

SOCIAL HOUSING

1 Introduction

Increased access to rental accommodation in South Africa's cities has long been recognised as a national priority. Many people cannot afford property in the urban cores, where land prices are high partly because these areas are near workplaces and urban amenities. Rental accommodation also serves people who do not wish to establish permanent ties to their places of work, preferring to see other places – whether in the countryside or elsewhere in the city – as their homes. However, many of those most in need of rented accommodation in the city cannot pay the rents that would make the construction of new housing stock of this kind commercially viable. But they also often belong to households whose incomes exceed the RDP housing subsidy limit. To avoid the permanent exclusion of these households from the core of the cities, public subsidies for the provision of appropriate rental housing are needed. This is the goal of the social housing programme.

Given the land and other input costs, developing rental accommodation in well-located areas tends to be significantly more expensive than developing low-cost housing on urban peripheries. To optimise the use of available space, social housing normally consists of multi-storey, multi-unit buildings. Such buildings require a degree of collective management in order to secure common areas and preserve the rental stock for all occupants.

Social housing can have important positive effects on surrounding areas. In some inner city areas, the introduction of social housing can help stabilise an area and play a catalytic role in the local economy. For this to happen, however, social housing must achieve the following goals:

- Significant scale, for it to make a meaningful impact on urban spatial structures;
- Economic sustainability across a portfolio of projects, leading to balance sheet growth; and
- Commercial viability at the project level, delivered on the basis of choices governing location, funding, costs and rentals.

Given the intention for social housing projects to achieve commercial viability, supported by the provision of public subsidies, this PER focused on why the sector failed to attract significant private investment. The PER was conducted by Rebel Group Advisory Southern Africa between October 2014 and March 2016. Some of its key outputs and insights are summarised here; the full report is available at www.gtac.gov.za/programmes-and-services/public-expenditure-and-policy-analysis.

2 The delivery of social housing

The Social Housing Act (No. 16 of 2008) requires approved social housing projects to be delivered through accredited social housing institutions that are regulated by the Social Housing Regulatory Authority. The key entities in the system are the social housing institutions (SHI), which are legal entities responsible for building and managing social housing stock. They can be for-profit firms or operate on a not-for-profit basis, but are intended to be sustainable institutions that can be cooperatively, privately or municipality-owned entities. As subsidies are intended to make rental accommodation accessible for low-income households, social housing institutions must accommodate families earning between R3 500 and R7 500 per month. This definition means that a significant proportion of new rental stock provided by the private sector is not considered social housing, and is not subsidised by government. As a result, it need not conform to all the



requirements governing social housing projects, including the specifications of the stock, the rents that may be charged, and the households to which units must be made available.

Because social housing institutions, unlike private rental stock, qualify for public subsidies, their establishment and operations are regulated by the Social Housing Regulatory Authority (SHRA). The delivery of social housing is subsidised directly through two instruments:

- The institutional subsidy is a conditional grant, managed by the national Department of Human Settlements, that is allocated on a project-by-project basis to provincial governments for approved social housing projects. Between 2004/05 and 2014/15, it amounted to R3.6 billion, or about 3.3% of all housing-related grants to the provinces.
- The restructuring capital grant flows from the national Department of Human Settlements to the Social Housing Regulatory Authority. It provides capital subsidies for approved projects managed by accredited social housing institutions (using a formula based on the number of units being delivered) and operating costs for the authority itself. Between 2004/05 and 2014/15, these subsidies amounted to about R2.5 billion.

2.1 Performance and expenditure

Between 2007/08 and 2013/14, 59 projects in ten municipalities produced about 18 000 units in a variety of housing types, such as high-rise, walk-up and single storey buildings (see Table 1). Two-thirds of all these units are in eThekweni, Johannesburg and Cape Town. Units vary from bachelor to three-bedroom flats, but around 60% have two bedrooms.

Table 1: Social housing projects and units funded, 2007/08 to 2013/14

Municipality	2007/08		2008/09		2009/10		2010/11		2011/12		2012/13		2013/14		Total	
	Proj	Units	Proj	Units	Proj	Units	Proj	Units	Proj	Units	Proj	Units	Proj	Units	Proj	Units
Buffalo City			1	480	3	854			1	180					5	1 514
Nelson Mandela Bay					1	136	1	347	2	32	2	750	1	400	7	1 655
Mangaung							1	402	1	145	1	328			2	897
Johannesburg			2	963			1	286	3	1 023			5	1 303	12	3 903
Tshwane					1	81	2	37	1	82	1	734			5	934
eThekweni	2	629			5	751			4	1 713					16	4 877
Msundzi	1	364									3	850			2	1 316
eMalahleni									1	104	1	952			1	104
Klerksdorp													1	576	1	576
Cape Town	1	705	1	450	1	219			3	390	4	1 507			10	3 271
Total	4	1 698	4	1 893	11	2 041	7	2 628	16	4 009	12	5 121	7	2 279	59	18 113

Since social housing projects generate a stream of rental income, unlike most other public housing programmes, they are supposed to be funded through a mix of public subsidy, debt and equity.

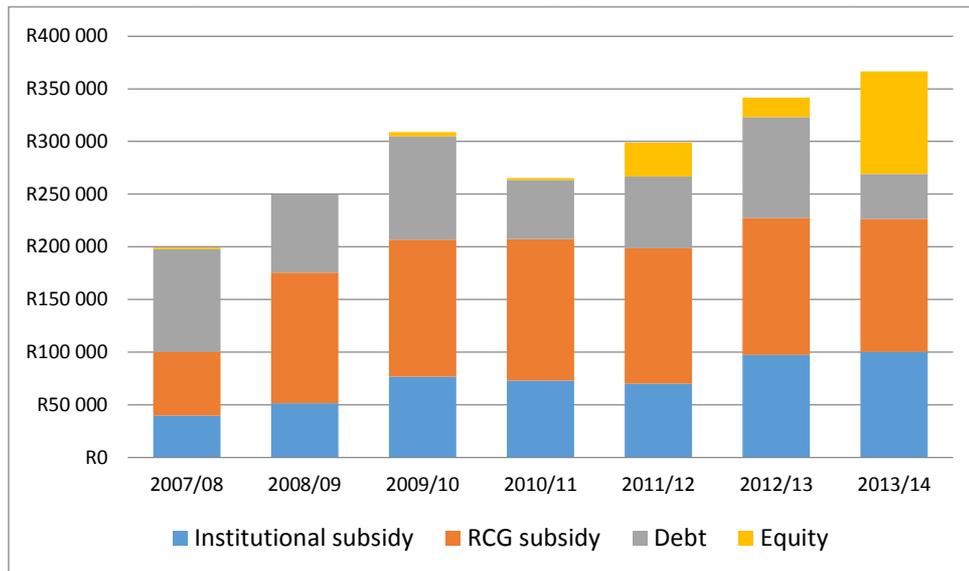
Accurate spending data on all the projects approved in the seven years under review was not available, because neither the Social Housing Regulatory Authority's data nor data from the social housing institutions is captured on the basic Accounting System (BAS). However, detailed numbers were available for the majority of projects. These suggest that R4.57 billion is the *minimum* total value of spending on the 59 projects. The figure can be broken down as follows:

- R1.92 billion in restructuring capital grant subsidies (42%)
- R1.11 billion in institutional subsidies (24%) from provincial governments
- R1.12 billion in debt (25%)
- R340 million in equity (7%)

- R84 million in donor funding (2%).

Average unit costs rose by around 8% a year between 2008/09 and 2013/14; this figure increases to 11% a year if 2007/08 is used as the base year (see Figure 1). These figures show that the growth in spending per unit outpaced inflation, implying that with a given budget, the number of units that can be funded will decline every year.

Figure 1: Average costs and sources of funding of units in social housing, 2007/08 to 2013/14



While 66% of spending was financed through direct subsidies from national government, much of the remaining 34% was provided to social housing institutions by other public sector institutions. The bulk of the debt funding came from development finance institutions and most of the equity funding was provided to projects managed by JOSCO, the principal shareholder of which is the Johannesburg City Council. It is clear, therefore, that social housing projects have not yet attracted the hoped-for level of private sector involvement. In addition, in a number of projects, social housing institutions have relied on the provision of free land by the relevant municipality, a form of indirect subsidy that is not captured in the expenditure data.

2.2 Challenges in attracting private sector funding

Policymakers envisaged significant private sector involvement in financing, delivering and managing social housing. In practice, however, a number of factors have undermined the ability of social housing institutions to attract significant private sector funding, given the limited commercial viability of social housing. Pressures on the commercial viability of these projects arise from:

- A failure to raise the nominal value of the restructuring capital grant subsidy in line with inflation; and
- A failure to raise the nominal value of the household income bands for the target population in line with inflation. Thus social housing must accommodate households with progressively lower levels of real income, and the increasingly onerous rents make them more likely to default.

As a result, social housing projects have become less attractive to lenders and investors, who are becoming more concerned about their capacity to service debt and generate a return on investment. These concerns are exacerbated by concerns about the (lack of) political will for raising rents and/or evicting non-paying tenants should this be necessary. Shrinking margins and

increasing risks mean lower expected revenues; thus projects become technically less feasible because the lower real value of their projected rental income makes it increasingly difficult to meet construction regulations.

While this has contributed to a reduction in the provision of social housing, it has also led social housing institutions to focus on households with incomes near the top of the qualifying bands, rather than those with lower incomes. In other cases, social housing institutions combine social housing stock with unsubsidised units for the general market. This increases the project and institutional viability, but it diverts the developmental and operational capacity of the social housing institutions away from the subsidised market.

2.3 Modelling the viability of social housing

In order to evaluate the effect of these concerns on the commercial viability of social housing projects, nine projects were analysed in detail to assess the returns investors might have enjoyed had more private participation been secured. The projects were developed by five social housing institutions between 2008 and 2012, and delivered about 2 800 units. Their combined funding was R766 million, of which 74% was subsidy, 25% was debt and 1% was equity. The main finding of the analysis was that, at 3.8%, the initial yield as a proportion of initial capital outlays fell far short of the 10% generally regarded as a benchmark in this industry.

Based on these scenarios, the PER constructed a model to test the impact of changes on key variables – the value of subsidies, the level of rent, the mix of funding sources, and the like – on the attractiveness of social housing projects to private sector participants. The key findings are that:

- The viability of social housing is highly sensitive to the level of rents, and can meet private sector benchmarks only if projects charge rents that exceed the ability of the current target beneficiaries to pay.
- Increasing the value of the restructuring capital grant would improve financial viability, but this should be reinforced by the upward adjustment of tenants' target income bands. Without these changes, the sector is unlikely to attract significant debt financing; this also holds true for projects that incorporate some units that charge market-related rents.

3 Conclusions

The social housing programme addresses a critical need: providing affordable rental housing in areas where land costs would normally make housing too expensive for its target constituency. The programme aims to mobilise private sector funding for projects that address the housing needs of people at the bottom of the housing market. In addition, its use of a project financing approach, which considers the full life cycle costs of the housing stock, as well as positive externalities (e.g. on municipal finances and urban investment), point to new directions in housing strategy.

The key constraint identified in the PER is that the existing policy has not created the conditions for attracting significant private sector participation. Unless this is addressed, private participation in social housing is likely to remain limited and the sector will need to rely on public funding and special financing arrangements through development finance institutions. Policy changes that might address this concern include:

- Increasing the restructuring capital grant to compensate for the lack of annual escalation since 2008, and implementing annual increases in line with inflation;
- Raising the income bands of eligible tenants to compensate for the lack of indexation since 2008, and continuing to index these in the future;



- Permitting inflation-linked annual rental escalation; and
- Offering a guarantee mechanism for private financiers who are concerned about the political will to raise rents or evict defaulters.

