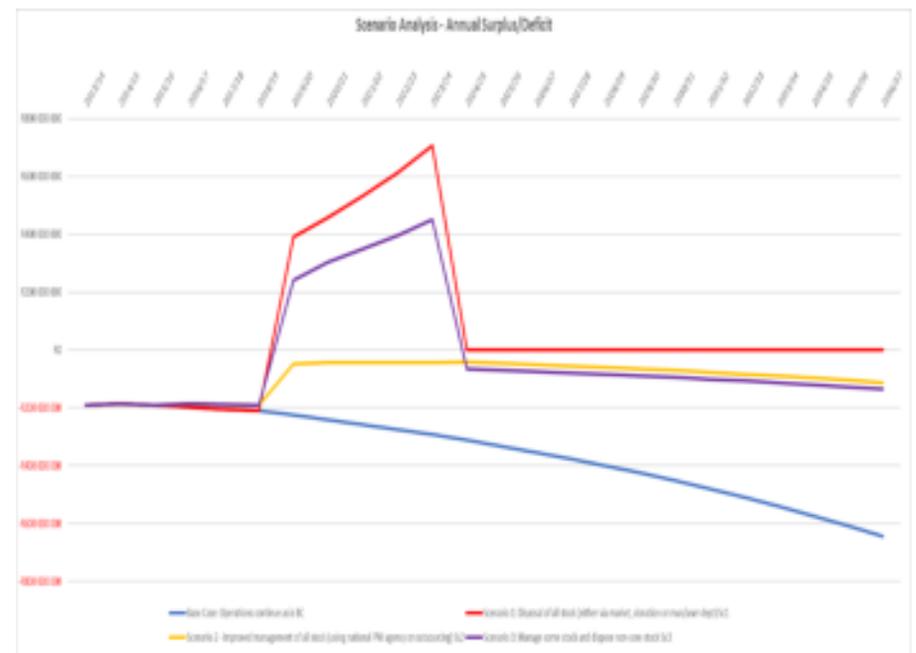
Table 7: Summary of fiscal projections per scenario

Summary of Fixed Scenarios and Scenario Description							Total over 20 years			Average loss per unit (Sales and Debtors)								
	Scenario	Years to Close the PW Programme (from 2018/19)	Ave Rent Collection %	Rent Increase	Rental % Below Market Value	Outsourced management from 2019/20	Net Cash Flow 2017-2037 (Equitable Share Utilised)	Debtors Balance remaining	Net Cash Flow + Debt w/o	Net Cash Flow 2017-2037 (Equitable Share Utilised)	Debtors Balance remaining	Net Cash Flow + Debt w/o						
Total Spent From Equitable Share																		
Projected Scenario (Select Scenario):																		
Base Case: Operations continue as is							BC	20	Existing	None	0%	No	-R9 121 049 764	-R625 514 807	-R9 746 564 571	-R1 489 881	-R102 175	-R1 592 056
Scenario 1: Disposal of all stock (either via market, donation or mun/user dept)							BC	20	Existing	None	0%	No	-R9 121 049 764	-R625 514 807	-R9 746 564 571	-R1 489 881	-R102 175	-R1 592 056
Scenario 2 - Improved management of all stock (using national PW agency or outsourcing)							Sc1	5	Existing	None	0%	No	-R1 067 501 135	-R207 624 037	-R1 275 125 173	-R174 371	-R33 914	-R208 286
Scenario 3 - Manage some stock and dispose non-core stock							Sc2	20	Target	Increase	50%	Yes	-R5 094 157 432	-R1 738 471 269	-R6 832 628 701	-R832 107	-R283 971	-R1 116 078
Scenario 3: Manage some stock and dispose non-core stock							Sc3	5	Target	Increase	50%	No	-R3 457 809 034	-R593 739 837	-R4 051 548 871	-R564 817	-R96 985	-R661 802
Scenario 3: Manage some stock and dispose non-core stock Outsource							Sc3	5	Target	Increase	50%	Yes	-R2 249 741 335	-R593 739 837	-R2 843 481 172	-R367 485	-R96 985	-R464 469

Graph 10: Equitable share required to cover losses per scenario



Graph 11: Annual surplus/deficit per scenario per financial year



10.3 Evaluation of the scenarios

Table 8 provides a summary of the evaluation of the base case and three scenarios tested in the cost modelling.

Table 8: Evaluation of scenarios

Scenario	Financial and implementation implications	Recommendation
Base case	Significant equitable share is required to cover the operating losses on the portfolio. An annual deficit per financial year is also shown. The arrangement is therefore not sustainable for the province.	Not recommended
Scenario 1	The disposal of all the stock relieves the equitable share funding required to cover operating losses and generates the most annual revenue from sale of stock. However, employee accommodation will still be required in remote locations and for essential services of government, which this scenario does not address.	Not recommended
Scenario 2	This still requires operating losses to be covered on the portfolio but less than in the base case. This scenario has a smaller annual deficit per financial year than the base case. Changes in monitoring and oversight would be required to ensure improved management is maintained.	Not recommended
Scenario 3	While the equitable share funding is still required in this scenario, there is an annual surplus for some financial years from the sale of properties. Employee accommodation can still be offered in remote locations and for essential government services. This is therefore the recommended scenario. The outsourced option shows better results than continued in-house management, but there is not a significant difference.	Recommended

The scenario evaluation does not provide a clear-cut solution for the stock, as in all the scenarios modelled a continued equitable share of operating funding will be required. Table 9 provides another way to analyse the options: it summarises the total cost to government of providing employee accommodation (all operating costs added together with the housing allowance provided) and compares this to market and affordable/social housing options for employee housing. Table 9 shows that Scenario 3, especially with outsourced management, would be 18% cheaper than putting employees in market rental accommodation.

Table 9: Analysis of overall cost to government of existing employee accommodation

Results summary	Scenarios				
	Total BC	Total Sc1	Total Sc2	Total Sc3	Total Sc3 outsourced
Premium to government of providing employee accommodation (operating costs/funding and employee allowance)					
Total cost to govt for employee housing over 20 years	R10 509 519 364	R1 958 780 168	R6 482 627 032	R4 524 001 927	R3 113 895 649
Average units over 20 years	6 122	1 224	6 122	2 694	2 694
Monthly cost to govt for employee housing over 20 years per unit per month	R7 108	R19 369	R4 367	R6 896	R4 714

Comparison to other rental options					
Cost of 20 years of market rental for all the units	R8 595 385 952	R515 723 157	R8 595 385 952	R3 781 969 819	R3 781 969 819
Comparative (savings)/cost to govt	18%	74%	-25%	16%	-18%
Cost of 20 years of social housing rental for all the units	R3 305 880 000	R198 352 800	R3 305 880 000	R1 454 587 200	R1 454 587 200
Comparative (savings)/cost to govt	69%	90%	49%	68%	53%

It is of concern is that the current continued provision of provincial rental accommodation for government employees (Base case) is providing a subsidy to government employees that is 69% more than the support provided to affordable rental housing or social housing. Government employees get greater government support for rental accommodation than low- to middle-income earners accessing affordable rental accommodation.

11 Conclusions and recommendations

Table 11 sets out recommendations based on the above expenditure analysis, financial cost projections, current context and programme objectives. They are largely derived from Scenario 3 – disposals of non-core stock and continued management of core stock modelled above.

Table 10: Summary of conclusions and recommendations

Conclusion	Recommendation
Policy and programme	
Focus on programme intention and purpose	Accommodation for essential services and employees in remote locations only. All other user needs for residential rental accommodation can be addressed by private rental market.
Policies too general and do not capture specifics required for proper residential property management	National directives or regulations for the management of residential properties required from Treasury and/or Auditor-General to encourage uniformity of data, information and property management performance.
Inadequate programme funding	Programme funding should allow for completion of asset and occupant audits and proper management of the stock to comply with legislative requirements. Separate stock from other assets managed by the province.
Lack of uniform, efficient and effective programme oversight and monitoring	National directives from Treasury are required to provide for uniform management and provision of information on the residential rental housing programme. Notably, operating costs as well as rental revenue need to be captured and tracked for this portfolio as a start, preferably in a common property management system linked to BAS and GEHS databases.
Government employee benefits need to be aligned with and benchmarked against other government programmes and policies and comparative sectors	Government employee rental benefits are significantly higher than the affordable rental housing sector and this needs to be addressed via GEHS and national/ provincial negotiating structure. Regular benchmarking is required with market-related rental housing provision. Consider alignment between province and municipal employee rental housing benefits.

	Compare benefits with private employee housing benefits for benchmarking purposes.
Asset planning	
Improved asset planning and budgeting required	Asset and occupant audits need to be completed to identify core and non-core stock and residential rental housing asset management strategy per province.
Improved budgeting for operating and revenue	Operating costs and rental revenue need to be captured and tracked for this portfolio as a start, preferably in a common property management system linked to BAS and GEHS databases. Separate stock from other assets managed by the province.
Review overall efficiency and effectiveness of systems, processes and management arrangements for the stock	Review overhead costs, staffing allocated to the stock, and outsourcing costs and options.
Enrolment and information sharing with GEHS	This will provide a proper indication of demand for rental accommodation to inform supply from Public Works.
Improved rental setting and rental increases	Implementation of policies using market rental assessments for rent setting and rent increases. Ensure rentals cover at least operating costs of properties.
Asset management	
Focus on government employees only in terms of policy intentions	No private tenants should be included in the core stock. Outsource non-core functions with performance requirements.
Uniformity in property management systems and processes	Review overhead costs, staffing allocated to the stock and outsourcing costs and options. Encourage a common property management system linked to BAS and GEHS databases. Separate stock from other assets managed by the province.
Improved property and lease management	Set targets for key rental indicators such as rental collection rates and debtor collection. Monitor indicators regularly. Guidelines and directives on property and lease management from province or National Treasury.
Asset disposal	
Uniform approach to disposals in line with policy and legislation	No undue benefit to employees who can afford to purchase non-core stock at market rates. Encourage disposal of non-core historical stock – dependent on completion of asset and occupancy audits. Manage extent of interference by unions in the process through GEHS, national and provincial structures.
Oversight and monitoring of disposals	Once audits are completed, medium-term targets can be set to monitor disposal of non-core properties.

The study recognises that implementing any of the scenarios will require careful planning covering a range of issues in policy development, asset planning, asset management and asset disposal. Political support in the face of resistance will be needed. In order to effect the necessary changes, it should be made clear that the focus of the public works rental accommodation is to only provide employee accommodation for essential services and in remote locations.

Significant improvements in the planning and management of the residential rental properties will require specific directives from the National Treasury and/or the Auditor-General. These must be directed specifically at facilitating uniformity in the information reported, oversight and monitoring of the property management and property disposals of the stock. It also needs to be recognised that while guidelines support the directives, they cannot on their own effect the necessary changes.

The influence of tenants and employees on the stock needs to be managed via GEHS processes and employee/employer negotiations. Comparative information on the cost to government of providing

residential rentals, as outlined in this analysis, can assist government to focus its efforts and gain acceptance for the need to effect change and curb interference in asset and property management practices in provinces.

12 Appendices

1. Logical framework
2. Expenditure analysis
3. Cost model
4. National and provincial maps
5. Rental housing market report
6. Reference materials and information
7. Data reliability and validity