Financing of Social Housing Investments in South Africa

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Abstract. The right to adequate housing is enshrined in the South African constitution. Accordingly, social housing has been identified by the government as one of the strategic interventions to be pursued in the delivery of housing services to the poor. As public sector funds are limited, it is imperative to establish alternative mechanisms for financing social housing investments.

A multiple case study approach reviewed social housing investment with specific reference to how they were financed, the challenges faced and whether there would have been a benefit in using alternative means of financing. This was supported by a literature review as well as interviews with relevant stakeholders.

The results highlighted that funding for the sector is available primarily through government grants and loan funding from national and provincial DFIs. Private sector participants are willing to participate in the sector and have the resources to do so. Nonetheless, there are concerns from private sector participants around the regulatory framework and the availability of collateral on funding provided to the sector. Social Housing Institutions (SHIs) also noted that the SHRA should facilitate discussions on the development of '*social housing agreements*' with municipalities that enable access to land, provide waivers on bulk contributions and afford SHIs rebates on municipal rates and tariffs. Successful delivery of social housing is dependent on both the private and public sector, sturdy institutions and a functional regulatory framework.

Keywords: Social Housing, Financing, South Africa, PPPs, Guarantee Funds, Bond Schemes, Structured Finance, Tax Incentives

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[*]Please note that the LNCS Editorial assumes that all authors have used the western naming convention, with given names preceding surnames (first name then last name). This determines the structure of the names in the running heads and the author index. No academic titles or descriptions of academic positions should be included in the addresses. The affiliations should consist of the author's institution, town, and country.

1 Introduction

The right to adequate housing is enshrined in the South African constitution (Parliament of South Africa, 1997). In the new democratic South Africa, the government has prioritised the right to housing and social housing has been formally identified as one of the key pillars in addressing this challenge (Department of Housing, 2004). However, the economy is increasingly faced with a constrained budget public sector funds are limited. Therefore it is imperative that innovative and sustainable solutions to funding social housing investments be explored and implemented.

2 Literature review

2.1 Potential impact of social housing in South Africa

Social housing is defined by the Social Housing Act of South Africa No 16: 2008 (hereon referred to as the Social Housing Act) as “a rental or co-operative housing option for low to medium-income households at a level of scale and built form which requires institutionalised management and which is provided by social housing institutions or other delivery agents in approved projects in designated restructuring zones with the benefit of public funding as contemplated in the Act” (Parliament of South Africa, 2008). It has the potential to address multiple socio-economic challenges. These include delivering spatial integration and restructuring of South African cities, catalysing urban re-generation and hastening local economic development whilst creating a safety net for citizens that neither qualify for free government housing nor can access mortgage financing (Department of Human Settlements, 2005).

While real estate and infrastructure are key drivers of economic growth, conversely they can also contribute to the poor performance of the economy in locations where there is a lack of adequate infrastructure. This is particularly evident in previously busy and dominant urban areas, where poor maintenance, changing trends and socio-economic factors result in businesses relocating to desirable locations elsewhere (Nel, 2001). The impact of this urban decay can have a debilitating effect on the local economy of an area through a loss of revenue to the local authority, high unemployment and increasing crime. However, through urban regeneration and gentrification, local authorities have the means to reverse the trend of urban decay and create vibrant growing cities (National Association of Social Housing Organisations (NASHO), 2012).

Social housing provides local authorities with a means to densify cities and locate populations in areas with existing infrastructure, minimising the need for new infrastructure (National Association of Social Housing Organisations (NASHO), 2012). As it is ideal for low to middle-income groups with constrained incomes, it means that this demographic could constitute a ready-made labour force which can lure businesses back to the city (Samara, 2005), while adding revenue to local authorities through rates and taxes.

Social housing can play a role in addressing inequality by providing a safety net for the poor (National Association of Social Housing Organisations (NASHO), 2012). At low-income levels, housing and transport costs constitute a significant portion of a household's budget. They are closer to economic opportunities and do not allocate a significant portion of their household budget to transport costs which then allows them to allocate more funds to education and healthcare (Swilling, 2006).

2.3 Social housing financing model applied in South Africa

While social housing investments are developed and managed by private entities (both for-profit and non-profit companies), a sizeable portion of the funding comes from government (The Government of the Republic of South Africa, 2012). The remainder of the project financing will have to be sourced from either debt or equity and relies on the financial strength of the social housing project sponsor. Loan financing is likely to come from commercial banks and DFIs which charge market rates. This type of commercial funding is often inappropriate both in terms of tenure and pricing for SHIs, more so new entrants. It is these funding challenges that are highlighted as hurdles in the delivery of social housing projects (Centre for Affordable Housing Finance in Africa, 2012). The Social housing funding structure in South Africa consists of capital grants (55%-60%), Debt portion (25%-30%) and Equity (10%).

2.4 Shortcomings of financing social housing in South Africa

2.4.1 Supply-side constraints

Growth in the social housing sector has meant that there is an ever-increasing number of social housing projects requiring funding from the SHRA. To address these social housing projects limit the number of units which negatively impacts the economies of scale a social housing project can achieve and net operating income generated. This compromises sustainability in the long run (Centre for Affordable Housing Finance in Africa, 2012).

Furthermore, the subsidies provided result in the SHRA retaining the first mortgage bond in the event of default. As this is contractually binding on the SHI and is also catered for in the Social Housing Act, a conflict arises as commercial lenders the mortgage bond that a lender would register against the property typically does not recognise the SHRAs right as espoused by the Social Housing Act (Centre for Affordable Housing Finance in Africa, 2012).

2.4.2 Demand-side challenges

Credit risk is a concern in social housing given that the target market for this type of housing is already financially constrained, making them more susceptible to default. Financial institutions highlight this risk as one of the key reasons for the lack of appetite in financing social housing projects, especially as they require expert tenant and property management (Centre for Affordable Housing Finance in Africa, 2012).

Social Housing tenants are allocated units based on their income bands. These bands are determined as per the gazetted legislation. Both bands (primary and secondary) at present do not increase with inflation and this becomes a challenge when a tenant leaves the unit. At this point, the SHI is required by law to replace the vacated tenant with one whose income is within the gazetted income bands. This may not be financially feasible as the rent would have increased by inflation over the years (Centre for Affordable Housing Finance in Africa, 2012). In this instance, the SHI is required to reduce the rental to accommodate the new tenant or pay back the subsidy to the regulator. This is not financially feasible as it results in a misalignment of income and costs impacting the ability of the SHI to repay their debt obligations. Commercial property is attractive from a lenders perspective in that annual escalations are often guaranteed in the lease agreements. Therefore lenders are assured of an increasing annuity that can be used to repay the debt. In the absence of this, lenders view the social housing project as being riskier and will either charge a higher interest or not provide debt funding (Colwell & Park, 1990).

2.5 Alternative financing mechanisms for South Africa

The models discussed below are applied in countries where the social housing sector is mature and stable relative to South Africa. The models may provide an alternative to the challenges posed above.

2.5.1 Public-Private Partnerships (Model 1)

The UK social housing sector is similar to the South African social housing sector in that there exists state support in the form of capital grants. In 2014, these constituted approximately 25% of the total project cost. The remainder is sourced from private sector funding with state-funded subsidies contributing a small portion. This "Public-Private" financing model seems to be adaptable to macro changes in the economy due to the collaborative effort of both the public and private sector (Williams & Whitehead, 2015). Such a model may be suited to the South African context.

2.5.2 Bond Schemes (Model 2)

In Austria, the bulk of funding for projects is sourced from sales of specialised bonds known as Housing Construction Convertible Bonds (HCCB). These bonds are issued by designated Special Purpose Vehicles (SPVs) known as Housing Banks who operate within a pre-determined legislative criterion to ensure that operating costs are minimised (CECODHAS Housing Europe, 2009). Such innovative bond schemes provide incentives for investors and preferential regulatory charges for participating institutions thereby crowding in commercial funding.

2.5.3 Guarantee Funds (Model 3)

The Dutch social housing sector has a three-tier collateral structure where the first two structures act as "Guarantee Funds". The first tier is the Central Housing Fund (CFV) a public entity whose role is to monitor the financial and operational performance of housing institutions. The second is the Waarborgfonds Sociale Woningbouw – Social Housing Building Guarantee Fund (WSW) an institution created by the housing institutions with a single capital injection by the state for the purpose of facilitating access to financing at favourable interest rates. The final one is the state (local authority and national government), who in the event that the first two tiers are unable to assist, step in on an equal basis to bail out the institution (CECODHAS Housing Europe, 2009). A similar system would strengthen the social housing sector in South Africa from a financing perspective.

2.5.4 Tax-Incentive driven model (Model 4)

All models applied in Austria, England, Netherlands and France, in particular, have an element of state support through the use of tax incentives. These models include the use of tax-free savings accounts, rebates on VAT, municipal taxes for social housing investments and tax-breaks for institutional investors who provide funding for social housing. Such "Tax-incentives" could be applied in the South African context (CECODHAS Housing Europe, 2009).

2.5.5 Structured Finance Model (Model 5)

The Austrian model in its entirety is made up of equity from developers of social housing units, state-sponsored supply-side subsidies and specialised bonds that offer investors incentives and favourable commercial loans. Through this bespoke "Structured Finance" model, Austria has managed to achieve an inclusive housing sector with quality accommodation for close to the entire population while maintaining public sector expenditure within the average of peer European countries (Amann & Mundt, 2010). Further analysis is warranted to determine which elements may be applicable in South Africa.

3 Research methodology

A multiple case study approach was employed, where selected social housing investments were reviewed with specific reference to how they were financed, the challenges faced and whether there would have been a benefit in using alternative means of financing. This was supported by a literature review on the subject of financing of social housing investments in different countries as well as interviews with stakeholders who are involved in the activities and processes related to the financing of social housing investments in South Africa.

4 Data analysis and results

A total of 10 semi-structured interviews with participants from the social housing sector were conducted and participants were grouped into four categories based on their roles.

Regulator perspective

The interviews highlighted that model 1 was viewed as a viable alternative financing mechanism. This was primarily based on the fact that the current funding model already had elements of a PPP. Furthermore more, model 4 was also considered an option as it can also be combined with model 1, particularly where the municipality can assist with the provision of land and preferential rates and taxes for social housing projects.

Private funders

Private funders asserted that model 5 is currently the model being applied in social housing for projects that qualify for private funding with the only differences being the limited collateral as lenders are not permitted to dispose of the property in a default scenario. Model 1 was considered an alternative depending on the strength of the cash flows. Model 3 was also viewed as an attractive proposition as it would address the issue of collateral upon default. However private funder participation would depend on the terms and conditions tied to the guarantee.

Development Finance Institutions (DFIs)

The main theme from the participants emphasized that the current model which has elements of model 1 and is largely structured in the same way as model 5 was the best alternative. Opportunities to improve the efficiency of the funding process did exist, primarily with respect to collaboration between the Regulator and DFIs and having a more formalised engagement. Both were of the opinion that models 2 and 3 were not as appropriate as model 1 and 5, however, the one participant noted that model 2 may be feasible if it was implemented on a larger scale which at present is not possible as the sector is small.

Social Housing Institutions (SHIs) and Industry Organisations

Participants responded positively to model 4, highlighting that benefits which included a waiver of bulk contributions during developments and rebates on tariffs and municipal taxes would enhance the current financing model. Similarly, model 1 enjoyed the support of all participants with the exception of one participant that was concerned about the interference of municipalities in operational matters. This resonated with the SHIs general view that a clear and concise framework should be developed where the benefits accruing to social housing projects are clearly articulated and roles and responsibilities defined when implementing model 1. Participants were least supportive of model 3 noting that the state was already supporting the sector extensively and that the guarantee fund should rather be set-up to support growing SHIs and be capitalised by larger SHIs that have received state support in the past.

5 Conclusion

It was established that while funding for the sector is available, Private Funders have not participated in the sector for a number of reasons which include, but are not limited to restricted collateral conditions on loans advanced, restrictive regulations and poor delivery capacity.

Stakeholders interviewed were of the view that SHRA should play a central role in the establishment of '*social housing agreements*' that clarify roles and responsibility and ensure better collaboration between stakeholders. In this regard consistency of application as it relates to the rules, obligations and rights was identified as a key reason for the preference toward such a model.

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