



BRIEFING

ZA

2014

In
collaboration
with



Low carbon frameworks

WALKING A TIGHTROPE: ENVIRONMENTAL SUSTAINABILITY AND SOUTH AFRICAN SOCIAL HOUSING INSTITUTIONS

CONTEXT

Social housing can be described as partially subsidised, privately provided (generally), rental or cooperative housing provided to low-income households, namely those earning R1,500 to R7,500 per month. These households either exceed the income threshold set for fully subsidised housing (commonly referred as RDP or Reconstruction and Development Programme housing), which is R3,500 per month, or have not yet secured a fully subsidised home. As a government initiative social housing is tightly tied to the objective of urban restructuring, aiming to provide lower-income households with quality affordable housing in close proximity to major economic hubs, thereby creating more integrated South African cities and redressing spatial inequalities of the past.

Formalised as recently as 2008 with the publication of the Social Housing Act, no 16, the sector is now growing rapidly and making a measurable difference. In 2013, the Medium Term Expenditure Framework set aside R814 million for funding approximately 5 500 units, planned to grow by a substantial 20% annually to reach R1.1234 billion and 7 805 units by 2015¹. This is indicative of the perceived cost effectiveness and suitability to South African conditions of this type of public housing. This contrasts with a general trend of declining marginal productivity of expenditure in the sector, implying a price tag in excess of R800 billion to provide fully subsidised housing for the remaining 3 million households in need². Thus, while social housing stock stands at a mere 1% of RDP/BNG housing in 2013³, it is the most promising channel for addressing unmet housing needs in future.

In terms of the Social Housing Act, social housing institutions (SHIs) are accredited and overseen by the Social Housing Regulatory Authority (SHRA). To date only nine of the 43 registered SHIs are fully accredited, with an even smaller number operating at scale⁴. More than 80% are not-for-profit organisations, perhaps as a consequence of S. 14(1)(d) of the Act which requires any operating surpluses to be reinvested in the SHI. The SHRA is also the government agency responsible for disbursing the Restructuring Capital Grant (RCG), the main national source of funding for social housing. The other source of state funding is the Institutional Subsidy administered by provincial governments. Combined, these subsidies absorb 60 to 70% of the capital cost of development of social housing; for example, a R205,000 benefit may apply to an average R340 000 unit⁵.

Author: Megan Sager
megansager@telkomsa.net



For more information contact:
Louise Scholtz
lscholtz@wwf.org.za

www.wwf.org.za/walking_a_tightrope

Disclaimer:

Views and opinions expressed in this paper do not necessarily reflect those of the WWF network or other organisations involved in contributing to the report. Contributing authors will not be liable for damages of any kind arising from the use of this report.

¹National Treasury. 2013. *Estimates of National Expenditure*. Pretoria.

²Financial and Fiscal Commission. 2013. *Exploring Alternative Finance and Policy Options for Effective and Sustainable Delivery of Housing in South Africa*. Midrand.

³BNG housing stock is currently approximately 3m units, while social housing stock is 33 000 units. Sources are National Treasury (2013) and National Association of Social Housing Organisations.

⁴Information obtained from www.shra.org.za at 31 October 2013

⁵National Association of Social Housing Organisations (NASHO)

The balance of social housing development finance requirements are usually covered with debt on commercial terms extended by either the publicly funded National Housing Finance Corporation (NHFC) or the large banks. Regional organisations, most notably the innovative Gauteng Partnership Fund, also play a key enabling role through offering finance on preferential terms. Conventional equity investment levels are generally significantly lower than the property finance norms, perhaps owing to a combination of the S.14(1)(d) provision, a relative abundance of public grant funding playing an equity-like role from the perspective of financiers, and the limited presence of financial sophistication in the sector.

THE CHALLENGING BUSINESS OF SOCIAL HOUSING

In spite of the tremendous need for more of it and its proven effectiveness as a South African solution social housing is a challenging industry to operate in.

Perhaps the most important contributor to the tightrope economics is the outdated funding and income schedule applicable to SHIs. When the sector was formalised in 2008, fixed guidance on subsidies and the target market was legislated with annual review on subsidy value. The RCG subsidy has not increased in the interim, despite the usual construction cost hikes as well as changes in building regulations which have increased the cost of construction (for example SANS10400XA, which sets minimum standards for building energy efficiency). Similarly, the target market has remained households with incomes below R7,500, which may be charged a maximum of 30% of this for rental. Prices have increased by 23% in the past five years⁶. This means that in effect households earning R1,155 to R5,775 in real 2008 terms are currently being targeted, implying that rental incomes are effectively reducing (in real terms) for SHIs.

A second important contributor is the set of strings attached to SHRA funding, should SHIs wish to apply for the RCG. To qualify for the funding, at least 30% of the beneficiaries of the housing development should come from the target market, namely households earning R1,500 to R3,500, charged an average of R750 per month rental. As a result, small units such as bachelor flats and one-bedroom flats would be favoured, despite the lower density and therefore relatively low efficiency of this type of accommodation. Similarly, the project internal rate of return (IRR) must be higher than the prime interest rate plus 4%, but not exceed 18%. In other words, developments should be viable but not generate significant surpluses that would allow for significant reinvestment or distributions to equity investors. Finally, the maintenance minimum allowance of 1.02% is often insufficient to cover larger expenses which are incurred five to ten years into the project. Given the marginal economics of these projects, it is difficult to imagine where else the funds might be found.

Successful SHIs are consequently very good at balancing the multiple demands of a growing cost base and a static social housing income stream. The first coping strategy they employ is to diversify income streams. For example, Johannesburg Housing Company (JHC) operates a mixed income development called Brickfields, where affordable rentals cross-subsidise social housing rentals. Another SHI, Communicare, operates other for-profit businesses which cross-subsidise its social housing operation. A second strategy is tight cost control. Maintenance costs can be minimised through use of good quality, durable finishes and keeping own maintenance teams on site. Capital costs can be reduced through accessing soft funding, for example debt on preferential terms from the Gauteng Partnership Fund. Thirdly, SHIs work to minimise bad debts and tenant turnover. Madulammoho Housing Association (MHA) operates a rigorous tenant selection process and engages in extensive upfront communication with tenants to ensure that tenants placed in their developments are reliable payers and aware of

⁶www.statssa.gov.za

their rights and obligations. JHC channels monthly statements through a supervisor based on site, who is available to tenants who have billing queries. Communicare proactively manages arrears accounts through timely tracking and on its discretion extending special payment arrangements to financially distressed tenants. And finally, some elect to move away from regulatory constraints entirely and develop social housing independently of the RCG, utilising only the smaller provincial institutional subsidy, or seeking alternative forms of capital, such as private equity investors.

ENVIRONMENTAL SUSTAINABILITY AND SHIS

Utility costs

Just as the social housing sector was finding firm footing as a recently established industry, the 25% annual Eskom tariff hikes were announced in terms of the Multi-Year Price Determination 2. Since 2010, electricity prices have more than doubled, with the most severe impacts being felt in low income households which have few choices with respect to this basic need. Currently, utility bills are running at 20% to 60% of rental costs for social housing beneficiaries, a material portion of total living expenses:

SHI	Average electricity bill (R/month) per social housing with indicative rental charge		
Name	Rooms (Communal facilities)	Bachelor/One-bedroom units	Two-bedroom units
	R1000 (Two-bed sharing)	R750	R2250
MHA (Johannesburg)	R470	R300	R500
JHC (Johannesburg)		R510	R500
Communicare (Cape Town)		R150	R450

Source: Interviews with SHIs

The consequence of these rising costs is a disruption of the equilibrium that SHIs have created in their developments. In addition to the socially undesirable outcome of tenants losing a scarce place in decent yet inexpensive accommodation, SHIs must absorb the following costs:

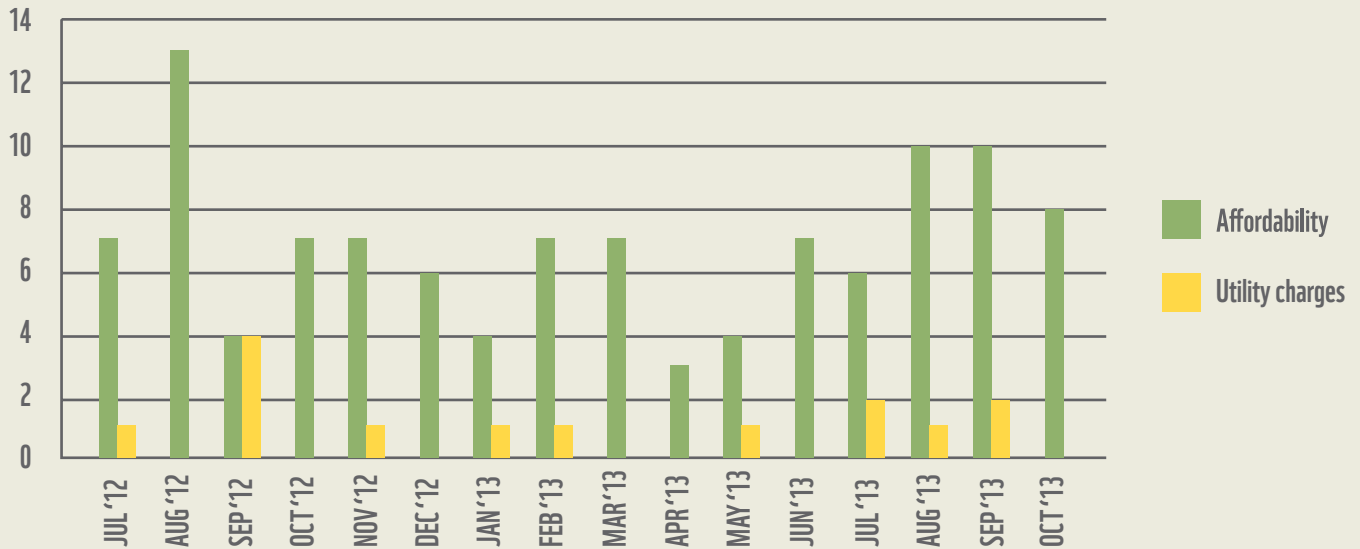
- Vacancy related expenses: marketing, applicant screening and new tenant education
- Debt write-offs: where tenants leave because they are no longer able to pay, there are likely to be bad debts
- Refurbishment expenses: these costs are generally proportionate to the duration of tenant occupation, sometimes reaching R12,000 to R15,000 for longer stays
- Decreased income: by SHRA rules, new tenant rentals should be at original 2008 levels
- Higher operating costs in common areas; typically R250 to R650 per unit per annum, on average⁷.

In addition to these costs, utility tariff hikes also impact revenue base. One SHI reports being unable to achieve desired annual escalation in rentals, instead settling for 1.5% less than this figure given the electricity tariff hikes that their tenants are grappling with.

⁷Interviews with SHIs

The graph below is illustrative, reflecting the concerns of tenants at time of exit. The City of Johannesburg passes through tariff increases annually in July/August, with an observed spike in exits noted during this time. Tenants exiting in September 2012 – following the last 25% increase - indicated that utility bills made the total cost of continuing to live in their unit prohibitive.

Concerns regarding affordability and utility charges: July 2012 to October 2013



Source: Johannesburg Housing Company

The SANS10400XA building regulation

An emerging new challenge related to environmental sustainability is compliance with SANS10400XA building regulation. While SHIs have been proactively investing in energy-saving measures such as efficient water heating and lighting, they are now challenged with meeting mandatory energy efficiency requirements in all new buildings. In its simplest, prescriptive form, SANS10400XA stipulates:

- At least 50% water heating must be supplied using means other than electrical resistance; and
- Thermal insulation must be installed to attain specified R-values, related to climatic zone; and
- If more than 15% building surface area is accounted for by glazing (windows), then SANS204 applies (i.e. prescriptions on energy intensity maxima, per building type and climatic zone).

To date, few social housing developments have been required to comply with this regulation. Indeed, few South African metro's are enforcing it universally yet. However, SHIs currently planning to build estimate that it will add approximately 2.5% to 10% to construction costs. At a sectoral level, this will cost an additional R42-180 million annually if the current annual growth of 6,000 units is used as a basis.

CONCLUSIONS

The baseline quantum of the RCG urgently needs to be increased in light of the rising cost base and declining ability of social housing beneficiaries to help cover these costs. The economics of operating as an SHI is unsustainable, as it currently stands.

An additional facility should be made available to SHIs which comply with SANS10400XA on new developments, to assist with covering the green construction cost premium. International initiatives for multi-unit residential housing for low-income communities show that the benefits of sustainability justify marginally more expenditure. The landmark Beddington Zero development ('BedZed') in the UK shows that beneficiaries can save 45% electricity⁸, a huge support for security of tenure. In Brazil, government is funding sustainable low-cost apartments through creating a certification system called Selo Casa Azul (Blue Seal for Homes programme). Some 10 000 units have reportedly been built⁹.

Finally, restrictions on social housing project returns should be re-evaluated if government wishes to encourage additional private sector participation and thus relieve fiscal strain (noted in the recent recommendations by the FFC¹⁰). Channelling all financial support via grants is providing an equity-like project layer, which is helpful for SHIs seeking commercial debt to cover the balance of their capital requirement. However, alternative financing structures used elsewhere – for example guarantee structures – may be worthwhile investigating further, perhaps as a mechanism for SHIs not currently eligible for the RCG to lower their capital raising costs.

⁸www.oneplanetcommunities.org

⁹Lourdes Printes, LCP Engenharia & Construções Ltda

¹⁰Financial and Fiscal Commission. 2013. Exploring Alternative Finance and Policy Options for Effective and Sustainable Delivery of Housing in South Africa. Midrand.

This is the first of a series of policy briefs addressing the current impact and future potential of environmental sustainability in the South African social housing sector from a financial perspective.



Why we are here

To stop the degradation of the planet's natural environment and to build a future in which humans live in harmony with nature.

www.wwf.org.za

WWF-SA is a registered Non-Profit Organisation, number 003-226 NPO. © 1986 panda symbol and ® "WWF" Registered Trademark of WWF-World Wide Fund For Nature (formerly World Wildlife Fund), Boundary Terraces, Bridge House, 1st Floor, Mariendahl Lane, Newlands 7700, P O Box 23273, Claremont 7735, Tel: +27 21 657 6600, Fax: 086 535 9433, www.wwf.org.za